

The Economics of MIDP

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MIDP: The Context

- Importance of the motor industry & its performance
 - exports, investment, rationalization, competitiveness
 - size of the program (well over R100 billion in subsidies from 1996 to 2008)
- Industrial policy strategy reviews; a possible model for other sectors (textiles?)
- Misconceptions and disagreements about how MIDP works and its economic impacts

Outline

- Economic analysis of MIDP
 - How it works
 - Value of incentives/subsidies provided
 - Impacts and economic costs
- Processes for designing, managing and assessing MIDP
 - Capacity, independence, transparency and accountability
- General questions and implications

Background: Pre-MIDP

- Long history of industry protection
 - High tariffs led to a high cost domestic assembly industry; aggravated by local content rules
- Industry could not survive under deregulation and trade liberalization that started in the 1990s

MIDP

- Launched in 1995 to help the motor industry become competitive in the new policy environment
- Initially set for 5 years; extended twice til 2012; recently extended to 2020 (25 years); now talk of additional bailouts
- Incentives were designed to rationalize production through specialization for export

What is MIDP?

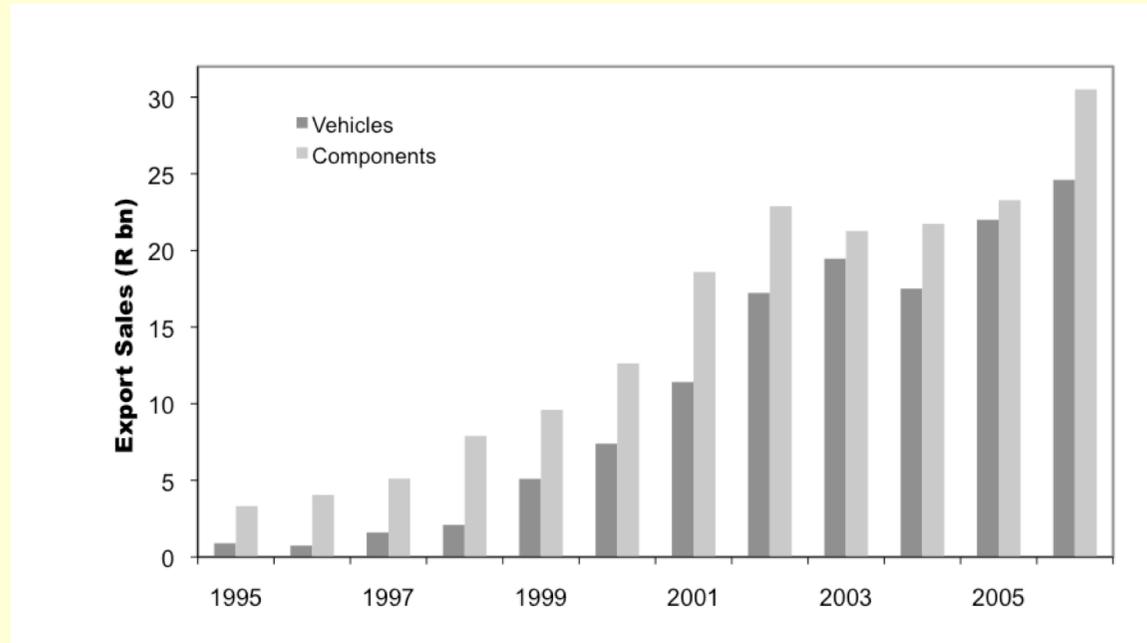
- High but declining tariffs on vehicles and components; virtual ban on used car imports
- No local content requirements
- Duty relief on imported inputs
- Duty credits for exports and for investment (and soon for production)

(Note: Many other incentives; but this is the “core” of MIDP)

Industry Performance

- The industry has performed remarkably well since the start of MIDP
 - Vehicles: investment, exports and imports
 - Components: investment and exports (main products are leather seat covers and catalytic converters)

