The Potential for Regional Integration of the SADC Motor Industry

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Acronyms

CBU	Completely Built Up
CKD	Completely Knocked Down
EPZ	Export Processing Zone
FTZ	Free Trade Zone
GDP	Gross Domestic Product
HS	Harmonized System
IRCC	Import Rebate Credit Certificate
MFN	Most Favored Nation
MIDP	Motor Industry Development Program
OEM	Original Equipment Manufacture
PAA	Productive Asset Allowance
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community
SKD	Semi Knocked Down
USAID	United States Agency for International Development
WTO	World Trade Organization

The Potential for Regional Integration of the SADC Motor Industry

Executive Summary

The recent growth of exports and investment in the South African motor industry has led the SADC Committee of Ministers to ask whether any of its benefits and especially those of the South African Motor Industry Development Program (MIDP) might be adapted to include other SADC Member States or to form the basis for a SADC industrial policy in this sector. They have also asked for an examination of specific barriers to intra-SADC trade and investment.

The following are the principal conclusions of this investigation.

- The most serious barriers to intra-SADC trade in the motor industry are the rules of origin which are far more restrictive than are enjoyed by South African motor industry in exporting to the United States under AGOA. The SADC rules of origin require a minimum regional content of 40 to 50 percent on most products (60 percent on trailers) of interest and also impose specific processing requirements. The AGOA rules require only 20 percent regional content, plus another 15 percent that could be sourced regionally or in the US. South African producers could not satisfy the current SADC rules in some cases.
- The SADC market is far too small to support a competitive motor industry. South Africa's MIDP provides substantial investment and export incentives that have succeeded in reorienting its industry to global markets. Without similar incentives no other SADC Member State would be able to attract global investors in this sector
- The MIDP could not be generalized to any other Member State individually or collectively. The duty pools available are simply too small to replicate the South African model.
- SADC preferential tariff phase downs in this sector are unusually slow.
- South African government procurement policies have created barriers to trade and have affected investment decisions in this sector.
- Significant relaxation of rules of origin and an acceleration of preferential tariff reductions on motor vehicles and components might offer some opportunity for development of niche sectors, especially in after-market components in some Member States.

The Potential for Regional Integration of the SADC Motor Industry

1. Introduction

A major purpose of the SADC Trade Protocol is to promote the development of the region through greater economic integration. In particular, it is hoped that it will increase the attractiveness of the region to new investments, increase the global competitiveness of regional producers and hence promote economic growth of Member States. Reducing regional barriers to trade is seen as a key vehicle for promoting these goals.

It is in the context of these general goals of the Trade Protocol that the Committee of Ministers proposed a technical study of the motor industry to examine how the Protocol might be utilized to promote and exploit the potential of the region in this sector.

Several substantive policy issues were highlighted in the Terms of Reference for this study.

- Identify and assess specific barriers to trade and investment in the SADC region affecting the motor industry that may positively or negatively affect the interests of particular Member States and the region as a whole. Recommend measures to reduce or eliminate these barriers.
- Comment on how the success of the South African motor industry could be usefully employed as a model for the development of innovative and more ambitiously integrated industrial policies for SADC – including possible measures and mechanisms beyond those so far provided for under the Trade Protocol and related agreements.
- Review and critically assess measures by which the requirements of the Trade Protocol, such as rules of origin and preferential tariff phase downs, might be improved to facilitate greater motor industry trade and investment in the region.
- Outline and assess the opportunities for encouraging greater cooperation in new trade or investment measures in the motor industry that would promote the economic welfare, competitiveness and economic development of consumers and producers in SADC Member States.

The principal reason for the focus on this sector is the recent success of the South African motor industry. Since the introduction of the Motor Industry Development Program (MIDP) in 1995 the South African industry has been transformed in many ways. Most notable have been the large increases in investment and exports of completely built up (CBU) vehicles and components.

The question of interest to the Committee of Ministers, therefore, is the extent to which it might be desirable and feasible to replicate the South African experience in other Member States, and/or to increase and spread its benefits to the region.

2. The SADC Motor Industries

The most important part of the motor industry in all Member States is vehicle sales and service. Even in South Africa sales, service and associated activities account for almost two thirds of employment in the sector.

