THE ECONOMIC IMPLICATIONS OF TRADE POLICY REFORM IN SOUTH AFRICA FOR THE AUTOMOTIVE INDUSTRY IN THE EASTERN CAPE PROVINCE

THESIS

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DECLARATION

Except for references specifically indicated in the text, and as such help as I have indicated, this thesis is wholly my work and has not been submitted for degree purposes at any other university

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ABSTRACT

South Africa is no longer a pariah state and has been fully integrated into the global family of nations. With the country's accession to multilateral agreements like the World Trade Organization (WTO), there has been pressure on the government to abandon its hitherto protectionist trade regime in favour of free and fair trade.

Trade liberalisation has had profound implications for the country's manufacturing sector in general, and the automotive industry in particular, which has seen tariff protection radically slashed and import restrictions greatly eased. Not only has the market share of domestic producers fallen, but increases in exports have to date not matched those of imports. As a result there has been a deterioration in the sector's balance of trade and a reduction in employment levels, at a time when the country desperately needs to create new jobs. Recent developments, however, suggest that this scenario may be set to change.

The thesis applies orthodox neoclassical and heterodox approaches to trade policy to an assessment of the likely economic impact of trade liberalisation on the automotive industry in the Eastern Cape, and by extension nationally. The thesis argues that reliance on orthodox trade theory to inform the direction of trade policy, especially in a developing country context, is unlikely to bring about an adequate increase in the level of exports and employment. This is because liberalisation of the import regime is likely to increase import levels without necessarily stimulating export levels, a scenario which serves to negate the presupposed benefits of liberalisation.

The study uses information from surveys conducted on both motor vehicle assemblers and component manufacturing firms to investigate the effect of trade liberalisation on the sector in the Province and finds that, by and large, the motor assemblers have not fared as badly as expected and have in fact positioned themselves to export more vehicles and

components. The components sector has had to contend with increased competition from cheaper imports.

The thesis, while acknowledging that, as far as possible, free trade is an optimal position, nonetheless argues that governments still have an important role to play in the promotion of industrialisation. The scope of government intervention should, however, be limited to selective interventions which are aimed at counteracting market failure and facilitating innovation and the diffusion of technological know-how. The thesis argues that institution of supply side measures, such as the encouragement of research and development (R&D), skills development and industrial training, is necessary for sustained growth in the manufacturing sector to be realised.

The thesis also finds that, contrary to expectations, the liberalisation of the automotive sector has not had the desired effects. Despite an increase in the value of automotive exports and an overall trend towards reduced net foreign exchange usage, employment levels are on the decline. The thesis also finds that without major export initiatives by both motor vehicle assemblers and component manufacturers, the future of the industry will be placed in jeopardy, especially with reduced protection and incentives.

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The views expressed herein are my own, and do not represent those of TIPS in any way whatsoever.

DEDICATION

This thesis is dedicated to the memory of my father

Evans Herbert Onyango (1939-1997)

"You were the light of our lives, and an inspiration to us all. Thank you for all the love, support, guidance and blessings that you bestowed on us."

Rest in Peace.

CHAPTER 1

INTRODUCTION

1.1 Problem Statement

Trade liberalisation is an issue that has generated immense controversy in post-1990 South Africa, especially since the watershed political events of 1994. These almost coincided with the country's accession to the Uruguay Round (UR) of trade negotiations, carried out under the auspices of the General Agreement on Tariffs and Trade (GATT), which has since transformed into the World Trade Organisation (WTO). Some of the salient features of the UR have included the shift from quantitative restrictions (QRs) and the abolition of export subsidies to the manufacturing sector under the General Export Incentive Scheme (GEIS). This is expected to cause a realignment of South Africa's trading patterns with the rest of the world.

Trade policy comprises those instruments which are used to influence a country's balance of payments (BoP) directly. Policy instruments used to achieve this goal include voluntary export restraints (VERs) and subsidies to both imports and exports. Trade policy is widely considered to be an instrument in attaining the goal of industrialisation, and allowing for increased output, and thus should not be considered an end in itself. Trade liberalisation, on the other hand, is undertaken to make a country's trade regime neutral between producing for the domestic market and for export. This involves among other things the pursuit of import liberalisation, relaxation of QRs, tariff reductions and measures to promote exports actively.

In South Africa, the period immediately after the 1960s was characterised by the pursuit of an active import substituting industrial policy (ISI), accompanied by the promotion of export subsidies. For the automotive industry, ISI was achieved under a series of successive

local content programmes which aimed at increasing a vehicle's local content, while simultaneously steeply increasing the price of imported fully built up (FBU) vehicles. This encouraged foreign motor manufacturers to set up assembly plants to benefit from the captive market.

However, by becoming a signatory to the WTO Treaty, the country is duty bound to lower both tariff and non-tariff barriers. Given that many years of protection have spawned highly capital intensive industries which are said to lack a competitive edge internationally, the lowering of tariff and non-tariff barriers has exposed the manufacturing industry to stiff competition from imports. For the motor industry, this has been seen in the proliferation of imported FBUs under the Motor Industry Development Programme (MIDP).

In order to benefit from tariff reductions, it has been argued that countries, especially in the developing world, have to shift from exporting traditional primary products to manufactured goods. South Africa is no exception to this for, as pointed out by Bell (1993:98) and the government's Growth, Employment and Redistribution document (GEAR, 1996:2), the country must significantly increase output in order to achieve economic growth. This makes the possible effects of trade liberalisation worthy of investigation.

1.2 Objectives of the Research

This thesis will investigate the impact of the on-going trade liberalisation on exports and employment in the automotive industry, with particular focus on the Eastern Cape Province. For this sector, there has been a shift in emphasis from local content programmes to an incentive based system under the Motor Industry Development Programme (MIDP), launched in September 1995. The MIDP proposed an accelerated tariff reduction regime in excess of that contained in South Africa's offer to the Uruguay Round of trade

negotiations, and which will see tariff protection for this sector fall well below WTO bindings by the year 2002, when the present MIDP expires.

It is instructive to note that the manufacture of motor vehicles in the Eastern Cape Province constitutes 39.9 per cent of the country's total output of motor vehicles and employs 24.1 per cent of the Province's labour force (IDC, 1997d:4). The motor vehicle sector also contributes 31.1 per cent to the Province's Gross Geographical Product (GGP).

Motor vehicle assembly, which has hitherto been a highly protected industry, is concentrated in the Port Elizabeth-Uitenhage metropolitan area, which is home to Volkswagen of South Africa (VWSA) and Delta Motor Corporation. DaimlerChrysler South Africa (DCSA) is located in the coastal city of East London. There is also a significant presence of automotive component manufacturing, especially in Port Elizabeth, where the bulk of the Province's component manufacturers are based.