Export Sales

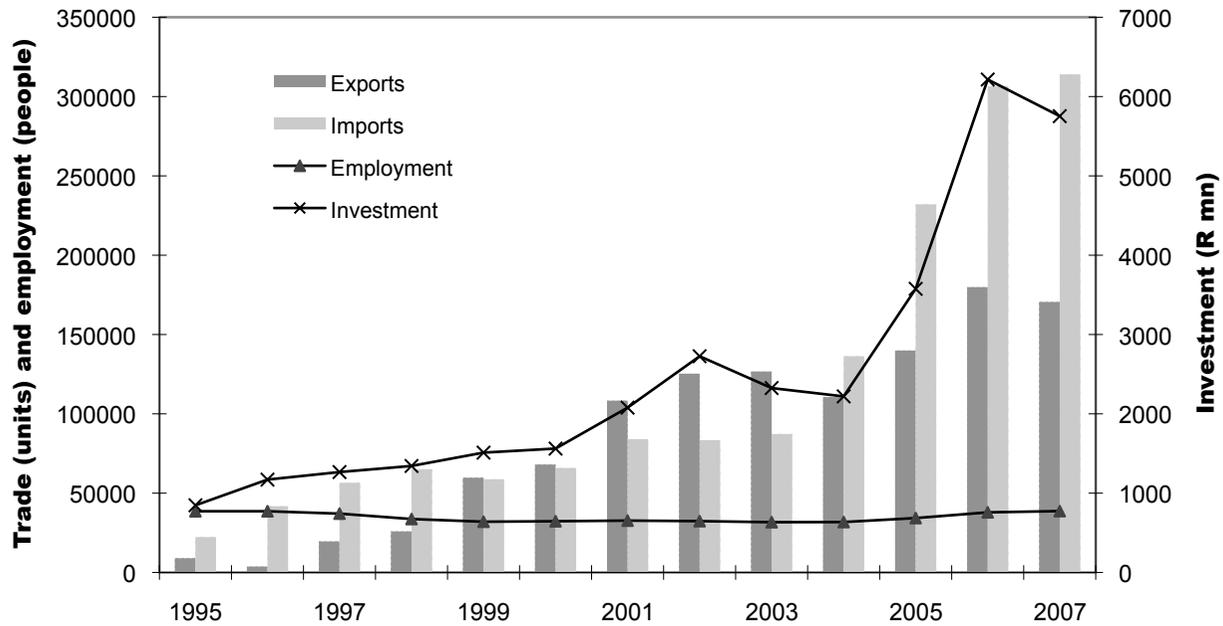


Motor Industry or...?

- IRCC earnings in 2007:

Vehicles:	R 8 billion
Components:	R 16 billion
o.w. catalytic converters:	R 8 billion

Vehicle Assembly



Employment

Employment in the Motor Industry (thousands of workers)

	95	96	97	98	99	00	01	02	03	04	05	06	07	08
Assembly	38.6	38.6	37.1	33.7	32.0	32.3	32.4	32.4	31.7	31.8	34.3	37.9	38.2	36.1
Components	47.0	45.0	44.0	40.0	39.0	38.5	39.0							
					67.2	69.5	72.1	74.1	75.0	74.5	78.0	78.0	78.5	76.0
Tires	11.0	10.0	9.5	9.1	9.0	8.6	8.7							
					6.7	6.6	6.3	6.0	7.2	7.2	6.8	6.5	6.7	6.9
Motor Trade	178.0	180.0	180.0	170.0	175.0	180.0	182.0	185.0	191.0	194.0	198.0	198.0	200.0	n.a.
Total	274.6	273.6	270.6	252.8	280.8	288.4	292.8	297.5	304.9	307.5	317.1	320.4	323.4	

Source: NAAMSA and NAACAM. Employment in assembly in 2007 and 2008 is measured as of July.

Note: The breaks in the series for components and tyres are the result of statistical reclassifications by NAACAM, the association of components producers.

Size and Costs of MIDP Incentives

Key MIDP Incentives

- **IRCC:** import duty credits related to value-added in exports of vehicles and components; their value arises from importing duty-free and selling at duty-inclusive domestic price (benefit goes to exporters, not consumers)
- **PAA:** duty credit equal to 20% of qualifying investment, over 5 years
- **Duty Free Allowance:** reduces burden of duty on components; for domestic market; 27% of sales
- **Duty Drawback:** rebate of import duties on imported inputs for exports

Effects on Firms

- The economic effects of MIDP depend on the incentives they create for producers and investors
- Two kinds of estimates are reported here
 - Effective rates of protection provided to exports and to domestic sales of components and vehicles
 - Rates of subsidy to typical investments in the industry

Effective Rates of Protection

Effective Protection: Motor Vehicles (%)

		1995	2000	2005	2012
Export Sales		65	47	29	18
Domestic Sales					
Import	30%	106	74	52	37
Share	50%	125	87	61	44
	70%	175	121	83	59

Effective Protection: OEM Components Exports (%)

	1995	2000	2005	2012
IRCCs used for CBUs:				
Converters	62	26	8	6
Other Components	62	33	18	11
IRCCs used for Parts:				
Converters	49	28	11	8
Other Components	49	35	23	14

Summary

- High but declining protection given to all activities
- Highest protection given to production for the domestic market (still as high as 83%, versus 29% for vehicle exports)

Net Subsidies to Investment

Net Subsidies to Investment

- Estimated as the increase in the net present value (NPV) of cash flows from typical investments as a result of MIDP incentives
- Increases in NPV are expressed as a percentage of the amount invested
- The investments are representative, but all parameters and assumptions can be varied in accordance with updated financial data

Results

- The investment subsidies are large; IRCCs are the main contributors to investment returns
- Although subsidy rates have been falling, they remain large