In most Member States the remainder of the motor industry is small and relatively underdeveloped. South Africa has the most developed industry, with significant assembly of vehicles of all types and manufacture of original equipment manufacture (OEM) and after market components. Under its relatively new Motor Industry Development Program (MIDP), South Africa is now exporting large and growing volumes of vehicles and components to world markets. SADC accounts for only about 10 percent of South Africa’s exports of cars and light commercial vehicles and 6 percent of her components exports. About 50 percent of South Africa’s exports of heavy commercial vehicles go to SADC, but this is the least important part of her motor industry exports (TISA 2003).

Small amounts of assembly and components production take place in other Member States, and there is some intra-SADC trade in such products. Mozambique, for instance, exported vehicle tires duty free under quota to South Africa under terms of the Mozambique-South Africa bilateral trade agreement. Under SADC tariff preferences, Mozambique can now export tires duty free to South Africa. Botswana exports wiring harnesses to South Africa and certain world markets under SACU and the MIDP. Prior to the recent difficulties, Zimbabwe had a local assembly industry, assembling CKD kits primarily for the local market. High costs and quality problems would have made it difficult for this to be a sustainable export activity. Small industries in many Member States make after-market components primarily for their local markets. Producers in a number of Member States weld bodies for certain types of trucks and busses sold primarily in their local markets.

The structure of MFN tariff protection varies across Member States. The tax structures are also complex, with a variety of sales and excise taxes generally making the total tax rate higher than nominal import duties alone. Table 1 shows current import duties on automobiles and components. All Member States impose significant duties on vehicles, ranging from 80 percent in Mauritius and Zimbabwe to 25 percent in Tanzania and Zambia. Mozambique levies a 30 percent excise tax on top of its 25 percent import duty. All Members impose lower import duties on components than on vehicles, thus providing high levels of effective protection to local assemblers. Duties on components range from 7.5 percent in Mozambique to 40 and 80 percent in Mauritius.

Table 1: SADC Auto Sector Tariffs, 2004

	Automobiles (HS 87.03)	Chassis (HS 87.06)	Bodies (HS 87.07)	Auto Parts (HS 87.08)
SACU[a]	36	20/36	20/30	0-30
Malawi	30	10	30	30
Mauritius	80	40	40	80
Mozambique	25[b]	7.5	7.5	7.5
Tanzania	25	10	10	15
Zambia	25	15	15	15
Zimbabwe	80	15	15	15

Notes:
a. This does not include provisions of MIDP.
b. This does not include an excise tax of 30 percent.

A major share of the market for automobiles in the poorer Member States is accounted for by used vehicles, many of which come from Japan, directly or indirectly *via* a large trading center in Dubai. In order to provide additional protection for its local assembly industry, South Africa imposes highly restrictive constraints on imports of used vehicles. All used vehicle imports require special permits, and the only vehicles that are allowed are personal possessions of immigrants and returning residents, vintage cars, racing cars, donated vehicles for welfare organizations and those adapted for persons with physical disabilities. Only 510 import permits were granted in 2002, the most recent year for which data are available.

3. MIDP and the South African Motor Industry

Since the South African industry is the model of interest, it is best to start with a description of its recent success and of the policies that have been instrumental in shaping it.

3.1 Recent Successes of the South African Industry

The success of the South African motor industry is generally measured by the growth of exports and investment in the sector.

While rationalization of the industry means that production of automobiles for the domestic market is now only 82 percent of its level in 1995 (in volume terms), it now exports 14 times more automobiles than it did in 1995 at the beginning of MIDP. Forty percent of the automobiles produced in South Africa are now exported. In Rand value terms motor industry exports (vehicles and components) are 10 times greater than in 1995. Since 1998 investment in the South African motor industry has more than doubled, from R1.3 billion to R3.1 billion.

3.2 Background and Description of MIDP

While the focus of current discussions has been on the relatively recent MIDP, there is a long history of government support of the South African auto industry. This past experience provides a useful perspective in considering the MIDP.

Assistance to the South African industry began in the 1920s.[1] The initial phase, lasting until 1961, was one of classic import substitution, favoring simple assembly for the domestic market. Very high protective tariffs on imported vehicles fostered development of an industry of small plants producing a relatively wide variety of models in small volumes, at high cost and with low domestic content.