This thesis attempts to evaluate the possible impact of trade liberalisation on the growth and structure of the Province's motor vehicle and component exports in relation to South Africa's total trade in automotive products. Most importantly, the study will make some inferences and recommendations for policies regarding the future of the motor vehicle industry in the Eastern Cape and, by extension, nationally.

For the purposes of the study, the automotive sector will be taken to encompass the assembly of vehicles principally designed to carry up to five people, and the manufacture of parts and accessories for the same (as classified under SIC 384).

1.3 Methodology

The thesis surveys the theoretical literature on trade policy reform in developing countries, with a particular focus on the likely static and dynamic economic effects of trade

liberalisation. This entails, *inter alia*, an examination of the literature on the impact of the UR on developing countries.

The debate on trade liberalisation revolves around two dominant perspectives, the orthodox neo-classical approach and the heterodox revisionist approach. The neo-classical school of thought upholds liberalisation on the grounds that it will bring about a rapid increase in exports and employment. On the contrary, critics of this standpoint, such as Bell (1993:114), argue that the immediate impact of trade liberalisation is likely to be delayed and possibly weak, thus worsening the trade balance at a time when improvement is crucial for economic recovery. Thus even if an outward looking export-oriented strategy is pursued, there is still a case for elements of import substitution.

It is instructive to note that even the East Asian Newly Industrialised Countries (NICs), which are today lauded as success stories for carrying out export oriented industrialisation, in fact provided heavy protection and massive export subsidies for industries in their nascent years of growth. As Cassim (1995:10) notes, the terms of the debate between ISI and EOI have considerably shifted, especially in the light of problems that have tended to emerge with the implementation of import liberalisation.

A more heterodox position has emerged which encourages an optimal policy mix of instruments, of which import liberalisation is a part. There is also an emphasis on supply side measures to augment the process of trade liberalisation.

The study relies on both primary and secondary data. The former are the results of surveys conducted of both the motor vehicle assemblers and component manufacturing firms affiliated to the National Association of Automotive Component and Allied Manufacturers (NAACAM) in the Eastern Cape. The questionnaires used for the surveys are based on a qualitative study conducted by Barnes (1998) on the automotive industry

in KwaZulu-Natal, Gauteng and the Eastern Cape Province. It was envisaged that by eliciting the views of these manufacturers, it would be possible to obtain first hand information on the effects of trade policy reform and trade liberalisation on their business concerns. For the purposes of the survey of component manufacturers, three non-exporting NAACAM member firms were omitted, leaving twenty firms. It was further established that one firm had since shifted to the production of non-automotive items. Three firms did not respond to the survey, and thus information from sixteen firms was used. In addition, one motor vehicle assembler declined to participate in the survey of assembly firms.

A qualitative as opposed to quantitative approach was adopted, largely due to the unavailability of disaggregated data on the automotive industry. While this opened the way to subjective and value-laden answers, the survey nonetheless gives a fairly accurate representation of the likely impact liberalisation has had on the automotive industry both in the Eastern Cape and nationally.

1.4 Outline of the Thesis

This thesis is divided into six main chapters. Chapter 2 outlines the genesis of the various theories of international trade. These include the classical, neo-classical and new trade theories. It then provides an analysis of how these theories have influenced thinking on trade policy reform. Attention is also devoted to the current debate on trade policy reform, which pits adherents of the orthodox neo-classical theory against the more heterodox neo-structuralists (revisionists).

Chapter 3 analyses the evolution of trade policies pursued in South Africa from the mid-1920s to the present day. It focuses on the country's efforts to move away from being an inward-looking economy manufacturing mainly for the domestic market to a more outward-oriented export-based regime. This is especially evident from the early 1970s to

the mid 1990s, when the country ratified the World Trade Organisation (WTO) Treaty. The chapter further focuses on the liberalisation efforts undertaken in the country's motor vehicle sector from the late 1980s, under Phase VI of the local content programme, and more recently the Motor Industry Development Programme (MIDP), which came into effect in September 1995.

Chapter 4 takes an in-depth look at the evolution of the motor vehicle industry in South Africa, before examining the sector in the Eastern Cape Province. It also focuses on the impact liberalisation under the MIDP has had on levels of exports and employment.

Chapter 5 presents and analyses the information obtained from the surveys of both the motor vehicle assemblers and component manufacturers and makes inferences for the future of the industry in the Province and nationally.

Chapter 6 summarises the arguments for and against liberalisation in the motor vehicle sector, before drawing conclusions for policy.

CHAPTER 2

INTERNATIONAL TRADE THEORY, POLICY PRESCRIPTIONS AND THE TRADE POLICY REFORM DEBATE

2.1 Introduction

This chapter outlines the genesis of the various theories of international trade from the nineteenth century to the present day. It examines how these theories have evolved and the way they have influenced thinking on trade policy in developing countries. Trade policy reform has gained much prominence in the 1980s and 1990s, mainly at the insistence of the Bretton Woods institutions, which impose it as a condition for balance of payments support and as part of structural adjustment programmes (SAPs).

2.2 Theories of International Trade

2.2.1 The Classical Theory of International Trade

The basic tenets of international trade theory can be traced to the writings of classical economists such as Adam Smith (1776), David Ricardo (1817) and John Stuart Mill (1848), whose contributions to economic theory are still acknowledged to the present day. According to the classical economists, countries trade because they are inherently different from one another, and they can benefit from these differences (Krugman and Obstfeld, 1997:13).

To demonstrate the gains that would accrue to a country from engaging in international trade, Adam Smith used a two country, two good model to propound the theory of absolute advantage. Based on the assumption that there was one factor of production, labour, which was perfectly mobile within nations but perfectly immobile between nations, he argued that a country stood to gain from international trade by specialising in the production of that

commodity which used fewer units of labour per unit of output. If the other country used fewer units of labour to produce the other commodity and specialised in its production, and assuming that surpluses in both countries were traded, then it followed that both countries would end up being better off.

The concept of absolute advantage was later refined by Ricardo, who introduced the notion of comparative advantage (Krugman and Obstfeld, 1997:15). This holds that even if one country has an absolute advantage in the production of both commodities, it would still be beneficial for the two countries to trade if one of them had a comparative advantage in the production of a particular commodity, that is, the opportunity cost of producing one unit of a commodity was lower.

As Myint (1958:318) notes, the theory of comparative advantage thus involves specialisation, with countries moving along a static production possibilities boundary based on given resources, the comparative advantage in question being determined by differences in technology. By specialisation, labour would move costlessly from one industry to another (but not between countries), leaving both countries better off by engaging in mutual and free trade. This is in stark contrast to the mercantilists, who measured a country's wealth by its store of precious metals. While they felt that accumulating precious metals through trade was advantageous, they frowned upon any reduction in the reserves of these metals, hence they advocated restricted trade.

