

**Development Policy Research Unit
University of Cape Town**



**What are the implications of the
SADC Protocol for the Automotive
Industry in Southern Africa?**

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Foreword

The Development Policy Research Unit (DPRU), located within the University of Cape Town's School of Economics, was formed in 1990 to undertake economic policy-oriented research.

The aim of the unit's work is the achievement of more effective public policy for industrial development in South and Southern Africa.

The DPRU's mission is to undertake internationally recognised policy research that contributes to the quality and effectiveness of such policy.

The unit is involved in research activities in the following areas:

- labour markets and poverty
- regulatory reform
- regional integration

These policy briefs are intended to catalyse policy debate. They express the views of their respective authors and not necessarily those of the DPRU.

They present the major research findings of the *Industrial Strategy Project (ISP)*. The aim of the ISP is to promote industrial development in the *Southern African Development Community (SADC)* through regional economic integration and cooperation. It is a three-year project that commenced in August 1998 and is funded by the *International Development Research Centre (IDRC)*. Ultimately, this project will identify the policies and programmes that support regional interactions that contribute to the industrialisation of SADC national economies.

This policy brief is a shortened version of the following paper:

Implications of the SADC Trade and Investment Protocol for the Automotive Industry in Southern Africa

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Introduction

The impact of trade liberalisation in Southern Africa is certainly going to be more significant for the vulnerable, previously protected industrial sectors across the region. This policy brief seeks to identify the key issues that are emerging within the regional automotive industry as Southern Africa prepares itself for the implementation and consequences of the Southern African and Development Community (SADC) Trade and Investment protocol. Issues such as trade and investment linkages, regional and global integration, and the policy implications thereof are provided in this brief.

Salient Features of the Regional Automotive Industry

The automotive industry in Southern Africa is characterised by the following features:

- The SADC accounts for less than 1% of global output
- South Africa accounts for up to 71% of Gross National Product (GNP) and over 90% of automotive production in the region.
- Besides South Africa, the other significant automotive producers in the region are Zimbabwe and Botswana.
- South Africa accounts for 80% of the passenger cars and approximately 70% of the commercial vehicles produced in Africa.
- Some automotive activity does take place in some of the other SADC countries but on a very small scale – assembly of trucks in Swaziland and emergence of component producers in Mozambique.
- Automotive plants in some SADC countries have ceased to exist – Fiat automotive plant in Livingstone, Zambia **(at the time of writing, the Willowvale auto assembly plant in Harare, Zimbabwe had just been shut down)**.

The Structure of the Industry in the Region

Production and Sales

Southern Africa constitutes a very small market, which is dominated by South Africa. In 1998 the SADC region produced 337 000 vehicles.

Proliferation

Heavy protection has resulted in proliferation to the extent that most manufacturers build a variety of models and in some cases more than one make in a single assembly plant.

Foreign ownership of assemblers

All assemblers are now wholly or partly owned by the parent company in Japan, the US or Europe. Toyota is the major producer of both cars and light commercial vehicles in Southern Africa.

Small-scale assembly activities

Outside of South Africa, assembly activities in the region are very small scale, consisting of licensed operations assembling low volumes of imported completely knocked down (CKD) kits. Original equipment component production is also very limited. The Zimbabwean industry has the capacity to produce 40 000 vehicles per annum but only 18 000 light vehicles were assembled in the record year, 1997, and output has since declined.

Swaziland is also now involved in the small-scale assembly of medium to heavy commercial vehicles and a similar small-scale operation is being established in Mozambique. The small Zambian industry has ceased to exist in the wake of structural adjustment and the poor economic conditions prevailing in that country.

Automotive investments

Hyundai Motor Distributors have begun the assembly of the Hyundai vehicle in a newly built plant in Botswana for the SADC market. The plant with an initial investment of approximately R300 million and a capacity of 40 000 vehicles per year is the largest automotive investment in SADC outside of South Africa.

Vehicle Park growth

In 1994, the Southern African region was estimated to have about seven million vehicles with South Africa accounting for 81% of the total followed by Zimbabwe with 6%. In spite of the low rate of market expansion, the vehicle park in the region is not insignificant and has continued to grow, reflecting both an increase in the average age of vehicles as well as increased imports of used vehicles into some countries.