Between 1961 and 1995 there were five distinct new phases of government support for the industry. They featured continued domestic market protection and a variety of incentives and requirements for increased local content. Local content requirements were supported by punitive tariffs on imported components.

The government attempted to keep pace with the industry and by correcting for unanticipated responses to each set of new incentives. Defining the local content requirement in terms of the weight of components, for instance had predictably perverse effects on the mass of South African vehicles; decreases in *nominal* protection sometimes resulted in increases in *effective* protection, perpetuating inefficiencies due to excessive product variety and short production runs. The government responded to the latter problem with increases in local content requirements to force some rationalization of production. In the late 1970s this had the desired effect of rationalizing the range of product lines, but at the expense of higher production costs and hence of increased consumer prices.

Phase VI in 1989 brought about a major policy shift through promotion of automotive exports. The two principal changes were a provision permitting exports to be counted towards the local content requirement, and a substantial reduction in the local content requirements.

The MIDP began in 1995. Its main features were

- abolition of all local content regulations,
- gradual reduction of import duties on built up vehicles and components,
- a duty-free allowance on imports of components equal to 27 percent of the value of vehicles produced for sale in the domestic (SACU) market, and
- an extension of the existing incentives for exports.

Between 1995 and 2004 the import duty on vehicles has been reduced in stages from 65 to 36 percent, and that on components from 49 to 28 percent.

The key export incentive operates through import duty reduction provisions to exporters of vehicles and OEM components.

Exporters can earn tradable import rebate credit certificates (IRCCs) that grant a reduction in the dutiable value of imported components or vehicles in proportion to the value of the local content of goods exported. For every Rand of CBU exported (measured net of the value of imported components used in their production), the firm can earn a one Rand reduction in the dutiable value of imported CBUs or components – i.e. they earn the right to import one Rand of CBUs or components

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[1] This description of government policies for the motor industry draws heavily on Black and Mitchell 2002.

duty-free. And for every Rand of components exported (measured once again net of the value of imported inputs used), either R0.65 of CBU or one Rand of components may be imported duty-free.

Under this facility, automobile exports with local content value of R100 million, for instance, generate the (tradable) right to import the same value of vehicles or components free of duty (or to reduce the dutiable value of imports by this amount). With the current 36 percent duty on imported vehicles, this would provide a duty reduction of R36 million on imported vehicles. This is 36 percent of the value of the domestic content of exports that generated the duty credit. If the credits are used for imported components, the duty reductions amount to a portion of the value of the domestic content of the exports generating the credit, with the portion equal to the import duty rate on components. The current import duty on OEM components by assemblers is 28 percent.

Following a mid-term review in 2000 it was agreed to continue the MIDP through 2007, with several adjustments, all of which reduce the value of this export incentive. The phase down of import duties was scheduled to continue, with the rate on vehicles falling to 30 percent by 2007 and that on OEM components falling to 25 percent. The "qualifying value of eligible export performance" used to determine the value of import duty credits earned in respect of exports was also scheduled to fall gradually from 100 percent to 70 percent of the value of exports (net of imported components) by 2007. And the value of credits for CBU imports in respect of components exports will fall gradually from 65 to 60 percent in 2007.[2]

To encourage investment the Government introduced a new "Productive Asset Allowance" (PAA) program that grants import duty credits equal to 20 percent of the value of qualifying new capital investments in the sector. The duty relief is spread over a period of 5 years from the date of the investment – i.e. providing a duty reduction of 4 percent of the value of qualifying investments in the year of the investment and each of the following four years. In the case of a qualifying investment of R100 million, for instance, the investor would be granted import duty credits totaling R20 million, of which R4 million could be used in the year of the investment and the same amount in each of the next four years. These duty reductions can be applied against duties otherwise payable on imports of OEM components or CBU vehicles.

In order to qualify for the PAA an investment must result in an increase in the scale of production of a particular product line and must be aimed at increasing production for export markets. In other words, like the earlier export incentive program, this allowance is for investments to expand the productive base for exports of components and vehicles.

A second review of the MIDP in 2002 led to a further extension of the program until 2012. Under this extension import duties will continue to be phased down from 30 to 25 percent in the case of vehicles and 25 to 20 percent for components. The reduction in the valuation of motor industry exports for import rebate purposes which was due to phase down from 100 percent of local content value to 70 percent by 2007 was delayed until 2009. The valuation of exports for import rebate purposes will then remain at 70 percent until 2012. The PAA was not reviewed at that time. All other elements of MIDP will remain in place until 2012.

