Box 2.2. **The Motor Industry Development Programme**

The Motor Industry Development Programme (MIDP) is a major governmental support for the car industry. It was established in 1995, replacing a support scheme based on local content requirements which was not fully WTO-compliant. This extensive programme favours firms producing for the domestic market or export. It comprises the following elements:

- Producers for the domestic market benefit from a duty-free allowance on imported components (amounting to 27% of the value of the vehicles).
- In addition to qualifying for duty drawbacks on imported components, vehicles and components exporters earn tradable duty-rebate credits in proportion to the local content of their export. Since the first review of the programme, the "qualifying" value of these Import Rebate Credit Certificates (IRCC) is being graduallly reduced from 100% of the local content value in 2002 to 70% by 2009 (60% for components).
- As a counterpart to the reduction of the "qualifying value" of IRCCs, a new production-asset allowance is granted to vehicle manufacturers which invest in new production capacities. This allowance corresponds to 20% of the capital expenditure, in the form of import-duty credits.

Initially, this programme was due to run until 2012, with a gradual phasing-out: the maximum rebate for each rand of exported local content is indeed decreasing with the gradual reduction of import tariffs.* Recently, the maintenance of support until 2020 was announced by the South African authorities, with a probable shift to a production allowance only. This decision is a reminder that, once in place, such programmes have a tendency to persist and prove difficult to remove. Undoubtedly, the MIDP contributed to a great extent to the expansion of the auto industry and the increased foreign direct investment, which led in turn to much improved export performance of the industry: the share of vehicles and components now accounts for around 9% of total goods exports (against 6% in 2000 and much less in 1995). As expected, car manufacturers specialised in the production of just a few lines, and the share of the domestic market served by imports grew in parallel with exports (Black, 2007).

Even if such a subsidy programme succeeds in generating exports and gaining economies of scale, the overall cost puts its effectiveness in question. Firstly, the relatively high level of protection induces higher costs for consumers, who pay a duty-inclusive price (Flatters, 2005). In other words, critics argue that the IRCCs allow the auto industry to sell at mark-ups products or components that have been imported duty-free.. Secondly, the direct subsidies for new projects are potentially distorting production and investment decisions by allowing uncompetitive investments to take place. For competitive investments that would have taken place anyway, such support schemes simply translate into a higher rent for car producers. Thirdly, the compliance and regulatory costs of the MIDP seem to be non-negligible (see SBP, 2006). According to Flatters (2005), the overall level of subsidies provided for car assembly and components production could be indeed very high and still exceed 200% of the amount invested. Other studies found on the other hand that consumers in South Africa do not pay a higher price than in EU markets and argue that the South African industry has almost reached cost competitiveness in an effectively duty-free environment (Barnes *et al.*, 2004). This would however also contradict the argument that the industry is still vulnerable to declining support and would also advocate in favour of a more rapid reduction in import duties. In any case, a detailed cost-benefit analysis of the programme would be highly welcome, especially given the DTI's intention to extend it over a much longer period than initially planned.

* Import tariffs for vehicles are set to decrease from 30% in 2007 to 25% in 2012.