

EXECUTIVE SUMMARY

THE EFFECT OF THE PROPOSED SACU-MERCOSUR AND SACU- INDIA TRADE DEALS ON THE SOUTH AFRICAN AUTOMOTIVE INDUSTRIES

1 BACKGROUND

The Southern African Customs Union (SACU) and Mercosur signed a Preferential Trade Agreement (PTA) in December 2004. An Understanding signed by the parties provides for a separate protocol for a PTA on automotive products. In addition, SACU and India have agreed at a political level to enter into a trade agreement, with negotiations likely to commence in the second half of 2005.

While the automotive industry in South Africa is at the forefront of manufacturing development thanks to the Motor Industry Development Programme (MIDP) that was launched in 1995, concessions granted by South Africa in bi-lateral trade agreements in automotive products can compromise the MIDP if not considered carefully.

To preserve the integrity of the MIDP, the National Economic Development and Labour Council (NEDLAC) through the Fund for Research into Industrial Development, Growth and Equity (FRIDGE) commissioned an investigation into the implications of the prospective agreements for the South African automotive industry.

2 PROJECT DESCRIPTION

2.1 OBJECTIVES

The overall aims of the research are to:

1. Develop defensive and offensive strategies with regard to the prospective trade deals;
2. Identify the likely impacts of the SACU-Mercosur and the SACU-India trade deals on the South African automotive industry; and
3. Advise on tariff and other concessions which would be the most advantageous to South Africa in each of the agreements.

2.2 APPLICATION

The research is to be used by:

1. Stakeholders to guide South African negotiators in discussions with their counterparts from Mercosur and India.
2. The Motor Industry Development Council to assist them in determining how to optimise market opportunities for South African products in Mercosur and India.

3. Trade and Investment South Africa (TISA) in order to attract Mercosur and Indian companies to invest in manufacturing operations in South Africa.

2.3 DEFINITION

The automotive industry for the purposes of this study is defined as:

- Original equipment manufacture (OEMs);
- Automotive components and after market parts;
- Light commercial vehicles;
- Medium commercial vehicles;
- Heavy commercial vehicles; and
- Buses.

The definition conforms to the South African conditions, MIDP products and, for example, ignores two- and three wheel vehicles that is an important component of the automotive industry in India.

2.4 DELIVERABLES

The deliverables for the project are:

- A defensive strategy for each of Mercosur and India; and
- An offensive strategy for each of Mercosur and India.

2.5 SCOPE

The research was to cover:

Policy

1. The status of the SACU-Mercosur and the SACU-India trade agreements.
2. A short overview of the macro economies and trade and industrial policies of South Africa, Mercosur and India

The industries

3. An overview of the markets for automotive products.
4. An overview of the features of the automotive industries

Trade policy mechanisms

5. An overview of the tariffs that are in force.
6. An overview of the non-tariff barriers that are in force in Mercosur and India.
7. Any other mechanisms

Trade flows

8. An analysis of automotive exports of Mercosur and India to the world and South Africa to assist in defining the defensive positions.
9. An analysis of automotive imports by Mercosur and India from the world and South Africa to help with finding the respective offensive positions.

Automotive Products

10. The calculation of defensive indicators per 4-digit HS tariff line in trade with Mercosur and India respectively, by taking into account various trade parameters.
11. Likewise the calculation of offensive indicators.
12. Preferences expressed by business.

Conclusion

13. A synthesis of the quantitative and qualitative results of the study as they define the respective defensive and offensive positions.

3 CONCLUSIONS: SOUTH AFRICA-MERCOSUR

3.1 Defensive

3.1.1 Economic background

South Africa and the members of Mercosur adopted trade and financial liberalisation as the core of their trade and industrial policies after the Uruguay Round. That required stabilization of their macro economies.

Perseverance with sound macro-economic policies by South Africa introduced strong economic fundamentals:

- A platform has been established to pursue growth.
- The Rand stabilised which is a good thing but its level is too high for the wellbeing of the trading sectors of the economy.

In 2004 the dollar value of the Rand was practically the same as in 1999 while the Brazilian Real was 70% and the Argentinean Peso 34% of their respective 1999 dollar values. South Africa is thus at a disadvantage in respect of the currency realignments of the past five years while the competitiveness of Brazil and especially that of Argentina is enhanced significantly.

Brazil and Argentina restrained inflation with their exchange rates pegged against the US dollar. The initial successes were followed by economic turmoil in the early part of the century accompanied by massive devaluations and in Argentina recently, debt default. At present the economies are recovering and are achieving better growth in some measure because of the level of their currencies.

Deep seated problems remain among the members of Mercosur because of their debt burdens. Stability in Brazil and Argentina seem to be fragile and a SACU-Mercosur PTA could suffer from exchange rate volatility that could disrupt South African markets.

3.1.2 Trade and industrial policies

Automotive manufacturing is a leading industry in South Africa and in Mercosur, with the objective of both sector policies being the penetration of export markets.

The automotive industries of Mercosur focus on export penetration to solve problems experienced with idle capacity and stagnation. The establishment of trade agreements is seen as an important vehicle to enhance export penetration. This would include giving content to the Mercosur agreement and agreements with other Latin American countries and trade blocks, and further a field, with China, India and South Africa.