A further review of the motor industry and of future government support is scheduled to occur in the next year or two.

3.3 Impacts of MIDP

The MIDP has brought about fundamental changes in the structure of the South African motor industry. Its main effect has been to reorient incentives away from production for the local market to production for export. This has led to a significant change in production patterns, with a smaller range of vehicles produced in longer production runs in order to take advantage of economies of scale. Exports of certain motor vehicles and components have boomed,[3] as have imports of products that are

[2] This was reduced from 70 to 65 percent in 2002.

[3] Over 54 percent of components exports are accounted for by just two products, catalytic converters and stitched leather seat covers. Catalytic converters alone accounted for 40 percent of components exports in 2003.

not made domestically. With increased specialization in components as well as vehicles, the degree of vertical integration of the industry has decreased since the introduction of the MIDP.

While exports and imports have increased, the incentives provided by MIDP continue to depend fundamentally on protection of the domestic market. The value of IRCCs earned from exports derives from the fact that the duty free imports that they provide can be sold at a substantial markup in the local market. The basis for this markup is the tariff on vehicles and components that are imported without duty reduction provisions. It is further sustained by a virtual ban on the import of used vehicles.

Since the value of the incentives depends on the domestic markup over import prices, their costs are borne by South African vehicle buyers and users. The incentives (tantamount to subsidies) do not appear in the government budget and are a cost to the budget only to the extent that they represent import taxes foregone. Since the tariffs and duty reduction programs are designed only to support the domestic industry, it is debatable whether they would remain in place, at least at their current levels, in the absence of a local industry.

The real cost of the incentive is borne by consumers. With an import duty on vehicles of 36 percent, the IRCC program would make it profitable to produce a vehicle worth R50,000 in the export market even at a domestic cost of up to R68,000. The difference of R18,000 would be made up by importing vehicles worth R50,000 on a duty free basis and selling them at a markup of R18,000 in the domestic market. South African consumers thus pay to subsidize vehicle exports through tariff-induced price markups in the local market.[4]

The size of the incentives to exports and export-related investments is substantial. The value of the direct export incentive through the IRCC program has and will continue to fall as import duties decline. This part of the program provided a subsidy of 65 percent (based on the tariff) to motor vehicle exports in the first year of the program; it is 32.4 percent in 2004; and it will fall to 17.5 percent in 2012.

The PAA program substantially increases this subsidy. Conservative estimates suggest that an investment in this sector that would have real rate of return of 10 percent in the absence of incentives would have a real return of over 85 percent as a result of the PAA and IRCC programs.[5]

In the face of such incentives, it is not surprising that there has been substantial growth of investment and exports of parts and components in South Africa. These investments and exports do not necessarily mean that the South African industry is internationally competitive. If producers are able to make profits only as a result of incentives, they are not truly competitive. Incentives of this magnitude in South Africa also make it virtually impossible for other Member States to attract investments by international producers contemplating a production base in the SADC region. Even if other Member States were of similar attractiveness otherwise, no investor would situate anywhere other than South Africa unless incentives of at least a similar magnitude were offered.

The following section asks whether it might be feasible and/or desirable to broaden MIDP to include other Member States.

4. Is the MIDP a Possible Model for SADC?

The rationale for MIDP is based on the recognition that the South African market is far too small to support an efficient motor industry. The same is true, much more so, for all other SADC Member

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These are both products in which South Africa might be argued to have a comparative advantage and hence might be able to export without the need for any special incentives. This is almost certainly the case with catalytic converters whose production has been highly profitable in South Africa, even before taking account of the value of the IRCCs they also generate.

[4] IRCCs are selling currently at over 90 percent of their face value in South Africa. After adding in transactions costs and commissions, this means that imported vehicles must be selling in the domestic market at a price reflecting at least the full duty markup.

[5] Source: author's calculations.

States individually and collectively. South Africa accounts for 75 percent of total SADC GDP. Adding 25 percent to the South African market would not be enough to support an efficient motor industry. Furthermore, the remainder of the SADC market for automobiles is much smaller than indicated by GDP aggregates. South Africa accounts for over 90 percent of the SADC market for automobiles (Black and Muradzikwa 2002).