2.2.2 The Neo-Classical Theory of International Trade

Neo-classical trade theory is a refinement of the classical comparative advantage approach, and was formalised by the Swedish economists Eli Heckscher and Bertil Ohlin (Winters, 1991:31). Their Heckscher-Ohlin variable proportions model focuses specifically on the differences in factor endowment between countries which results in diverse commodities being produced in different countries.

According to Sodersten and Reed (1994:66), the assumptions underlying the the Heckscher-Ohlin model are:

(i) absence of transport costs and other impediments to trade;

(ii) perfect competition in both product and factor markets (and by implication absence of scale economies; homogeneity of technology between firms and countries; and known, automatic and predictable learning processes);

(iii) production functions differ between commodities but are the same for both countries;

(iv) capital and labour are perfectly mobile between industries in the same country but perfectly immobile across national boundaries;

(v) there are no factor intensity reversals.

Capital abundant countries would thus specialise in the production of capital-intensive goods whereas labour abundant countries would specialise in the production of labour-intensive commodities. Through international trade, a country would alleviate factor shortages through the importation of commodities requiring larger amounts of its relatively scarce factor.

The conclusions that can be drawn from this model are that for internationally traded goods and services, efficient allocation of resources is determined by the marginal productivities of factors at internationally traded prices. This is achieved via the unfettered operation of the market system, with prices acting to allocate resources according to comparative advantage.

Secondly, given that increasing domestic resource costs cause domestic prices to exceed world prices, the notion of factor price equalisation comes into play. The idea of factor price

equalisation assumes that free trade between nations in the Heckscher-Ohlin model will equate factor prices between nations, provided neither country specialises fully in the production of a commodity. This situation arises when the price of the factor needed to produce a commodity in one country increases with rising production, bidding up its relative price. With the price of the abundant factor in each country rising, international trade would ultimately equalise these prices in both countries.

The basic policy prescriptions flowing from neo-classical trade theory are that the best allocation of resources is achieved by:

(i) the removal of domestic market distortions such as government intervention or other institutional rigidities which prevent efficient market operations;

(ii) liberalisation of international trade and foreign exchange markets, enabling economies to function as closely as possible to a free-market regime.

Not unlike the classical theory of international trade, the limitations of neo-classical theory mainly arise from its static equilibrium analysis. This ignores potential dynamic benefits of international trade such as increased growth over time, as a result of increasing propensity to save and the rate of technological progress. As Lall (1994a:68) points out, some of these assumptions also mean that some critical areas of market failure are ignored.

The major empirical critique of neo-classical trade theory is to be found in the Leontief paradox. Named after Nobel laureate Wassily Leontief, this paradox established that for the United States, a capital abundant country, the balance of trade was biased in favour of capital intensive imports, contrary to expectations. Several explanations are offered for this phenomenon.[1] One popular explanation, for instance, is that this paradox was observed

[1] A detailed treatment of the Leontief paradox is beyond the scope of this chapter. The interested reader is referred to Leontief (1953).

because the United States had a special advantage in high technology exports, which relied heavily on skilled labour and innovative entrepreneurial skills. Its imports, on the contrary, relied on technologies which had diffused widely and could thus use large amounts of capital (Krugman and Obstfeld, 1997:82).

Krugman and Obstfeld (1997:85) argue, however, that whereas the Heckscher-Ohlin model has not been as successful in providing explanations for actual patterns of international trade, it nonetheless remains crucial as a means of understanding the effects of trade, especially the distribution of income. With increasing North-South trade in manufactured commodities, the factor proportions theory has been firmly thrust into the centre of debates on international trade policy.

2.2.3 New Trade Theories

The 1980s have seen a rise in prominence of what are collectively known as new trade theories, largely due to the inability of conventional trade theories to explain the volume and composition of trade, and the pervasive presence of imperfect competition. Krugman (1989:348) sees these new trade theories as a fusion of industrial organisation theory and the conventional idea that trade results from specialisation and the pursuit of scale economies. Imperfect competition encompasses increasing returns to scale, product differentiation, intra-firm and intra-industry trade, which are strong features of worldwide trading patterns. New trade theories also incorporate neo-technology models which focus on the dynamic effects of trade, and the link between trade, technology and growth (Greenaway, 1991:158). Various authors have tried to formalise models which incorporate these features, in an attempt to address the shortcomings of conventional trade theories.

With regard to imperfect competition, the models of increasing returns to scale (IRTS) assume that economies of scale are internal to firms. Trade, therefore, need not be a result of differences in technology or factor endowments, but rather a way of expanding the

market and allowing for the exploitation of scale economies. Intra-industry trade, which involves the simultaneous import and export of the same good, takes place largely because countries with similar factor endowments still trade due to the existence of economies of scale in production. It also mainly occurs in products manufactured with similar factor proportions. The models embodying product differentiation assume that there are economies of scale in production and that the differentiation of products at firm level is costless. Winters (1991:62) describes differentiation of products as either cosmetic or functional, with different varieties being sought by consumers.

The main assumptions underlying trade in differentiated products are the existence of demand for several varieties and the presence of economies of scale which hinders the effective satisfaction of this demand. Winters (1991:63) notes that, as a result of imperfect competition, firms face downward sloping demand curves, but earn normal profits due to the free entry of competitors into the industry. However, gains from trade between two economies may still take place despite identical tastes, technology and factor endowments.

Another determinant of intra-industry trade, identified by Linder (1961)[2], is *per capita* income. With income as a major determinant of tastes, wealthier individuals demand better goods for which they are willing to pay a higher price. In the presence of trade, more varieties are purchased from other rich countries than poorer countries, hence more intra-industry trade occurs between countries with almost similar *per capita* incomes[3].

Neo-technology models highlight differences in technological capabilities between countries, and how these differences affect international patterns of trade and growth. Dosi *et al.* (1990:3) define technological capabilities as the skills and knowledge necessary to develop, produce and sell products. Innovativeness refers to the actual realisation of that

[2]For a detailed treatment of Linder's thesis, see Linder (1961).

[3]Cited in Winters (1991:67).

capacity to generate and commercialise new and better products and production processes. Dosi *et al.* (1990:3) treat technology as an endogenous variable which is firm-specific, tacit in nature and cumulative in its development. They see it as strongly dependent on investment and production, and contend that technical choices at firm-level are discretionary and non-optimal, given the impossibility of foreseeing the nature and likelihood of all possible future technological and market developments (Dosi *et al.*, 1990:9).

Neo-technology theories emphasise the notion of increasing returns, particularly those associated with production and technology, and develop a model based on international technology gaps, which reflect superior and inferior techniques. These technology gaps, which are synonymous with Ricardo's comparative advantages, are important in explaining the participation of each country in international trade flows and international differences in income levels. Dosi *et al.* (1990:11) see comparative advantage as resulting not from endowment but rather the learning process (innovation, imitation and organisational change) which is sector and country specific.