The South African automotive industry is driven by the MIDP especially its trade facilitating attributes. An outcome of that has been a focus on increases in exports of passenger vehicles. The reduction of import duties on completely built up units (CBU's) has also led to an escalation in their imports and a wide choice to the automotive consumer. A reduction in models assembled has resulted in improved economies of scale. Since its launch in 1995, the MIDP elevated the automotive sector to the forefront of manufacturing growth, in terms of fixed investment, value added and exports as well as demonstrable integration into international markets. It is also making a positive contribution to employment.

Tariffs are an integral part of the MIDP-mechanism. Tampering with tariffs is implied by an automotive PTA. This may erode the effectiveness of the MIDP.

3.1.3 Size and status

The South African automotive industry is about a fifth of that of Mercosur and at a disadvantage to achieve comparable scale benefits. In terms of labour cost South Africa is at a competitive disadvantage at the existing exchange rate. Interest rates in Brazil are higher than South Africa's while the position in Argentina is awkward with no published long term rates, negative real short term rates and a recent massive debt default.

The Mercosur market remained closed to imports. Imports by Brazil as a percentage of vehicle sales declined uninterruptedly from 29.5% in 1998 to 4.1% in 2004. The cheapness of the Mercosur currencies and systemic discouragement of imports can explain this. Conversely, the South African market behaved differently and opened to imports because of the trade facilitating attributes of the MIDP and an import friendly exchange rate. In 2004 28.4% of South African vehicle sales were imported compared to 23% in 2003.

The danger is that trade balances can become structurally skewed when South Africa absorbs imports from Mercosur without a reciprocal uptake on its part.

After a period of stagnation, growth resumed in the South African and Mercosur automotive markets in 2004. South African sales of vehicles are projected to increase by 22% to reach 588 300 in 2007. Exports of vehicles are expected to increase by 30.8% in 2005. The industry is thus on an export led growth path. Investment is taking place in respect of existing and new export commitments. The automotive industry in Mercosur is improving too, sustained by export growth. In the event of a PTA, Mercosur is expected to step up the present aggressive export initiative into South Africa.

3.1.4 Tariffs

South Africa and the Mercosur members bound 100% of the tariff lines of the automotive industry in the World Trade Organisation (WTO). The bound rates are 50% for MIDP motor vehicles and 30% for components of heading 87.08. The Mercosur countries bound all their (automotive) tariff lines at a ceiling of 35%. South Africa bound its tariffs at free on board (FOB) value and Mercosur at cost insurance and freight (CIF).

The applied tariff of Mercosur is 35%. The South African 2005-applied tariff rates for MIDP vehicles and components are lower: 34% for passenger and light commercial vehicles; 20% for medium and heavy commercial vehicles; 30% for bodies of passenger vehicles; 20% for bodies for commercial vehicles; and 28% for OE components.

The tariff rate for aftermarket components/parts of heading 87.08 is 20%, with a few exceptions. Mercosur's are lower at 18%; 14 %; 2% and 3 headings that are free. The rates applicable to South Africa's major component exports are 18% and 16%.

South Africa's tariffs are not a deterrent to Mercosur exporters in view of the huge trade balance in its favour. Mercosur obviously benefits from the trade facilitating attributes of the MIDP. In addition the South African tariffs are to be phased down until 2012. Mercosur and others will benefit from that.

3.1.5 Non-tariff barriers to trade

There are numerous non-tariff barriers in Mercosur. Producers in Mercosur benefit from them being assured of their home market they gain a competitive platform that can enhance their export performance. This is also true of their demonstrated willingness to apply trade remedies such as anti-dumping to redress the erosion of their home markets by unfair trade practices.

Brazil is promoting the use of ethanol in vehicles and has also introduced flex fuels which is driving the increase in domestic sales. Concessions on the taxes on vehicles are used to enhance sales of small vehicles and the use of ethanol and flex fuels.

3.1.6 Exports by Mercosur

Analyses of trade flows are compromised by the unsettled economic conditions in Mercosur over the past number of years. Under normal circumstances intra-Mercosur-exports should be around 40% of its total exports. This dropped to 20% in 2003. In the same year automotive exports by Brazil were 17% higher than in 1999 on the back of automotive components (+34%). Component exports increased to 76% of automotive exports compared to 66% in 1999. Exports of passenger vehicles dropped to 5.8% from 17.7% in 1999 because demand in Argentina disappeared. Apparently conditions improved in 2004 and trade should eventually return to a more normal product mix.

The amount in dollars of components that Brazil exported was about similar in 1999 and 2003. It achieved rapid growth in the export of engines (8407 and 8408) up from 8% of component exports in 1999 to 14.6% in 2003. Seats (9401) exported by Argentina increased from 8.1% of component exports to 12.6% in 2003.

South African automotive imports from the world in Rand terms were 2.6 times higher in 2004 than in 1999. That of passenger vehicles was 5.6 times higher. Various factors are responsible: the cheapening of imports by the Rand; absorption of imports because of the MIDP and the boost to demand by lower interest rates.

The share of Mercosur export in South Africa's import of automotive products increased from 1.4% in 1999 to 4.1% in 2004. Eighty five percent of automotive exports from Mercosur to South Africa come from Brazil.