The only possible way to create a viable motor industry in all or any part of SADC is to be able to compete in world markets. Would the MIDP or some similar program be a means of achieving this?

The MIDP model could be employed in one of two ways.

- Member States could implement their own MIDPs or
- South Africa's MIDP could be expanded to include other Member States or even all of SADC.

The small size of the motor vehicle markets in all the other Member States would make it impossible for the MIDP model to work in these States. The export and investment incentives provided under MIDP arise from and depend on the "duty pool" created by imported vehicles. The amount of incentive available to exporters and investors under MIDP-like programs is limited by the size of this "duty pool" in the relevant market. Duty credits are only of value if they can be used to import vehicles on a duty-free basis and then sell them at a markup in the domestic market. Once the domestic market is saturated with such imports, the duty credits become worthless. The amount of exports that can be subsidized by an MIDP-like program, therefore, is limited by the size of the domestic market for imported vehicles. There is no SADC Member State other than South Africa in which this "duty pool" is of sufficient size to support an efficient scale of vehicle production.

Even if there were some niche components exports that could be supported in this way, the question would still arise as to whether a Member State would wish to tax its vehicle consumers (or sacrifice motor vehicle import duty revenues) to subsidize such exports.

The second type of SADC MIDP would be one in which MIDP benefits were simply extended to all Member States. In this case, IRCCs or other duty reduction privileges earned on exports from any Member State could be used to import vehicles on a duty-free basis to any other Member State. Under such a program the "duty pool" available for export incentives would be supported by the markets of all of the Member States.

This would provide a duty pool even larger than that available in South Africa and thus would have the potential of offering even greater subsidies than could be provided in South Africa or any other Member State alone. However, such a scheme would almost certainly have differential distributional effects among Member States that would render it unattractive to most Members.

Suppose a participating Member State other than South Africa attracted substantial new investments in the export of some motor vehicle(s) or component(s). How would the IRCCs earned in this way be utilized? The incentive would be to employ or sell them in the markets with the highest import duty rates until the duty pool in that market were exhausted. They would continue to move on down the line in this way, and given the relative size of the different SADC markets they would eventually come to South Africa.

The result would be the subsidization of export production in one Member State by consumers and government Treasuries in other Member States, primarily South Africa and any Member States with higher import duties than South Africa. A scheme with distributional consequences such as these is unlikely to be politically acceptable to all Member States.

More fundamentally, even if such a scheme could be agreed and implemented, Member States would want to ask whether it is really in their interest to ask their consumers and/or Treasuries to support exports that would not otherwise be sustainable on the basis of their private profitability. An industry that can compete only on the basis of such incentives is not "competitive" in any economic sense, and detracts from rather than contributes to economic development. Only if the incentives are paid by consumers or Treasuries elsewhere would it make any economic sense for a country to try to attract new investments in this way. But that is not politically sustainable in the long run.

5. Other Issues in Regional Integration of the SADC Motor Industry

Under current conditions and levels of development it is highly unlikely that any Member State outside of South Africa would be an attractive destination for investment in OEM production for global markets. But even if they might be, the existence of MIDP in South Africa would almost certainly tip the balance in favor of South Africa. Expanding or adapting MIDP to redress this balance is neither desirable nor feasible.

High cost and uncompetitive CKD or SKD assembly industries might be possible, but this could be achieved only behind high protective barriers and would not serve the development interests of the Member State(s) concerned.

However, this does not rule out the possibility of competitive production of various after-market components in other Member States. The MIDP is not directed at such products and so all Member States are playing on a level playing field in this sector. After-market products are characterized by considerable product heterogeneity; many are labor intensive; and economies of scale are not necessarily as important as in the OEM market. The importance of second hand cars in many markets outside of South Africa provides another interesting niche market in which components producers in many Member States might be able to compete.

It is conceivable as well that there might be a small number of OEM products in which non-South African producers might be competitive if, for some reason, South African producers choose not to invest, in spite of the incentives offered by MIDP.

This section examines other barriers to regional integration in the motor industry, with attention both to OEM products that are built primarily in South Africa, and non-OEM products that might be produced anywhere in SADC.