This model illustrates how international technology gaps are instrumental in the determination of specialisation and macro-economic activity, and establishes that the evolution of innovative/imitative capabilities in each country is responsible for shaping the trend in relative and absolute growth rates of the tradeable sector.

With regard to policy prescriptions, the new trade theories which emphasise imperfect competition have led to two main arguments, which can be classified as the external economies and strategic trade policy (rent-snatching) arguments. As Greenaway (1991:165) and Alam (1995:369) note, the former is based on the notion that beneficial spillover effects exist in an industry. If these benefits are unpriced, then reliance on market effects results in under provision of the good or service in question. This justifies the need for government intervention on the ground that these industries would otherwise not exist. Krugman (1992:435) points out that if through temporary protection an industry can be created that

would otherwise not have existed, then the higher earnings from the factors in that industry can compensate for any short-term distortions. This argument is further reinforced if positive externalities between industries are presupposed.

The strategic trade policy (rent-snatching) argument recognises the oligopolistic nature of world competition, with the resulting markets being concentrated and characterised by the presence of rents (Greenaway, 1991:162). Rents are defined as payments to a resource owner, which are over and above the amount those resources could command in their next best alternative use. Strategic trade policy suggests that, by government intervention, national welfare can be increased by competing those rents away from foreign to domestic firms. According to Gilpin and Gilpin (1987:186), strategic trade policy uses export subsidies (which are tantamount to investment in excess capacity) and entry barriers, and therefore harnesses domestic demand. This would make home firms gain the scale economies that allow them to compete in, and dominate, world markets.

Neo-technologists, on the other hand, argue that free trade is best suited for technological dynamism and growth within established technological patterns, particularly for countries on or near the technological frontier.

The question as to whether new trade theories reinforce the case for free trade or not is highly controversial (see, for example, Krugman, 1989, 1992; Alam, 1995). On the one hand they are perceived to uphold open trade policy. Greenaway (1991:168) argues, for instance, that caution must be exercised in postulating arguments for protection. This is largely because protection more often than not results in increased rent-seeking behaviour as opposed to industry expansion. He instead argues for first best interventions such as production subsidies and training subsidies, as opposed to direct protection.

2.3 The Trade Policy Debate

Section 2.2 distinguished the different trade theories and the way they have influenced thinking on policy prescriptions. This section will go a step further and attempt to provide an insight into the different orientations trade policy has taken over the years, especially in the twentieth century.

2.3.1 The Structuralist Approach to Trade Policy

Structuralism emerged in response to the difficult economic period of the mid- 1930s and early 1940s (the Great Depression and World War II), with some of its more prominent advocates including Prebisch (1950), Singer (1950) and Cheneris and Bruno (1962). The essence of structuralism should be understood in the context of a core-periphery relationship between developed and developing countries. According to Prebisch (1984:176), at the centre of the "economic constellation" lay industrialised countries, favoured by their earlier technological progress, which facilitated the organisation of the system to suit their own interests. Producers of primary products and raw material exporters were linked to this centre by virtue of their natural resources, forming a vast and heterogeneous periphery incorporated in the system in different ways and to different extents.

According to Krueger (1997:3-4), the following stylised facts were often used to describe developing countries:

(i) a heavy orientation towards the production of primary commodities;
(ii) a belief that the adoption of free trade policies would see their comparative advantage forever lie in primary production;
(iii) the global price and income elasticities of demand for primary products were low, hence export earnings would not grow rapidly, if at all;
(iv) the existence of a labour force mainly engaged in agricultural production; this labour force was perceived to have a marginal productivity of labour of zero or less;

(v) the belief that capital accumulation, which was crucial for growth, could only occur with the importation of capital goods;

(vi) the ineffectiveness of price incentives owing to structural problems within the economy.

It was the contention of structuralists that the price system as perceived by neo-classical theorists did not function in accordance with the perfectly competitive model, hence rendering it largely inapplicable to developing countries. According to Greenaway and Milner (1993:45), at the heart of the structuralist case was widespread market failure, which rendered the price system insignificant, and even misleading. Market failure was the culmination of many factors, ranging from capital market imperfections to production externalities and even the complete absence of some markets.

Fishlow (1984:192) adds that market imperfections were exemplified by monopolies in the centre and/or segmented capital markets in the periphery, which caused excessively high prices of manufactured goods and excessive production of low priced primary exports. Structuralists therefore stressed the need to shift from reliance on international trade and primary products to domestic industrialisation. Structuralists advocated domestic import-substituting industrialisation (ISI) as an alternative engine of growth. This would help counteract the tendency towards a foreign exchange constraint on development, which arose from a high income elasticity of demand for goods from the centre, compared with a low income elasticity of demand from the periphery (Prebisch, 1984:179). According to Kirkpatrick (1987:73), producing for the domestic market also had the undeniable psychological appeal of demonstrating an ability to produce something for oneself rather than relying on imports.

Helleiner (1990:8) defines ISI as the reduction in the share of imports in the apparent consumption of manufactured goods. The aim of ISI was to develop a country's industrial base behind a protective wall of tariff and non-tariff barriers, which would not only make

it difficult for imports to permeate the protecting economy but also provide a captive domestic market for local industry. Page (1990:110) further identifies directed allocation of subsidised credit through the commercial and development banking system, and public investment in industrial activities as other principal avenues of accelerated industrial growth through ISI.

A third important reason for supporting ISI was couched in the infant industry and externality argument, noted in Section 2.2.3.

However, despite all its good intentions, ISI often became the chosen trade strategy not because of economists' rational arguments but rather because of expeditious 'third best' or '*n*th best' policies undertaken to cope with balance of payments crises and because of social and political forces acting on policy makers (Meier, 1990:156). By adopting a protectionist stance, not only was a sheltered home market promoted and the welfare of political interest groups catered for, but the trade taxes (revenue tariffs and export taxes) provided an important source of revenue for the developing country (Rodrik, 1992a:312).

As Meier (1990:157) observes, critics of ISI point to the fact that it was not targeted according to systematic criteria, but was instead pursued in a chaotic, inefficient manner and for too long a time. This had the result, at the micro-level, of yielding too many plants with insignificant output and low quality, not to mention the underutilisation of capital and an increasingly oligopolistic or monopolistic industrial structure. ISI, as Meier (1990:157) further notes, caused a sheltered firm's profits in local currency terms to seem high, notwithstanding the higher domestic resource cost, which increased with every unit of foreign exchange saved.

Added to the fact that effective rates of protection were exceedingly high, domestic value added in some instances was actually negative at world prices. Valuable resources were also expended on directly unproductive profit seeking and rent seeking activities. Rent seeking

behaviour involved attempts by bureaucrats and businessmen to thwart or capture policy initiatives not in their interest, which made protection a very costly exercise (Krueger, 1997:16). Further, businessmen and bureaucrats acquired an interest in maintaining the system once established; with resources expended in maintaining the status quo, it was recognised that changing the system would be politically difficult.