Argentina is prominent in the export of vehicles for the transport of goods and also features in the export of buses to South Africa.

In 2003 South Africa progressed to 9th position as destination of 3% of Brazil's automotive exports.

Between 1999 and 2004 automotive exports by Mercosur to South Africa increased seven fold to R2 587 million. OE components from Brazil are the lion's share (R 1.8 billion in 2004) in imports from Mercosur. The existing trade facilitating regime of the South African automotive industry thus leaves ample scope for Mercosur to penetrate the local market.

Although the trade in OE components is directed by the multi-national OEM's, non- OE component imports from Mercosur trebled in value between 1999 and 2004

South Africa has a negative trade balance in automotive products of about \$2.0 billion; Argentina \$500 million while Brazil has a small surplus.

Brazil runs a trade surplus in the trade in automotive products with South Africa. The balance in favour of Brazil increased almost ten fold to R2.4 billion between 1999 and 2004. Balances in favour of Brazil are achieved in all of the different sub-groups of the automotive sector. The depreciation of Brazilian Real since 1999 undoubtedly contributed to this state of affairs. A narrowing of the trade gap with Mercosur and specifically Brazil, preferably by improved South African exports, should be a major aim of South Africa's negotiators.

Defensive indicators (DI's) taking into account a variety of quantitative parameters were calculated for automotive products. Although their interpretation remains arbitrary, DI's are useful as a last resort in circumstances where trade-offs are required in negotiations. Concessions should be avoided on tariff headings with high DI's while concessions could be considered where DI's are at the lower end of the scale on provision of due consideration of qualitative issues and due consultation with affected parties in business.

3.1.7 Conclusion on a defensive position

The following are the more important considerations in defining a defensive position with regard to Mercosur:

- 1. The automotive industry in South Africa is a sensitive one assisted by the MIDP to globalise its operations. Since its inception the MIDP launched the automotive industry to the forefront of manufacturing growth, in terms of fixed investment, value added, and exports while it is contributing to employment. The industry is on a growth path. Tampering with existing tariffs in terms of a PTA can distract from the effectiveness of the MIDP. Thus, because of the importance of the MIDP to South African manufacturing and economic growth, any trade agreement or provision in a trade agreement that may compromise the MIDP should be avoided. Tariffs are**

phased down in terms of the MIDP until 2012 anyway. That is to the advantage of Mercosur and others.

2. South Africa is absorbing imports from Mercosur (Brazil) under the present trade regime to the extent it has in a short while become the 9th most important destination of automotive exports by Brazil. Brazil is exporting 3% of its automotive products to South Africa supplying 4.1% of the latter's import needs compared with 1.4% in 1999. Brazil is running a trade surplus in automotive products with South Africa that amounted to R2.4 billion in 2004. The existing protective regime of the South African automotive industry thus leaves ample scope to Mercosur to penetrate the local market. Furthermore, Mercosur will aggressively exploit any export opportunities offered by an agreement with SACU, ably assisted by the competitive exchange rates of its members.
3. The danger is that trade balances can become excessively skewed in circumstances where South Africa absorbs imports from Mercosur without a reciprocal uptake of imports on its part. Alternatively, the question can be posed why Mercosur (in particular Brazil) needs an automotive PTA in view of the strides it is making into the South African automotive market anyway? A narrowing of the trade gap with Mercosur and specifically Brazil, preferably by improved South African exports, should be a major aim of South Africa's negotiators.
4. The current exchange rates of the Rand, Real and Peso are such that suppliers from Mercosur are in a strong competitive position compared to their South African counterparts. This is further enhanced by the size of their plants that provide scale economies while they are more competitive on cost items like labour.
5. In size South African automotive industry is about a fifth of that of Mercosur. Mercosur thus has a competitive base far larger than South Africa that is furthermore supported by non-tariff barriers and a willingness to use trade remedies against what it considers to be unfair trade practices.

3.2 Offensive

3.2.1 Trade

Automotive imports by Mercosur in 2003 were less than in 1999. In dollar terms the imports of components by Brazil in 2003 were practically the same as in 1999 while those of vehicles were halved. In 2004 Argentina's imports were half the amount of 1999. Improvements in trade should eventually lead to a return to a more normal import product mix and once again introduce growth in automotive imports.

Devaluation of the Rand inflated sales in the South African market until early 2002, while real expansion of the market started in 2004 on the back of improved economic fundamentals and lower interest rates that enhanced sales. In the meantime the MIDP succeeded in its objectives. In 2004 the exports of passenger vehicles were 41.4% of the value of automotive exports compared with 33% in 1999 while the share of component exports dropped to 55.5% compared with 61.2% in 1999.

South African sales of vehicles are projected to increase by 22% to reach 588 300 in 2007. Exports of vehicles are expected to increase by 30.8% in 2005. The industry is thus on an export led growth path. Investment is taking place in respect of existing and new export commitments

Germany, Japan, Australia, the UK and USA took 70.1% of South African automotive exports in 2004. In 1999 it was 61.9%. However, a better balance came about between the first five between 1999 and 2004. Excessive reliance on Germany diminished to 20% of exports as opposed to 43.6% in 1999. The share of the other four increased notably that of Japan, whose share in the export of passenger vehicles rose from 0.01% in 1999 to 33.0% in 2004.