5.1 Rules of Origin

SADC's currently agreed chapter rule for motor vehicles and components (HS 87) requires that the value of imported inputs not exceed 60 percent of the *ex* works price of the product. But most products of interest have more restrictive list rules, in the form of specific processing requirements and/or higher local content rules.

For most chassis or vehicles there is a processing requirement that "the engine, transmission, axles, radiators, suspension components, steering mechanisms, braking or electrical equipment or instrumentation must be fitted to the floor panels or chassis frame of the vehicle." And for most vehicles it is required that "the manufacture or assembly of the vehicle entails that the floor panels, body sides and roof panels must be attached to each other." These are meant to disqualify vehicles or chassis that result from simple assembly of SKD kits.

Production of vehicles from CKD kits is a notoriously high cost activity and could never compete with international scale vehicle production plants. The only way they can survive in any market is through high levels of import protection on vehicles and very low tariffs on imported kits.

The only condition under which CKD assembly could compete against full manufacturing production in another market would be if the target market was protected through high and escalating protection of both components and CBUs and the kit products were able to circumvent the high CBU tariffs. This is what threatened to happen in South Africa several years ago when an automobile assembly operation was set up in Botswana under protection of the high external SACU tariff on vehicles and with the benefit of duty-free import of kits. The very high tariffs on components in South Africa at that time, together with Botswana's duty-free access to the South African market under SACU, appeared to make it possible to overcome the competitive disadvantage of the high cost Botswana assembly operation. Significant financial subsidies to the company in Botswana also contributed.

But SA tariffs are now much lower and are falling, and the general duty rebate on inputs under MIDP make the burden of protection of inputs much lower still. In practice, South African vehicle producers operate in a duty-free environment for their component inputs. With SA producers no

longer burdened by high input tariffs, the potential threat from another CKD kit venture is very difficult to imagine. The only way this could happen again would be with the assistance of large investment and/or export incentives as well. If this ever should happen, it should be handled through disciplines on subsidies, not through a restrictive rule of origin.

In addition to these process requirements, the regional content levels stipulated for many products are more restrictive than the chapter rule. For particular types of vehicles the maximum import content is set at 55 percent, and for vehicle components, the maximum import share is 40 or 50 percent, depending on the type of component.

These rules are quite restrictive and are now recognized as such by South African producers. The SADC rules are also much more restrictive than those in other preferential trading arrangements in which SADC Member States participate.

The AGOA rules of origin on motor vehicles, under which SA is currently exporting duty-free to the US market, require local value added (cost of materials from AGOA-eligible countries plus direct costs of processing in AGOA-eligible countries) of at least 35 percent of the fob value; the import content may not exceed 65 percent. Up to 15 percent of the 35 percent local value can comprise US-made inputs (TISA December 2003). This means that only 20 percent of value of vehicles or components exported from South Africa needs to be sourced in the region in order to meet AGOA's rule of origin requirements.

Without a relaxation of the restrictive SADC rules of origin, there will be very little preferential trade in this sector, even when tariff rates are finally phased down (see section 5.2 below).

Representatives of NAAMSA have indicated that they are taking this issue under consideration and will be making their own recommendations for relaxation of the SADC rules in due course. Other Member States, whose motor industries are much less developed than South Africa's, should assess these recommendations to determine whether they will afford them any opportunity to participate in the regional motor industry. *There is no need for the specific processing requirements that are now in the SADC list rules for this chapter.*

5.2 Tariff Phase-Downs

Tariff phase-downs offers in all Member States in this sector are slow and back-loaded. South Africa, which has generally offered the fastest tariff phase downs of all Member States, has treated the motor industry as a more sensitive sector, similar to textiles and garments. Significant tariff phase downs for vehicles did not begin until 2003 and the preferential duty will not go to zero until the final year of its tariff reduction period, 2008. For an industry that is advertised as a successful world class exporter of vehicles, it is difficult to understand why it feels it necessary to delay its tariff reduction offers to its SADC neighbors, none of whom even has anything resembling a competitive motor industry.

South Africa's tariff phase downs on components are slightly faster than for vehicles, but for all those "of interest" to her (i.e. those with a 40 percent MFN rate in 2002), the SADC preferential rate does not go to zero until 2007, one year before the end of the tariff reduction period.