Fishlow (1984:194) sums up ISI as a second best policy, imposed to tax agriculture and reallocate resources to industry, that was eventually brought down by the very circumstances it was supposed to avert: a shortage of foreign exchange. This was especially so, given the fact that countries failed to develop the export of manufactures at the same time as exports of primary products lagged (Meier, 1990:157). Krueger (1997:6) points out that this resulted in the imposition of foreign exchange rationing, which together with increased imports of capital and intermediate goods, led to a weakened balance of payments situation. With accompanying budget deficits and inflationary pressures fuelled by ambitious development plans, the end result was a large fiscal drain.

Meier (1990:157-8) concludes that with the end of the easy stage of ISI which involved the replacement of non-durable consumer goods, production increasingly became high cost and less economic. The incremental capital-labour ratio increased, the rate of growth in aggregate output slowed down, and employment lagged as further ISI became more difficult. ISI policies imposed dynamic losses on entire economies that far outweighed the loss of neo-classical static allocative efficiency.

2.3.2 The Neo-Liberal Approach to Trade Policy

The 1970s and 1980s marked a resurgence of neo-classical economic thought under the guise of neo-liberalism. The more prominent writers associated with this strain of thinking include Little *et al.* (1971), Balassa (1971), Ranis (1981) and the World Bank (1993). The emergence of neo-liberalism is generally agreed to have been brought about by the 1973 oil crisis, worldwide recession and burgeoning foreign debt on the part of most developing

countries. This scenario was further exacerbated by the widely acknowledged failure of classic ISI to allocate resources efficiently, together with deteriorating employment and income distribution. With the easy stage of ISI exhausted, the only option open to most developing countries was to maintain domestic growth rates by either boosting domestic demand or exports, the latter option being unfeasible owing to inefficient industries (Schmitz, 1984:3).

Embracing traditional growth theory, the early neo-liberal theorists assumed growth to be a natural process. According to Wright (1995:3), the resulting production function assumed diminishing returns to factors of production (capital and labour) and constant returns to scale. It was further assumed that an economy would converge to an equilibrium steady state with capital and output growing at a similar rate as population and labour (with labour augmenting technological growth). This model assumed both the rate of savings and growth in labour force to be exogenously determined, with growth resulting from increased capital employed per worker (Holden, 1993:216).

The heightened prominence of neo-liberal thought can also be understood in the context of phenomenal growth rates realised by the East Asian nations of Hong Kong, Taiwan, Singapore and South Korea, whose departure from ISI was marked by liberalised trade programmes. According to Meier (1990:158), to achieve neutrality between production for the domestic market and for export, it is important for the exchange rate for exports to increase such that the ratio of the effective exchange rate for exports to that of importables becomes close to unity. Meier (1990:158) further notes that this policy was extensively carried out in East Asia, where competitive exchange rates were ensured by depreciation-if domestic prices rose more rapidly than foreign prices-and by an attempt to limit wage increases and inflation to increases in productivity.

In an attempt to explain the disparity in growth rates between East Asia and the rest of the world, attention is drawn to the fact that these differences arose due to exchange rate

management and the trade regime. This reinforced the proposition that outward oriented policies, as reflected in real exchange rates that spurred exports, encouraged the development of the tradeable sector. On the other hand, inward orientation and an overvalued exchange rate fostered the growth of the non-tradeable sector in Latin America and Africa (Dollar, 1992:523).

However, these earlier neo-liberal models failed to explain adequately the growth rates in total output and output per capita that were observed in the post World War II era (Holden, 1990:216; Lipsey *et al.*, 1993:774). Implicit in these production functions was the unexplained difference between potential and actual growth, which was resolved by considering technology to be exogenously determined. Critics of traditional growth theory also drew attention to the fact that if both population growth and technological growth were exogenously determined, then so was overall growth. Hence it was not possible to predict the growth rate or the variables affecting it (Lipsey *et al.*, 1993:774). Also, because technology was perfectly mobile between nations, and it played a pivotal role in explaining growth, traditional growth theory predicted that all countries would ultimately converge at a worldwide constant growth rate, an observation at variance with the real world, where growth rates varied between countries.

Nonetheless, neo-liberal thinking, reinforced by their interpretation of the East Asian miracle, was the backbone of World Bank and IMF structural adjustment programmes and lending that developing countries were subjected to in the 1980s, as well as the cornerstone of multilateral trading agreements such as the GATT.

According to Lall (1994b:645), the stance of the Bretton Woods institutions was ultimately challenged by the Japanese delegation to the World Bank, as a result of which a report to establish what really took place in East Asia was commissioned. The resultant 1993 World Bank publication titled “The East Asian Miracle: Economic Growth and Public Policy” (hereafter referred to as the Miracle Study) affirmed that economic growth was

determined by growth in total factor productivity (TFP), arising from increased openness, greater competition and higher investment in human resources.

In an admission that the state and market were inextricably intertwined, the Miracle Study conceded that market failure was pervasive in developing countries, hence the need for government intervention. Lall (1994b:647) describes the market failures in question as the inability to co-ordinate investment within industry, due to missing information markets, capital market deficiencies, economies of scale, interdependent investment in vertically related activities, externalities in skill creation and learning and "multiple linkages".

In order to ameliorate these market failures, Lall (1994a:65) adds, the World Bank advocates functional "market friendly" interventions which do not favour one selected activity over another. Functional interventions contrast sharply with selective interventions, which take into account individual activities/groups in order to remedy specific failures or externalities that would lead to sub-optimal resource allocation, either in a static or dynamic sense.

In adopting TFP growth as their theoretical foundation, later neo-liberals adopted endogenous growth theories, so called because technology was treated as an endogenous variable. Endogenous growth models, as Singh (1994:1813) points out, assumed free mobility of capital, labour and technology, together with free entry and exit of firms to be favourable for the spread of knowledge and technological change. However, as he further notes, the assumptions underlying the TFP approach, namely full employment and perfectly competitive markets, together with a wholly supply side nature, ignored demand side factors, which proved to be a fundamental flaw.

Nonetheless the main policy prescription by the later neo-liberals is to adopt a "market-friendly" strategy, which dictates that countries seek their comparative advantage and as

far as possible have free markets. This involves adoption of structural adjustment programmes, an integral part of which is trade liberalisation.

Trade liberalisation has been variously defined by authors such as Michaely *et al.* (1991:13) to mean "any act that would make the trade regime more 'neutral'-nearer to a system free of government intervention, and which frees the flow of trade between a country and its (actual or potential) trade partners". Advocates of trade liberalisation point to the static and dynamic benefits to be gained from this process. One of the main static reasons for advocating trade liberalisation is couched in arguments of allocative efficiency. Dornbusch (1992:74) argues that by eliminating tariffs or quotas and their accompanying distortions, it is cheaper to import goods which would otherwise be produced locally at greater cost. Efficiency is thus gained by a reallocation of resources in keeping with the country's comparative advantage.