The export of South African automotive components remained highly concentrated. In 2004 the export of catalytic converters; seats and tyres were 66.4% of component exports. Export of engines and security equipment became more important since 1999.

While the export of passenger vehicles became more important in South Africa's export basket there may be room to diversify to a greater number of export destinations and to a wider range of components.

South African component sales were about R35 billion in 2003 (excluding OE) while Brazil sold components worth R90 billion. The Brazilian component industry has undergone revolutionary change over the last 10 years. This involved in-depth consultation with all OEMs, prominent component manufacturers and government departments to enable it to transform itself from an inefficient relic of market protectionism to a globally competitive industry.

South African exports to Mercosur are small. Exports of components were R165 million in 2004. That was R203 million less than Brazil's export of non-OE components to South Africa. In addition Brazil exported R1.8 billion in OE components to South Africa.

3.2.2 Trade Balance

The trade surplus in favour of Brazil in automotive products increased almost ten fold to R2.4 billion between 1999 and 2004. Brazil is in surplus in all subgroups of automotive products. Brazil benefited from the depreciation of the Real and the trade facilitating attributes of the MIDP. A narrowing of the trade gap with Mercosur and specifically Brazil, preferably by improved South African exports, should be a major aim of South Africa's negotiators. The objective would be to balance the asymmetry in the automotive trade between Brazil (Mercosur) and South Africa.

3.2.3 Multi national OEM's

The eight OEMs with plants that manufacture passenger cars and light commercial vehicles in South Africa are subsidiaries of international motor manufacturing companies. Ford also manufactures Volvo and Land Rover vehicles. The assemblers of medium commercial vehicles (MCVs) and heavy commercial vehicles (HCVs) are all foreign owned. The following OEMs are found in more than one of South Africa, Argentina and Brazil:

Manufacturer	South Africa	Brazil	Argentina
Passenger / Commercial			
Daimler Chrysler	X	X	X
Fiat	X	X	X
Ford	X	X	X
Nissan	X	X	
General Motors	X	X	X
Toyota	X	X	X
Volkswagen	X	X	X
Peugot-Citreon		X	X
Renault		X	X
Commercial Only			
Iveco	X		X
MAN-ERF-Neoman Bus	X		X
Scania	X	X	
Volvo	X	X	

The OEMs with their power in directing production location, international sourcing and distribution would therefore be central in taking South Africa's automotive exports forward in terms of the MIDP. With all of the OEMs (except BMW) operating in Mercosur opportunities may arise to enhance South African exports. Their areas of impact are in the export of build-up vehicles from South Africa, the export of components and in the trade in OE components.

A significant difference between South Africa and Mercosur lies in the demand according to size of cars. Assemblers in Brazil focus on small cars (1000 cc and less) that averaged 64% of passenger car sales between 1999 and 2004. In 2004 36% of the number of cars sold in South Africa were smaller than 1500cc; while the focus were in the category 1500 to 3000cc (2500cc if diesel) with 57% of sales. Argentina tends toward bigger cars.

While South African vehicle exports may benefit from tariff concessions on larger cars in the Brazil market, resistance can be expected from Argentina. On its part Brazil would focus on the South African market for small cars. Exploitation in this direction would be in the hands of the multi-national OEMs.

3.2.4 Tariffs

While the customs tariffs of Mercosur are broadly comparable to those of South Africa they are at levels that serve as deterrents to South African exports to Mercosur. Duties on passenger cars are levied at 35% and duties on South Africa's prominent component exports are 18% and 16%.

3.2.5 Non-tariff barriers

Several taxes and fees in addition to customs duty are payable in Brazil. Some are uniform nationally while others vary from state to state. Taxes

apply incrementally and therefore have a cascading effect. The rates applicable on imports of passenger vehicles are progressive and escalate from small to bigger cars.

Although these taxes are applicable to both domestically produced and imported goods and are therefore in principle not discriminatory, it is alleged that most manufacturers avoid paying taxes or at least as much as possible thereof. Importers are assessed at one point and cannot avoid the tax. It is also alleged that these taxes may have a discriminatory effect on imported goods in the sense that they are applied incrementally at the point of importation while they are applied individually on domestically produced goods. The cumulative effect of this all is that the total dues on imports can double the customs duty.

Regulations in Brazil and Argentina change regularly and are unpredictable. Imports of motor vehicles into Brazil (with minor exceptions) and a number of components are subject to special non-automatic licensing. Non-automatic licences are granted within 60 days. It has been reported that applications for licenses often remain indefinitely pending. Most reports list the customs clearing system in Argentina and Brazil to be difficult, cumbersome and causing long delays. The time taken for imports to clear customs could take between 14 and 32 days

The complexity of exporting vehicles to Mercosur is made even more difficult and costly with specific rules of origin, labelling requirements and high logistics costs. Brazil and Argentina are prone to use anti-dumping measures in instances of perceived unfair trade practices.

3.2.6 Products

Offensive indicators (OI's) taking into account a variety of quantitative parameters were calculated for automotive products (paragraph 10.4). Although their interpretation remains arbitrary, OI's are useful as a last resort in circumstances where trade-offs are required in negotiations. .