Declining Employment levels

The automotive industry in the region employs close to a 100 000 people in actual component manufacture and assembly (where South Africa and Zimbabwe account for 80% and 13% respectively), and thousands more are employed across the region in the motor trade. Employment levels in the regional automotive industry have been declining steadily over time due to various factors.

- *In Zimbabwe*, the falling levels of automotive employment are attributed to the economic meltdown of the country that has reduced capacity utilisation, production and employment in all sectors of the economy.
- *In South Africa*, weak domestic demand coupled with a significant decline in new vehicle sales during 1998 and 1999 forced the industry to rationalise operations and cut costs which acted negatively on employment levels in the form of retrenchments and redundancies.

Automotive trade

Intra-regional investment ties in southern Africa, while growing, are still at a relatively low level. **The major driver of regional integration is trade**, especially as it is likely to foreshadow closer investment links when trade barriers are reduced.

Export growth

Automotive exports by SADC countries and trade within the region have expanded rapidly over the past decade. South Africa accounts for over 90% of total exports by SADC countries and also dominates regional trade. Automotive exports from South Africa have expanded dramatically from just R315 million in 1988 to approximately R15 billion in 1999 of which just over R5 billion is accounted for by vehicles. In unit terms, light vehicle exports have increased from 11 400 units in 1992 to approximately 58 000 units in 1999.

There has been a major expansion in a wide range of components, especially of products such as leather seating material, catalytic converters, wheels and tyres. The industry supplying leather seat covers supplies the bulk of BMW's global requirements and is an important supplier to a number of other foreign vehicle manufacturers.

Major links

The major links of these firms are with the global networks of the parent companies and not within the Southern African region.

Reasons for export growth in South Africa:

- The import-export complementation arrangements of Phase VI and the Motor Industry Development Programme (MIDP) have powerfully assisted export expansion, in particular, by facilitating the integration of South Africa as a supplier of selected components to the global networks of the major carmakers. *In this sense integration is happening more rapidly with the major producing countries, especially Germany, than within the southern African region itself.*
- Falling protection and limited domestic market growth possibilities have forced firms into the export market. A significant share of this export expansion has been destined for SADC, a process that has accelerated since the advent of democracy in South Africa and the dropping of sanctions.

Policy Developments

The development of the automotive industry in the region has been shaped by government policy especially tariff protection.

The automotive policy currently being applied in the Southern African Customs Union (SACU) is the MIDP and this is the policy option, which is being offered to the non-SACU members of SADC. The MIDP, which was introduced in 1995, consists of two parts:

- The light vehicle programme
- The medium and heavy vehicle programme.

The light vehicle programme covers passenger vehicles, mini buses and light commercial vehicles. The **key elements** are the following:

- The excise duty based local content system, which applied under Phase VI, has been changed to a tariff driven programme.
- There is no minimum local content requirement.
- Tariffs are being phased down to 40 % for light vehicles and 30% for components by 2002.
- Manufacturers of light vehicles are entitled to a Duty Free Allowance (27% of the wholesale value of the vehicle) for the importation of original equipment components.

- Import duty on components and vehicles may be offset by import rebate credit certificates derived from the export of vehicles and components. The value of the certificates is equal to the net foreign currency earnings of the exports, that is the FOB export value less foreign currency usage in the manufacture of exported products. The prevailing component duty applies to the balance.
- The programme also contains a provision for additional Duty Free Allowance for small vehicles.

Current policy developments

Opportunity to rebate import duties: Strong incentive to assemble locally

While nominal duties on imported light vehicles will remain fairly high, the opportunity to rebate import duties by exporting enables importers to bring in vehicles at lower effective rates of duty. However, export complementation also enables assemblers to use import credits to source components at close to international prices. This means that there is still a strong incentive to assemble locally.

Increasing international integration

These policy developments together with the ending of the political and economic isolation of South Africa have rapidly led to the industry becoming more internationally integrated. This is apparent in the growing levels of foreign ownership and investment and the rapid expansion of trade especially exports.

Political acceptability and an automotive policy, which encourages exports and, therefore, specialisation have given strong encouragement to parent companies to increasingly incorporate their South African interests into their global networks.

Current and possible future investments

- Direct equity stakes by Nissan and Toyota could be the forerunner of direct Japanese investments in the component sector.
- There has been significant foreign investment, particularly by German firms, in the component sector.
- Investment links within the region have been slower to develop.