A second reason for trade liberalisation is identified as technical efficiency, which arises from the exposure of local firms to greater international competition. These firms are thus forced to cut costs and modernise their production techniques in order to compete with foreign producers (Rodrik, 1990:155). As Dornbusch (1992:74) further points out, this is especially the case for small countries, where restriction of imports results in a limited variety of low quality manufactured goods, whose prices are well above those prevailing in the world market.

Eradication of rent seeking and other associated directly unproductive behaviour is a third reason for advocating trade liberalisation. Bliss (1989:1218) and Bell (1993:114) describe the two as responsible for the wastage of valuable resources in pursuit of rents created by tariff barriers and other forms of protection such as quotas. This results in rising costs of protection and other forms of intervention. Examples of rent seeking and unproductive behaviour include the building of factories or plants with excess capacity in order to gain higher allocations of foreign exchange.

As observed earlier, dynamic effects are seen in the growth of TFP, as well as the diffusion of technology by multi-national corporations (MNCs). In an assessment of MNCs and technology diffusion in South-East Asia, Harianto and Safarian (1997:197) argue that as part of their investment packages, MNCs bring in a bundle of technologies embodied in their financial, production, management and marketing capabilities. In addition, their likely impact on the economy can be felt through the purchase of raw materials and intermediate inputs locally, as well as technical linkages with domestic suppliers and buyers.

According to Harianto and Safarian (1997:197), the same domestic buyers and sellers gain in the form of technical linkages including, *inter alia*, information linkages, technical assistance, managerial and organisational assistance, financial assistance and procurement assistance. Thus the more open the economy and the freer the entry of MNCs, the more the benefits that could be reaped in terms of access to new technologies and skills, not to mention the beneficial spillovers absorbed from the developmental activities of other firms or industrial sectors (Harianto and Safarian, 1997:215).

2.3.3. The Neo-Structuralist (Revisionist) Approach to Trade Policy

Revisionism is associated with the writings of Amsden (1989) and Lall (1994a) among others. The revisionist school of thought, in a radical departure from mainstream structuralism, acknowledges the failure of classic ISI, characterised by irrational and inefficient forms of intervention (Lall, 1994a:65). It not only questions the neo-liberal interpretation of what really happened in East Asia, but also the accompanying policy prescriptions drawn from the neo-classical perspective, which are at variance with the real world.

Revisionists draw on new trade theories, particularly the technology models of trade which focus on how technology and growth affect trade patterns, and argue that trade policy should be designed with explicit consideration of technological change. Central to the revisionist standpoint is the notion of technological learning. According to Lall (1996:117),

technology is characterised by "tacit" elements, thus it is not possible for it to be transferred like a physical product. In order for it to be mastered, there has to be investment in new skills, technical information, organisational methods and external linkages. Lall (1996:117) further adds that mastering technology may be relatively short, easy and predictable in the case of easy technologies, and prolonged, risky and unpredictable where they are complex and require many stages of production and large numbers of interacting firms in the production chain.

Once the neo-classical assumptions of perfect information in technology markets and full transferability of technology are relaxed, market failure results. As Lall (1996:117) notes, with the costs, risks and information gaps in the learning process, firms have a tendency to under invest in such technology. This undermines the process of technological deepening, entry into complex technologies, increasing local content and the performance of more demanding technological tasks like research and development activity.

The capabilities approach embraced by revisionists to propound a case for state activism dismisses the notion that selection, absorption and mastery of technology are costless and passive. Hence it sees the need for the development of new knowledge, skills and organisational forms, and linkages between enterprises in the acquisition of technological capabilities, a process which in itself is faced with a host of market failures arising from learning cost considerations.

With regard to policy implications, revisionists put forward a strong case for industrial policy (defined as all those activities undertaken to promote industrial development beyond that permitted by free market forces), and by extension the state, in encouraging the learning and investment that are prerequisite for industrial development. This is premised on the notion that rapid industrialisation is only possible through intervention. According to Lall (1994b:646), the nature of intervention advocated is of a selective as opposed to functional nature, aimed at counteracting market failure in the promotion of technological deepening

and entry into complex technologies. Through selective intervention, it is possible for governments to design these interventions if they have the right objectives, skills and information, and if these interventions are set in a framework of export orientation.

Interventions are necessary if market failure in resource allocation within and between firms is to be alleviated. These interventions may cover particular sets of activities and require the promotion of large firms. Lall (1994b:649) also argues the case for interventions to be integrated with selective interventions in factor markets, including measures affecting the mode of technology import. Further, these incentives have to be offset by measures that motivate investment in capability development.

A host of case studies on various countries provide support for this perspective. In the case of South Korea, these studies highlight remarkable parallels in the form of state action by the government of the time, and the prescriptions revisionists advocate as being prerequisite for development (Streak, 1997:317).

Despite advocating state activism in industrial development, revisionists remain acutely aware of the real possibility of interventions failing (government failure), but argue that state intervention will not always produce this result.

2.4 Which Way for Trade Policy?

The current debate on trade liberalisation pits the World Bank "market friendly" approach against the revisionist heterodox approach, with the main point of contention being the efficacy of industrial policy in promoting industrialisation. Considerable controversy also arises from the different interpretations of the East Asian success stories by these different paradigms, and whether any inferences can be drawn for other developing countries.

According to Singh (1994:1821), both the market friendly and revisionist standpoints acknowledge the role government intervention played in rapid economic growth and

industrialisation. However, differences still emerge insofar as the role of industrial policy is concerned. World Bank economists advocate wholesale liberalisation, deregulation and the opening up of economies to facilitate the free flow of capital, goods and technology, but due to acceptance of endogenous growth theory, argue for functional interventions to develop skills and avert market failures. On the other hand, revisionists argue that state action (in the form of import protection as export promotion, involving the use of strategic trade policy) in the period when South Korea and other newly industrialising countries began to take off, is consistent with what they advocate as being prerequisite for rapid development (Lall, 1994b:650).

Examples of state action include, *inter alia*, the identification and nurturing of selected industries where comparative advantage was sought, together with managed control of technology transfer, entry into the industry, capacity expansion and the attainment of export targets. Streak (1997:318) further points to the creation of large conglomerates (the *chaebol*), promotion of mergers between firms, dictation of entry/exit of firms from the industry in accordance with the requirements of scale economies, and conditions of world demand as being instrumental in South Korea's growth. The existence of tight controls on foreign direct investment (FDI), foreign majority ownership and the licensing of technology also played a prominent role.