3.2.7 Conclusion on an offensive position

The following are the more important considerations in defining an offensive position with regard to Mercosur:

- 1. Trading conditions in the automotive sector of Mercosur seem to be improving. The South Africa industry is on an expansionary path. The current exchange rates of the Rand, Real and Peso are such that South African exporters to Mercosur are in an uncompetitive position and are possibly unable to take advantage of better economic conditions in Mercosur**
- 2. Brazil benefits from the trade facilitating attributes of the MIDP without a reciprocal increase in its imports from South Africa. The large positive trade balance that Brazil runs with South Africa need to be redressed preferably by a narrowing of the trade gap by enhanced South African exports to Brazil. The guiding principal of South Africa's negotiators should be to**

remedy the present asymmetrical balances that favour Mercosur.

3. This could possibly be achieved in a phased manner. A first step would be to attack the existing skewed trade in favour of Mercosur. It would be expected of Mercosur to provide concessions to enhance South African access to its market for automotive products because of the benefits it already enjoys in the South African market as the result of the trade facilitating attributes of the MIDP and of benefits to come because of the annual down phasing of tariffs until 2012. Such a concession should serve to balance the benefits (OE components) that Mercosur already enjoys in the South African market on the back of the MIDP. When this milestone is achieved a phase can commence where reciprocal tariff concessions are traded.
4. It must nonetheless be appreciated that tariff concessions alone may not be sufficient to ensure significant increases in exports to Mercosur because of the complexities that non-tariff barriers introduce in the penetration of the automotive market of Mercosur. Excessive taxes on vehicles and a variety of non tariff measures can be serious obstacles to an export initiative into Mercosur. It has been reliably calculated that the range of taxes in addition to the import duty may double the latter. On top of that are a number of hidden costs because of lack of transparency in regulations, customs procedures and delays, import licensing and more. In essence it could mean that the benefits expected from a PTA are not achieved in reality.
5. Because of their power in directing the location of production, international sourcing and distribution, the OEMs are central in taking South Africa's automotive exports forward in terms of the MIDP. With all of the local OEMs (except BMW) having counterparts operating in Mercosur opportunities may arise to enhance South African exports. Their areas of impact could be in the export of build-up vehicles from South Africa, the export of components and the trade in OE components. The OEM's need to be fully consulted, especially on ways to realise perceived potential in the above context.
6. Because of Brazil's focus on small cars South Africa may focus on tariff concessions for larger cars. In addition it is important to broaden South Africa's narrow export base in components product wise and geographically. Because of the improvement in economic conditions in Mercosur the import demand for automotive products may become better than in the recent past.

4 CONCLUSIONS: SOUTH AFRICA-INDIA

4.1 Defensive

4.1.1 Economic background

When it departed from the protective regime following Uruguay in the early nineties South Africa first had to follow policies to achieve macro economic stability before growth could be seriously contemplated. Disciplined macro-economic policies eventually brought a great measure of stability and established a platform from where growth can now be pursued. The Indian economy was already stable at that time. India was thus positioned to focus on economic growth. India set about this in a very systematic manner and recently started to achieve its high growth targets.

The fundamentals of the Indian economy may be somewhat sounder than South Africa's. Interest rates are marginally lower than in South Africa; the Rupee is relatively stable and the Indian economy is powered by a high investment rate. In 2004 the dollar exchange rates of the Rand and the Rupee were practically the same as in 1999. None of the two thus scored an exchange rate advantage from the exchange rate realignments of the past five years. Fears of macro-economic instability in this, the 11th largest economy of the world, are thus weak.

4.1.2 Trade and industrial policy

After years of inward focused policies in their automotive industry, Indian policy makers accorded it eminence in their pursuit of high growth in a globalising economy. The Indian authorities tackle liberalisation and globalisation in a systematic manner and the automotive industry is seen as driver of economic growth in the overall economic development plan of the Indian economy. In this respect India is more concerned about emissions than South Africa is. It introduced measures aimed at an 80% reduction in emissions.

Unlike the South African MIDP there seems not to be a development programme for the automotive industry although measures to support growth in the sector existed in the recent past. The focus of the Indian automotive industry is on the international small car market and on reliable provision of components. A major constraint that the Indian economy faces is the poor condition of infrastructure. The provision of roads is seen as an important incentive to the automotive industry.

4.1.3 Sector Aspects

In terms of production the South African automotive industry is just more than a third of the size of the Indian industry. South Africa is thus at a disadvantage to achieve comparable scale benefits. India produced 1.2 million vehicles in 2004 and high growth is projected to continue.

Eighteen OEMs are located in India. The entrenched local manufacturers dominate the market. The largest two of them Maruti Udyog and TATA dominate the market with Hyundai in third place. The combined market share of the multi-nationals is 8.1%. Ford has 3.5% of the vehicle market and Toyota, which entered the Indian market in 2002, has 3.2%. The impact of MNCs on the Indian automotive industry is seen in increased competitiveness; a focus on technology; and modern practices, such as vendor tiers and JIT/lean production.

Tata who has recently established a supplier presence in the South African market produces 22.9% of Indian vehicle output. Its entry into the South African market is indicative of the trade facilitating attributes of South Africa's automotive regime.