5.3 Treatment of Export and Investment Incentives

The SADC Trade Protocol does not yet include specific provisions regarding the preferential treatment of goods produced under various kinds of export incentive programs. If an intention of the Trade Protocol is to enhance the international competitiveness of regional producers, a strong argument can be made for granting SADC preferences to goods produced under standard duty drawback and exemption regimes, such as those provided by Free Trade Zones (FTZs) and Export Processing Zones (EPZs).[6] These are exactly the kinds of activities in which Member States throughout SADC have managed to compete effectively in world markets and generate the investment and employment being sought through integrating with the global economy. It is also the path that

[6] See Kirk 2004.

has been followed successfully over the past several decades in countries ranging from Mauritius to the highly successful exporting countries in east and south east Asia. Subject to satisfaction of the rules of origin, goods produced under such conditions should be granted SADC tariff preferences.

However, Article 19 of the Trade Protocol also states that Member States 'shall not grant subsidies which distort or threaten to distort competition in the Region' and that any new subsidies should conform to WTO provisions. The Article (paragraph 2) allows for Member States to continue offering a subsidy as long as it conforms to Article 3 which refers to the elimination of barriers to intra-SADC trade.

Although some persons might claim otherwise, there can be little doubt that the export and investment subsidies granted under MIDP would not withstand close scrutiny under the WTO. The subsidies are clearly in excess of those permitted under WTO-consistent duty drawback and exemption programs. The MIDP incentives cast doubt of the usefulness of MIDP as a model for future SADC industrial policy in this or other sectors.

The more substantive argument, with the same conclusion, however, is not legal but rather an economic one regarding the economic costs of such subsidies as outlined in the previous discussion of MIDP (section 4 above).

5.4 Public Sector Procurement

While South Africa is by far the dominant force in the SADC motor industry, small players in other countries have managed to secure small niche markets. Several years ago a small company in Namibia designed and started producing an off-road multi-purpose vehicle that became known as rugged and reliable for a variety of purposes including game viewing, mine transport and general off-road use. Rural police have found it to be ideal for patrolling in remote areas and a number of South African police forces expressed an interest in replacing some of their pick-up trucks with it. However, government procurement policies in South Africa made it impossible for them to purchase a Namibian vehicle in preference to one made in South Africa. In order to take orders from South African government customers, therefore, the company has had to set up an assembly facility in South Africa.[7]

Restrictive procurement rules can have a real effect on the regional distribution of production and investment in this sector.

6. Conclusions

The recent growth of exports and investment in the South African motor industry have led the SADC Committee of Ministers to ask whether any of its benefits and especially those of the South African Motor Industry Development Program (MIDP) might be adapted to include other SADC Member States or to form the basis for a SADC industrial policy in this sector. They have also asked for an examination of specific barriers to intra-SADC trade and investment.

The following are the principal conclusions of this investigation.

- The most serious barriers to intra-SADC trade in the motor industry are the rules of origin which are far more restrictive than are enjoyed by South African motor industry in exporting to the United States under AGOA. The SADC rules of origin require a minimum regional content of 40 to 50 percent on most products of interest (60 percent on trailers) and also impose specific processing requirements. South African producers could not satisfy the current SADC rules in some cases.

[7] There is also a potential issue with rules of origin for this vehicle. The main inputs are reconditioned Toyota engines and drive trains, after market spares and regionally purchased steel frame and body materials. At the moment the motors and drive trains are acquired in South Africa. However, if the company is able to achieve a sufficient scale of production, it would cost-effective to import a container load of such parts directly from Japan. In that case the vehicle would no longer satisfy the current SADC rules of origin. Why should restrictive rules of origin be used to penalize this producer and deprive it of preferential access to SADC markets?

- The SADC market is far too small to support a competitive motor industry. South Africa's MIDP provides substantial investment and export incentives that have succeeded in reorienting its industry to global markets. Without similar incentives no other SADC Member State would be able to attract global investors in this sector
- The MIDP could not be generalized to any other Member State individually or collectively. The duty pools available are simply too small to replicate the South African model.
- SADC preferential tariff phase downs in this sector are unusually slow.
- South African government procurement policies have created barriers to trade and have affected investment decisions in SADC.
- Significant relaxation of rules of origin and an acceleration of preferential tariff reductions on motor vehicles and components might offer some opportunity for development of niche sectors, especially in after-market components in some Member States.

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