However, most of the instruments of industrial policy are increasingly constrained by the dominant neo-liberal led conditionality policies of the International Monetary Fund/World Bank and multilateral organisations like the World Trade Organization (WTO), which uphold the primacy of liberalisation and the supremacy of the market. Streak (1997:319) argues that this has undermined the ability of developing country governments to engage in the same institutional innovation and policies that are prerequisite for rapid industrialisation. Singh (1994:1821) also criticises the World Bank stance, and argues that it should concern itself more with the institutional imitation and innovation that would be necessary to launch developing countries onto a higher growth path. Without this, Streak

(1997:323) sums up, rapid growth will be solely dependent on an ability to attract FDI, the extent of the negative impact of liberalisation on the balance of payments, the responsiveness of exports to devaluation and other economic windfalls.

The limitations associated with wholesale trade liberalisation cast doubts on whether it is appropriate for developing countries. This is especially in light of the fact that trade liberalisation episodes in developing countries take place against a background of serious macroeconomic instability, which sometimes serves to negate the net effects of the liberalisation itself.

Bell (1993:114-115) enumerates some of the ill effects of import liberalisation, a key component of trade liberalisation. Noting that the immediate impact of tariff reduction is an increase in the value of imports, he further adds that any stimulatory effect on exports is likely to be delayed and possibly weak. This further weakens the country's trade balance and aggravates macroeconomic instability. Besides tariff reduction impeding fiscal balance (due to taxes comprising a large share of government revenues), import liberalisation is likely to have adverse effects on import competing industries, by reducing their market power and ability to dictate prices by withholding sales. The impact is mostly felt in traditional labour intensive industries such as clothing and textiles (Rodrik, 1992b:101).

Another issue of contention lies in the credibility of governments in implementing trade policy reforms. As Rodrik (1992b:101) and Bell (1993:115) note, if the private sector responds with scepticism to trade reform packages, it may be disinclined to allocate resources efficiently, and thus the potential efficiency gains do not materialise. The lack of credibility hence renders the process of trade reform harmful.

Rodrik (1992b:101) further casts doubts on the notion that technical efficiency through cost cutting, rationalisation of production and the identification of new markets is sustainable on theoretical or empirical grounds. Bell (1993:116) adds that this is because

the idea of entrepreneurial slack, which is the basis of most models, and which argues that entrepreneurs will be spurred into additional effort in the wake of liberalisation, does not necessarily hold. This is especially true of countries which have, in the wake of prolonged recession, practised so much cost cutting that no more slack exists.

Wright (1995:15) and Rodrik (1992b:103) observe that undue emphasis should not be placed on trade policy reform as a panacea for all economic problems because it only provides an enabling environment for development, without necessarily guaranteeing long term growth. Wright (1995:15) further adds that attention should be focused on specific policies aimed at directly influencing innovation, diffusion and the enhancement of technological capabilities, with the ultimate aim of encouraging structural change and the shifting of comparative advantage into more technologically dynamic sectors (and ensuring sustained growth). Some of these policies would encourage research and development, technology transfer and foreign direct investment, aimed at enhancing domestic capabilities and skills, and greater support for industrial training objectives.

2.5 Conclusion

This chapter set out to examine the various trade theories and how they have influenced thinking on trade policy orientation. It argued that orthodox neo-liberal thinking, which currently dominates economic thought, provides policy prescriptions which are flawed and lacking in robustness, thus making them largely inapplicable in a developing country context. It was also argued that industrial policy and state activism still have an important role to play in technological deepening and ensuring sustained growth.

It is in this context, therefore, that the following chapter critically analyses the evolution of trade policy in South Africa, and whether sustained growth is likely to be forthcoming, given the neo-liberal stance that policy makers have in recent years adopted.

CHAPTER 3

THE EVOLUTION OF TRADE POLICY IN SOUTH AFRICA

3.1 Introduction

This chapter will investigate the evolution of trade policy in South Africa against the backdrop of the discussion in Chapter 2 and the country's efforts to liberalise its trade regime from the early 1970s to the present day. The aim of the chapter is to provide an understanding of attempts to liberalise the motor vehicle sector, and the implications arising therefrom.

3.2 Background

South Africa currently boasts an economy which is not unlike that of other middle-income developing countries. The country's manufacturing sector was by 1995 a significant contributor to overall gross domestic product (Table 3.1).

Table 3.1: Distribution of gross domestic product[4] by sector 1995 (per cent)

Country/Sector	Agriculture	Industry	Manufacturing	Services
Brazil	14	13	24	49
Mexico	8	7	19	67
Namibia	14	20	9	56
South Africa	**5**	**7**	**24**	**64**
Zimbabwe	14	20	9	56

Notes:
(1) Industry comprises mining, construction, electricity, water and gas.
(2) Manufacturing is considered separately owing to its dynamic nature.
(3) Services incorporate unallocated items.

Source: World Bank (1997:236-237).

[4]Totals may not be 100 because of rounding.

The manufacturing sector in turn is broadly based, and comprises heavy capital-intensive activity based on mining and energy, including iron and steel, heavy chemical industries and beneficiation of other non-ferrous metals. There also is significant production of food and beverages, electrical machinery, transport equipment, motor vehicles and components

Not unlike many other middle-income developing countries, South Africa has alternately travelled the paths of import-substituting industrialisation (ISI) and export-oriented industrialisation (EOI), as documented in various studies. Notable among these are Holden (1990), Bell (1993), Belli *et al.* (1993), Strydom (1995) and Jenkins and Siwisa (1997), which all identify chronologically the stages the country's industrialisation has undergone. From 1925 onwards, South Africa elected to adopt ISI, not only as a vehicle for industrialisation, but also to reduce its reliance on exports of agricultural produce and gold, together with dependence on Great Britain. All this was undertaken, as McCarthy (1998:67) and Hirsch (1997:1) note, with the ultimate aim of boosting employment (and, in the process, alleviating the poor white problem, to champion the interests of the Afrikaner elite).

However, with the easy stage of ISI exhausted, South Africa opted not to switch to EOI but rather to deepen ISI in capital intensive upstream heavy industrial and chemical ventures such as SASOL, Atlantis Diesel Engines (ADE) and MOSSGAS. This was done behind a wall of tariffs which, while moderate in comparison to other countries, was further complicated by a complex system of customs duties and import surcharges, with exemptions being granted on a firm-by-firm basis. Belli *et al.* (1993:3) observe that these implied importer-specific rather than product-specific tariffs.

According to Belli *et al.* (1993:1), a World Bank study into the trade regimes of 32 developing countries corroborates this, placing South Africa just above the median out of the sample of countries studied, the distinguishing features of the country's protective regime being complexity and a high level of dispersion. With 35 *ad valorem* tariff rates, 2 685 items with specific/formula/other types of rates and four levels of import surcharge rates,

South Africa, they note, displayed an exceptionally high ranking with regard to the coefficient of dispersion of tariff rates. This scenario was further compounded by the fact that the manufacturing sector was often able to lobby the Board of Trade and Industry (BTI), which traditionally adopted a sympathetic stance to such applications (Roberts, 1998:21).