The focus of the Indian automotive industry is on small cars (77% of car sales) and on components. The Indian automotive components industry is rapidly transforming itself from a low-volume business, with fragmented supplier networks to an industry that aligns itself with global supply chains. There are 400 component manufacturers that employ 250 000 people. The industry expectations are that the current export levels of US\$1 billion per year would potentially increase to US\$2.7 billion by 2010. The replacement market is mainly supplied by some 5 000 informal component manufacturers.

4.1.4 Trade

South Africa is far more export intensive than India in vehicles. India does not import vehicles. This is to South Africa's disadvantage as a vehicle exporter.

Components are the backbone of India's automotive exports. Parts and accessories for motor vehicles, tyres and parts for engines are the most important components that are exported mainly to the developed countries of Western Europe. Indian exports to Algeria, China and South Africa made significant gains between 1999 and 2003.

Indian exports to South Africa increased from R61.3 million in 1999 to R485.3 million in 2004 with a positive balance of R 340 million. Positive balances are found primarily in the trade in components. Only 8% of Indian automotive exports to South Africa are vehicles but they are gaining.

4.1.5 Productivity and costs

Earnings in Indian manufacturing in \$ per hour is low at \$ 0.40 as opposed to South Africa's \$3.40. The cost of capital (WACC) is 14.9% in India and 19.6% in South Africa if debt and equity employed is 1:1.

4.1.6 Tariffs

The tariffs applied by India on cars are significantly higher than South Africa's. In addition regulations are complex and NTBs abound. The Indian automotive industry is still in a relatively protective mode.

4.1.7 Products

Defensive indicators taking into account a variety of quantitative parameters were calculated for automotive products (paragraph 9.5). Concessions should be avoided on tariff headings with high DI's while concessions could be considered where DI's are at the lower end of the scale on provision of due consideration of qualitative issues and due consultation with affected parties in business.

4.1.8 Conclusions on a defensive position

The arguments in formulating a defensive position for India in some respects may differ from that of Mercosur but there are important similarities. The most important similarity is the ease with which both India and Mercosur make impressive gains in the South African market while their markets are relatively closed to

South African exports. The second is the sheer size of the respective markets compared to South Africa's and the benefits in scale economies that they derive from that.

A defensive strategy with regard to India rests on the following

- 1. The automotive industry is a sensitive one assisted by the MIDP to globalise its operations. The pursuit of this objective is successful and the automotive industry has become a leading growth sector in South African manufacturing. The industry is on a growth path and because of the importance of the MIDP to South African manufacturing and economic growth, any trade agreement or provision in a trade agreement that may compromise the MIDP should be avoided.**
- 2. India achieved a substantial positive trade balance with South Africa in a short space of time. Imports are increasing at a fast rate and are found in all product groups of the automotive industry. Once again India's export build up demonstrates that the automotive protective regime is accommodative of newcomers. In this respect it is important to underscore the fact that tariffs are phased down in terms of the MIDP until 2012 anyway. This is to the advantage of trading partners and will, unfortunately, strengthen the existing asymmetry that trading partners enjoy with South Africa. The evidence thus suggests that the merit for a PTA on the part of India is highly questionable.**
- 3. In size the South African automotive industry is about a third of that of India. India has a competitive base far larger than South Africa. South Africa is thus at a disadvantage to achieve comparable scale benefits. South Africa is at a competitive disadvantage against India in manufacturing cost with both labour and capital cost lower in India.**
- 4. Indian producers of passenger vehicles are further entrenched by an import duty of 60% and a complex import regime. India's pursuit of international competitiveness and globalisation is still supported by a reliance on protectionism as witnessed by the high tariff on cars and the absence of car imports. This offers producers an advantage in exporting because they are assured of a safe home market that in many instances can generate the cash to enter international markets**
- 5. The focus of the Indian automotive industry is small cars and automotive components. The market for small cars is concentrated in the hands of two local manufacturers. Multi-national OEM's are small in the Indian market but some are making progress capitalising on their advanced technology. The automotive component industry is crucial in the growth**

plans of the Indian automotive industry. The component sector is gearing itself for growth and development to be the focus of Indian automotive exports. South Africa is in deficit in its trade account in components with India.

4.2 Offensive

4.2.1 Status of the industry

The vastness of its market, the markets of its Asian neighbours and potential markets promises strong competition on the part of India. At the same time the opportunities that they offer is a challenge to trading partners. The automotive industry is seen as a critical sector in official efforts to expand the Indian economy at high growth targets. The Indian automotive industry focuses on small cars and the international trade in components to achieve these growth objectives.

Consumer demand is strong as a result of growing business confidence, the good performance of the manufacturing and agricultural industries, as well as infrastructure projects. It is stimulated by a positive response from consumers to a much wider choice of product from new model ranges and model upgrades, supported by the availability of consumer credit. In 2004 1.2 million vehicles were sold of which 78% were passenger vehicles and 686 500 were cars. Small cars (mini-compact) were 77% of cars sold with mid-size cars a further 20%. Production is projected to reach 1.5 million vehicles in the near term. The long-term sustainable growth rate expectation of the industry is between 8% and 12% per year. The automotive industry in India is on a strong growth path.

