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State’s subsidy by any other name is still a subsidy

Frank Flatters

THE motor industry is lobbying the government for more help in dealing with the recent collapse in its sales. This industry is not unique in suffering from the economic downturn. Demand has been falling across the economy, in sectors from housing to electronics to minerals.

What is unique about the motor industry is, first, the intensity and sophistication of its lobbying efforts, and second, the huge extent of assistance it already receives.

The principal avenue of support has been the Motor Industry Development Programme (MIDP), which began in 1995, has been extended several times, and was recently extended again, under a new name, Automotive Production and Development Programme (APDP), until 2020.

Among the more intriguing claims made by industry representatives are:

- it is not asking for handouts;

- it is not receiving state subsidies; and

- South African consumers are prime beneficiaries of government support.

Underlying all this is the suggestion that the future of South African manufacturing depends on the success or failure of the motor industry. It is too important to fail.

Is the industry benefiting from state subsidies? Its representatives say they have never received cash handouts. If so, why do they lobby so hard for government support? Because they receive enormous non-cash benefits from the MIDP. These are just as costly as cash handouts; and they will continue under the APDP.

Exported vehicles and components are rewarded with “import rebate credit certificates” (IRCCs) that allow firms to import vehicles (or their assembly kits) duty free and sell them at prices that are protected by high import duties and a ban on used car imports.

More than R35bn of IRCCs were issued last year. Far more is earned from exporting components than from vehicles; the most lucrative components are catalytic converters, or canned platinum. Most of the IRCCs from components are handed over to the international vehicle companies that buy the components. The value of export IRCCs to the motor industry was about R10bn last year. The profitability of the motor industry exports depends less on what it sells than on what it earns from IRCCs. Firms are driven not to increase competitiveness, but to maximise IRCC earnings.

Cars sold locally are protected by the tariff on imported vehicles. This benefit is partly offset by the cost of tariffs on imported kits and components; and this is cushioned in turn by a duty-free allowance that allows assemblers to import some of their parts duty-free. The net value of the tariff for cars assembled for the local market is more than R4bn.

The final leg of MIDP support is an investment incentive that was worth about R500m last year.

Add these up and you get about R15bn in direct MIDP benefits for the motor industry last year. In 2007 it was R12bn. Call this whatever you wish; but a subsidy by any other name is still a subsidy. And this one is huge.

The tariff on motor vehicles is currently 28%. In the first year of the MIDP it was 65%. It will be reduced to 25% by 2012. Import duties generally raise domestic prices of taxed goods. The industry claims that SA's motor vehicle tariff is different. The duty reductions provided by IRCCs are said to be passed on to consumers, not to vehicle producers. This is not supported by evidence. If their value is not enjoyed by producers, why would firms buy IRCCs for 80% or 90% of their duty reduction value? And why would the industry object to further duty reductions?

The industry also points out that vehicle prices have been increasing less rapidly than overall consumer prices and argues that this shows the value of the MIDP to consumers.

Why has this happened? Falling import duties — from 65% in 1995 to 28% today — have fostered more import competition, greater choice, and somewhat improved prices for consumers over the past 15 years. Contrary to industry claims, the import tariff is a key determinant of domestic vehicle prices. Unfortunately, the APDP will freeze car import duties at 25% after 2012, removing one of the few good things about the original programme — the phasing down of the tariff. This means no further reductions in industry subsidies (in fact subsidy rates will increase in 2013); no more pressure on the industry to improve long-term competitiveness; and no more gains to consumers.

The cost of the tariff to consumers is about R20bn a year.

The main issue, especially in light of the current economic downturn, is jobs. Industry representatives talk of 300000-450000 jobs at stake in the motor industry. This is highly misleading.

According to industry data, 36000 persons work in vehicle assembly and another 82000 in components. This is less than 120000 jobs; and even these numbers are exaggerated. "Components jobs" include about 10000 employees of ArcelorMittal SA and other steel makers. Some of the jobs reported by the National Association of Automobile manufacturers of SA for vehicle assembly appear to be higher than reported independently by the firms. And a number of uncompetitive firms in the components industry have already closed.

Further confusion about job numbers arises from including about 200000 workers in automotive sales and service. These jobs do not depend on the local vehicle and components industries. They depend on vehicle sales and the number of vehicles on the road. The most effective way to protect these jobs (and to help consumers) is to cut vehicle prices. The import tariff and the ban on used car imports do the opposite. While a reduced vehicle tariff might result in some job losses in production, it would create more jobs in sales and service.

The motor industry receives about R15bn a year in government assistance, and is costing consumers about R20bn. This is a high price to protect less than 6% of all manufacturing jobs. For R9bn, a fraction of what motor industry support costs, the government could pay a subsidy of 25% of the median wage to all SA's manufacturing workers, providing far more support to employment across the economy, without favouring uncompetitive firms.

The CEO of BMW in Germany recently described how motor industry subsidies "lead to irrational consequences and the wrong businesses being propped up". Well-managed and competitive firms such as BMW have the resources and the incentive to adjust to circumstances without government assistance.

This message applies equally in SA. Firms in other local industries are adjusting to maintain their competitiveness in the economic downturn, without state support. Socialising the losses of heavily subsidised motor firms, however, would perpetuate a cycle of costly subsidies to uncompetitive firms. It would magnify the waste caused by current policies and reduce rather than promote long-term growth of incomes and employment.

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