The SADC Trade Protocol

- The integration of the automotive industry in the SADC is at an early stage.
- South Africa exports to the rest of the region and South African based firms have modest investments but the inter-linkages are minimal. Vehicle exports, while important, are not for the most part key to the strategies of SA based assemblers and component exports are primarily into the after-market.
- For its part South Africa imports very little from the region.
- Nevertheless, the regional automotive landscape could change quite rapidly as the free trade protocols are implemented, particularly if the momentum towards higher growth rates in the region is sustained.

SADC proposals for the automotive industry

- In the SADC trade talks, both the SACU and Zimbabwe have placed their automotive industries on the list of 'sensitive' products to be negotiated separately. From a South African perspective, this is partly because of the complexities raised by the existence of the MIDP.
- A 1999 SACU position paper sets out two proposals. Firstly, if Zimbabwe or any other SADC country adopts the MIDP in full then all MIDP rules on manufacture would apply. This would mean that no import rebate credit certificates can be issued by SADC countries wishing to export into SACU (and vice versa) and there would be no tariff barriers between SADC countries and SACU with regard to automotive products.
- Secondly, if Zimbabwe or any other SADC country chooses to remain outside the MIDP, then there will be no tariff concessions by SACU on either vehicle imports or automotive components. There is also the possibility of bilateral arrangements.

The likely impact of the proposals

The South African perspective

South African automotive producers welcome the removal of trade barriers for the following reasons:

- South African vehicle assemblers do not feel threatened by the prospect of competition from other SADC members.
- With free trade in SADC, it is likely that the vehicle operations of the global carmakers would be consolidated into a single regional entity most probably

headquartered in South Africa and South African based firms would obviously welcome such a development.

However, there are a number of reasons why South African based vehicle manufacturers are lukewarm about the prospect of a free trade arrangement.

- Import-export complementation arrangements would have to be eliminated and firms feel that the removal of trade barriers into SADC markets would only partially compensate for this.
- The SADC market is not perceived to be very important at least in the short term and in any event the market share of South African producers is already high.
- South African firms fear the possibility of reduced regulatory controls under a free trade scenario.
- Evasion of customs controls is widespread and vehicle manufacturers are concerned that the introduction of a large free trade area would only increase these opportunities.

Concerns of other SADC member states

Other SADC countries have also raised a number of concerns:

- All automotive activity may have to locate in South Africa because of its already much more developed automotive infrastructure and larger market.
- Customs revenue will be lost from increased sourcing of automotive products from a relatively high cost producing country like South Africa.

Regional integration is likely to have a major effect on the existing automotive operations of South Africa's SADC neighbours. The Zimbabwean assembly industry for instance faces major adjustment. Low volumes, dated plants, quality problems, restrictive licensing agreements, the absence of clear industrial policy and the domestic economic crisis are all factors which negatively affect prospects.

Appropriate policy for SADC member states

Based on the development of the automotive industry in the region to date most of the SADC countries outside of South Africa would be unlikely to attract significant investment in the automotive industry in the short term. *But as individual markets, their prospects are even more limited.*

Adopt the MIDP

For countries such as Zimbabwe the best course may be to join the MIDP but to argue for a slower phasing down of access to their domestic market from South Africa at least for vehicle production and selected aftermarket products. Any further restrictions on the importation of original equipment components than already apply under the MIDP would rule out the possibility of significant further investment in the Zimbabwean assembly industry.

Adopt the MIDP for components only

It may suit some countries to adopt the MIDP for components only. This could allow the advantage of full market access to the South African market for component suppliers. Firms exporting outside of SADC or to SADC countries which have not joined the MIDP would be able to earn Import Rebate Credit Certificates which could be used to import vehicles or components into SADC or sold. This strategy may encourage the full integration of certain existing and new component suppliers into regional and even international production networks.

The decision not to adopt the MIDP

For countries, which opt not to adopt the MIDP, there would be little or no prospect of further investment in the automotive industry. If tariffs were raised, a small amount of investment could be attracted, but given the small market this would come at high cost and would be counter productive. Existing customs revenue would be maintained and could be expected to increase over time. Vehicle costs could also be kept low through the continued importation of used vehicles although this would continue to pose problems for the collection of customs revenue.

It would probably be essential for existing or new independent component producers to enter into joint ventures with South African or other foreign firms because in order to compete they would need to have access to the entire region in specific niches. Firms, which are not able to do this, would face fierce competition from other producers in the region.