4.2.2 Trade

In dollar terms India's imports in increased by 60% between 1999 and 2003. Imports of components were 97.3% of Indian automotive imports in 2003. Although imports of passenger vehicles trebled between 1999 and 2003 it remained a low 2.5 % of imports. Japan, Germany, Korea and the USA are the foremost suppliers to the Indian automotive industry. Japan's share in India's imports was halved between 1999 and 2003. Germany and especially Korea became more important suppliers. China and Thailand increased their market shares. Italy, the UK and the USA lost market share.

South Africa is small in Indian automotive imports (0.8%). South African exports to India consist exclusively of components. South African component exports are spread in small amounts over a range of products. The major ones that were exported to India in 2004 were parts for engines, catalytic converters and new tyres. India has a positive trade balance with South Africa of about R 340 million. With a focus on component exports India can be expected to grow its trade with South Africa. Penetration of the Indian market for components should be an important aim of the negotiators since the import of vehicles is insignificant.

4.2.3 Tariffs

India did not bind tariffs on passenger vehicles in the WTO. The 60% of automotive tariff lines that India bound are found in components and other vehicles at 40%. Applied tariffs are 60% for passenger vehicles and 15% for commercial vehicles and for components (30% before the 2005 budget 40%).

India thus reserved room to increase tariffs on important sections of the automotive trade if required. Its applied tariff on cars is much higher than South Africa's.

In addition exports to India face very substantial non-tariff barriers that discourage importing. The insignificant import penetration of vehicles into the Indian market is probably the result of a combination of high tariffs and NTBs.

The Indian market for cars is protected by high import duties to the disadvantage of South Africa that relies on exports.

4.2.4 Non-tariff barriers

There are two additional duties to the import duty. The effect of the additional taxes is that the customs duty of 15% on a commercial vehicle is raised to 42.1% in total duties and taxes and on a passenger car from 60% to 107.5 %.

India seems to be fond of applying trade remedies when unfair practices are perceived. India is now the single biggest user of anti-dumping measures with 17.9% of the total number of measures imposed by all countries between 1995 and 2004. India is tenth on the list of countries against which most anti-dumping measures have been imposed, with 52 cases (3.3% of the total). India has not imposed any countervailing duties but 20% of all existing countervailing duties have been imposed against India.

Import and export (EXIM) rules are complex and frequently modified. According to the private sector, over-regulation is one of the main problems of doing business in India. In several cases, the rules are adopted without prior notification and explanation of rules to the private sector. Policy unpredictability is thus extremely prevalent in India.

Following the lifting of quantitative restrictions, the Government of India announced import rules for vehicles that require all imported vehicles to be right hand steering and controls, speedometer indicating the speed in kilometres and photometry of the headlamps to suit "keep left" traffic. Reasons given are road safety and environmental considerations. New imported vehicles are only permitted through the harbours of Nhava Sheva, Calcutta and Chennai. A number of permits are required. The technical requirements should not be a problem for South Africa. The problem is that India dislikes the idea of car imports.

Labelling requirements are stringent and relevant to prospective aftermarket component exports to India. All pre-packaged commodities, imported into India, shall in particular carry a number of declarations of which some will be hard to comply with. If an exporter supplies products aimed to be sold in various states, he will have to produce as many different labels as there are States of final destination for each item sold. This results in significant additional costs. Labelling requirements will discourage prospective South African aftermarket component exports to India.

Indian standards are formulated by the Bureau of Indian Standards (BIS). All the BIS certification schemes are operated according to the relevant ISO/IEC guides and the quality system certification scheme is accredited by the Dutch Council for Accreditation (Raad voor Accreditatie).

It has been reported that Indian government procurement practices and procedures are neither transparent nor standardized. Foreign firms do not generally win Indian government contracts.

Apparently India tends to be wary of foreign investment. The onus is on the investor to satisfy the Indian government that its proposal would not jeopardize the interests of the existing venture or the stakeholders thereof.

India suffers from a slow bureaucracy and regulatory bodies that reportedly apply monopoly and fair trade regulations selectively. Due to bureaucratic constipation Indian firms face few if any disincentives to engage in anticompetitive business practices.

India, like Argentina and Brazil, are on the USA's IPR "Priority Watch List" of 14 countries due to continuous serious concerns about copyright and trademark infringements, inadequate enforcement of intellectual property rights, and the need to greatly improve the processing of patent applications in a manner that is consistent with their international obligations.

4.2.5 Multi-nationals.

Of the eighteen assemblers in India six multi-nationals are in the manufacture of cars and Medium Heavy Vehicles (MUV's) and one in trucks. The combined market share of the multi-nationals is 8.1%, with Ford having 3.5%. Toyota entered the Indian market in 2002. It has already captured a 16% share of the MUV segment and a 2% share of the passenger car segment that translates into a 3.2% overall market share. The impact of MNCs on the Indian automotive industry is significant and can be witnessed in increased competitiveness; a focus on technology; and modern practices, such as vendor tiers and JIT/lean production. However, the indigenous companies have a strong entrenched position: passenger cars 65%; MUV's 81%; and LCV's 79%. In terms of the MIDP South Africa relies on the multi-nationals to drive national automotive exports. The small presence of the multi-nationals in India may thus stand in the way of export penetration into the Indian automotive market for the immediate future. However, since multi-nationals are expected to gain in the Indian market they should be consulted on the potential of South African products and possibilities for the realisation thereof.