MIDP Subsidies: Typical Investments

Investment	Subsidy (% of amt. invested)
Auto Assembly, 1996	494%
Auto Assembly, 2005	275%
Components, 1996	681%
Components, 2005	264%

Some Economic Implications

Consumer Prices

- Domestic prices are higher than they would be in the absence of MIDP
- At the budget end of the market, the policies reduced the quality of cars available to domestic consumers (Tazz, CitiGolf)

Rents and Economic Waste

- Subsidies to exports and production for the local market are either
 - necessary to cover excess costs of producing in South Africa (i.e. economic waste) or
 - unnecessary (because domestic production is competitive) and therefore create large rents for producers and investors
- Rents transferred to foreign shareholders are also economic waste for South Africa

Economic Waste in Non-Competitive Projects Due to MIDP

Investment	Economic Waste per Billion Rand Invested (R billions)
Auto Assembly, 1996	4.9
Auto Assembly, 2005	2.8
Components, 1996	6.8
Components, 2005	2.6

Employment

- Weak job growth in vehicle and components manufacturing
 - Jobs fell by 17% in the first 5 years of MIDP
 - In 2000-2004 employment in vehicle production hardly grew despite investment of over R12 billion; jobs in components grew by 1% per year
- Twice as many jobs in labor intensive sales and service; these have grown in step with vehicle sales; higher vehicle sales could provide many downstream jobs

Aggregate Costs

- Current subsidies to producers R11-12 billion per year; cost to consumers R19-20 billion per year
- From 1995-2007 subsidies to producers R100-120 billion; cost to consumers almost R200 billion
- Subsidy/job R300-400 thousand/year
- Subsidy to investment 225-700 percent

Other Economic Issues

- External technology benefits
- Administrative and compliance costs
- WTO
- Competitiveness and sustainability without subsidies

APDP

MIDP vs APDP

MIDP & APDP Main Parameters (%)

	2010	2012	2013	2015	2020
CBU tariff rate	0.27	0.25	0.25	0.25	0.25
CKD tariff rate	0.22	0.2	0.2	0.2	0.2
Production					
subsidy rate**	0.7	0.7	0.55	0.53	0.5
DFA rate***	0.27	0.27	0.2	0.18	0.18
PAA rate	0.2	0.2	0.2	0.2	0.2

** Under the "old" or current scheme the production subsidy applies only to exports. The rate used here assumes the IRCCs earned on exports are used to import CKDs.

*** Under the "old" or current scheme the DFA applies only to domestic sales.

MIDP vs APDP

MIDP & APDP Subsidy Rates

Rate of Subsidy (%) to Production of Autos for Export

Subsidy from:	2010	2012	2013	2015	2020
Tariff	0.0	0.0	0.0	0.0	0.0
Prod'n Subsidy	15.4	14.0	11.0	10.6	10.0
DFA	0.0	0.0	13.3	12.0	12.0
PAA	3.3	3.3	3.3	3.3	3.3
Total	18.7	17.3	27.7	25.9	25.3

Rate of Subsidy (%) to Production of Autos for Local Sales

Subsidy from:	2010	2012	2013	2015	2020
Tariff	38.7	36.7	36.7	36.7	36.7
Prod'n Subsidy	0.0	0.0	15.0	14.5	13.7
DFA	25.1	22.5	16.7	12.5	12.5
PAA	3.3	3.3	3.3	3.3	3.3
Total	67.1	62.5	71.7	67.0	66.2

Policy Processes

The MIDP Review: TORs

- TORs very broad and interpretation flexible; two sets of consultants
- The industry view (and the dti's) was that the job was to extend MIDP and maintain current support levels in a WTO-consistent manner
- This assumes there is no need to review, from a national perspective, the overall economic costs and benefits of the program or of possible alternatives

Independence

- Large role of the motor industry
- This and previous reviews have been conducted by persons with close ties to the program and/or the industry
- The dti's capacity in the sector appears to be weak and diminishing
- The apparent lack of independence highlights the fine line between cooperation and capture

Transparency

- Rules and regulations of the program are not easily available from government sources
- Data on program costs are not published anywhere
- Lack of transparency might help explain why the economic impacts are poorly understood and appreciated

The Way Forward

MIDP

- MIDP was meant to assist an inefficient industry become competitive and it has done so generously; the costs are high
- Adjustment assistance does not normally last forever; an independent assessment of MIDP's economic impacts is overdue
- Examine options for finalizing the motor industry's adjustment to a normal economic environment; consider the Australian model on which MIDP is based

General Questions

- What are the minimum requirements for economic analysis of benefits and costs of trade and industrial policies?
- Are industry subsidies such as MIDP the most effective way to create jobs and facilitate labor market adjustment?
- Do the capacity and process issues identified here provide lessons for the use of targeted industrial policies in South Africa?

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