The following multi nationals are common to South Africa and India.

Multinational manufacturer ¹	South Africa	India
Passenger/Commercial		
DaimlerChrysler	X	X
Fiat	X	X
Ford	X	X
General Motors	X	X
Toyota	X	X
Volkswagen	X	X ²
Commercial vehicles only		
Volvo	X	X

¹ Hyundai is not an OEM IN South Africa but in India it has a 3.2% market share.

² Present as Skoda

Thus, a potential exists for an interface to develop between the South African and Indian based multi-nationals. Apart from the brands named above two suppliers, Hyundai from Korea and Tata from India, are operating in the South African market.

4.2.6 Products

Offensive indicators taking into account a variety of quantitative parameters were calculated for automotive products. Although their interpretation remains arbitrary, OI's are useful as a last resort in considering trade concessions (paragraph 11.4).

4.2.7 Conclusion on an offensive position

The following are the more important considerations in defining an offensive position with regard to India.

- 1. The vastness of its market, the markets of its Asian neighbours and potential markets promises strong competition on the part of India. At the same time the opportunities that they offer is a challenge to trading partners. The automotive industry is supported by a development plan that focuses on small cars and a place in the international trade in components.**
- 2. Lately consumer demand has been strong on the back of sound economic growth. In 2004 (year end March), 1.2 million vehicles were sold of which 78% were passenger vehicles and 686 500 were cars. Small cars (mini-compact) accounted for 77% of cars sold with mid-size cars a further 20%. Production is projected to reach 1.5 million vehicles in the near term. The Indian automotive industry is on a strong growth path. The long-term sustainable growth rate expectation of the industry is between 8% and 12% per year.**
- 3. India's imports in dollar terms increased by 60% between 1999 and 2003. Imports of components were 97.3% of Indian automotive imports in 2003. Although imports of passenger vehicles trebled between 1999 and 2003 it remained a low 2.5% of imports. South Africa is small in Indian automotive imports (0.8%). South African exports to India consist exclusively of components. The major ones are parts for engines, catalytic converters and new tyres.**
- 4. India has a positive trade balance with South Africa of about R 340 million (2004). The trade facilitating attributes of the MIDP and the further down phasing of automotive tariffs until 2012 will further aggravate the asymmetry in the trade with India. Efforts to remedy the asymmetric trade between South Africa and India should thus focus on concessions on components and vehicles. Again the approach in negotiations should be that concessions on the part of India be gained that will balance the asymmetry in the trade between the two**

countries. Thereafter trading of tariff concessions between the two parties could commence.

- 5. In terms of the MIDP South Africa relies on the multi-nationals to drive national automotive exports. Unfortunately, the market share in India of the multi-nationals is only 8.1%. The small presence of the multi-nationals in India may thus stand in the way of South Africa's export penetration into the Indian automotive market. However, on the realistic assumption that the multi-nationals will enlarge their share in the Indian market, they should be consulted on the potential of South African products and possibilities for the realization thereof.**
- 6. The Indian automotive industry remains highly protected with the help of tariffs and non-tariff barriers. India bound about 60% of automotive tariff lines in the WTO. Passenger vehicle tariff lines (all of heading 87.03) are not bound against an increase. The tariff lines for other vehicles and components of heading 87.08 are bound at a rate of 40%. In respect of major South African components catalytic converters, engines/engine parts and wiring harnesses are bound at 40% while tyres and seats/seat parts/leather products are not bound. India's thus reserved freedom to increase tariffs on important sections of the automotive trade if required. The tariff on cars is significantly higher than South Africa's. The insignificant vehicle imports and high duties in force in India is to South Africa's disadvantage as a vehicle exporter**
- 7. In addition to the basic duty, India applies an additional duty and a special additional duty. The effect of the additional taxes is that the amount due based on a customs duty of 15% on a commercial vehicle is raised to 42.1% and the amount on a passenger car from 60% to 107.5%. India also seems to be fond of applying anti-dumping duties**
- 8. Non-tariff barriers apply widely and add to an already complex trade environment. There seems to be a predilection to replace the quantitative restrictions of pre-Uruguay with a number of non-tariff measures. Among these are policy unpredictability and vagueness; import regulations; stringent labelling requirements; standards and prescriptions for imported cars. Import and export (EXIM) rules are complex and frequently modified. According to the private sector, over-regulation is one of the main problems of doing business in India.**
- 9. Indian government procurement practices and procedures are considered neither transparent nor standardized by some. Foreign firms do not generally win Indian government contracts.**

- 10. India suffers from a slow bureaucracy and regulatory bodies that reportedly apply monopoly and fair trade regulations selectively. Due to bureaucratic constipation Indian firms face few if any disincentives to engage in anticompetitive business practices. India, like Argentina and Brazil, are on the USA's IPR "Priority Watch List" of 14 countries due to continuous serious concerns about copyright and trademark infringements, inadequate enforcement of intellectual property rights, and the need to greatly improve the processing of patent applications in a manner that is consistent with their international obligations.**

- 11. In the event of a trade agreement the above aspects can discourage South African business to the extent that the perceived benefits are never realised. A reduction in the tariff alone is insufficient to generate enthusiasm for exporting into the Indian automotive market.**