Hence there was increased protection from international competitors. In return for protection, these industries were expected to supply at least 60 per cent of the domestic market, while criteria such as contribution to employment creation, economic growth and technological development were also taken into account. This was in an attempt to identify areas of potential comparative advantage (McCarthy, 1998:69).

As Belli *et al.* (1993:3) observe, in the decades after 1925, ISI under "moderate and selective" protection was the driving force behind the country's industrialisation, together with a wide ranging system of quantitative restrictions (QRs). The explanation for this inward-looking approach to industrialisation is couched in the strategic industry argument. McCarthy (1998:70) argues that this involved the South African government of the time selecting industries for fast-track development through the provision of special assistance, and the establishment of a domestic motor industry. From the 1970s, when South Africa's status as a pariah state became more pronounced, the high and sustained growth realised in the immediate post-World War II era began to slacken, accompanied by the weakening and stagnation of the domestic economy (Table 3.2).

Table 3.2: Average Annual Growth Rates in Real GDP (per cent)

	1961-65	1966-70	1971-75	1976-80	1981-85	1986-92	1992-97
GDP	5.94	5.15	3.49	3.13	1.36	1.03	2.60

Note: GDP at factor cost measured in constant 1990 Rands.
Source: Quarterly Bulletin of the Reserve Bank of South Africa, various issues.

It is also worth noting that with most of the country's exports in semi-processed form, there had been very little improvement in their competitive edge. This, together with the emergence of a highly capital intensive and inefficient manufacturing sector prompted the government to analyse its strategy critically, and thus the first liberalisation episode was born.

3.3 The First Liberalisation Episode (1972-1977)

The first liberalisation episode was heralded by the 1972 report of the Reynders Commission of Inquiry into South Africa's Export Trade. Mandated with the task of the identification and removal of obstacles hindering free trade, and suggesting ways of bolstering South Africa's export competitiveness, the Reynders Report recommended the following:

(i) the introduction of an "export development assistance scheme" to spur exports, involving a tax allowance for marketing expenses (Belli *et al.,* 1992:3; Jenkins and Siwisa, 1997:7);

(ii) the replacement of QRs with tariffs lower than those implicit in the QRs, together with a real devaluation of the Rand.

The Reynders Report further recommended the promotion of exports in the manufacturing sector as a long term solution to meeting future foreign exchange needs, and suggested the introduction of export incentives to countervail the effects of distance from markets and the influx of subsidised exports from other countries (Jenkins and Siwisa, 1997:6). These included direct cash grants, tax concessions on export turnover and export profits, rail freight concessions, tax concessions on the use of tariff laden inputs, and rebates on import duties paid on imported inputs. The Report also laid emphasis on the need to reduce reliance on gold as a source of foreign exchange, and more specifically to diversify into the export of non-gold items.

Bell (1993:85) notes that this first liberalisation episode was relatively mild, its effects being largely eroded by a substantial real appreciation of the Rand owing to a gold-led export boom, which culminated in the reduced competitiveness of South Africa's manufactures, and increased calls for protection. Jenkins and Siwisa (1997:8) observe further that this, together with the prevailing world recession in the early 1980s, lent credence to the notion that exchange rate management and the level of demand were more important determinants of export levels than the export incentives offered in the early 1970s. This conclusion contrasts with a study by Holden and Gouws (1997), which found that not all manufacturing exports were influenced by the exchange rate, since some industrial sectors enjoyed greater productivity as the proportion of output exported grew (Holden and Gouws, 1997:28).

3.4 The Second Liberalisation Episode (1983-1990)

Bell (1993:87) identifies 1983 as the beginning of a more intensified period of trade liberalisation. This period was characterised by a decline in the pace of economic expansion, which can be ascribed to the collapse of the gold price, a sharp decline of exports in general, burgeoning foreign debt and heightened political instability (Bell, 1993:93). In the period between the onset of the second episode and the end of the preceding one, however, notable developments included the constitution of the van Huyssteen Committee, which was charged with the task of revising the country's system of export incentives.

This culminated in the introduction of a more powerful system of export incentives designed to ease the pressure on exporters of the comparatively higher cost of local production and delivery to overseas markets. Customs duty drawbacks and duty exemptions were granted to exporters. Bell (1993:87) dismisses this system as unwieldy as it was not used to acquire free access to more competitive inputs. The incentive system was further negated by the massive real appreciation of the Rand, accompanied by a worldwide recession, which, as discussed in the previous section, led to the beginning of a sharp decline in South Africa's exports.

In the second episode of liberalisation, the abolition of the dual exchange rate in 1983 (which was to be reimposed two years later) was accompanied by the implementation of export subsidies to reduce the anti-export bias inherent in the economy. The latter flowed from the findings of the Committee on Industrial Development Strategy (the 1983 Kleu Report), which also advocated moderate protection and periodic tariff reviews in an attempt to temper the cost-raising effect of tariff protection (McCarthy, 1998:70). The reduction in QRs and their replacement with tariffs lower than those implicit in the QRs would be construed as an aspect of trade liberalisation.

Jenkins and Siwisa (1997:10) further note that the Kleu Report was critical of existing export incentives, which neither favoured domestic intervention nor created incentives for technical innovation, querying the merits of uniform versus selective export assistance, as uniform assistance would benefit even those exporters who needed it least.

The process of trade liberalisation was further enhanced in 1985, when the government changed the publication of a positive list (which specified items needing no approval for importation) to a negative list of items which needed approval prior to importation. Bell (1993:87) identifies this action as a major step in the process of trade liberalisation. In the same year, however, there arose a debt crisis, which can be attributed to a dramatic reduction in foreign direct investment and capital inflows, culminating in a large and sustained balance of payments deficit.

This resulted in some policy reversals, with the reimposition of the dual exchange rate system coupled with a significant real depreciation of the Rand and the introduction of a 10 per cent import surcharge. The latter contributed to an increase in the weighted average of the effective protection rate (EPR) from 30 per cent to 70 per cent (in 1987 estimates). EPRs ranged from a low of 1.0 per cent (for non-electrical machinery) to a high of 348 per cent for synthetic resins, as compared to a range of 1.0 per cent to 143 per cent for the same commodities in the preceding period (Jenkins and Siwisa, 1997:13-14).

Towards the end of the 1980s, South Africa's commitment to trade liberalisation became more evident, especially with the Board on Tariffs and Trade (BTT), which had succeeded the BTI, hardening its stance towards private sector requests for protection. In 1989 only 20 per cent of such requests were supported, as opposed to 38 per cent in 1988 and 65 per cent in the previous year (Jenkins and Siwisa, 1997:11). Export promotion was further enhanced by the introduction in 1989 of sectoral "structural adjustment programmes". These sectoral programmes had been at the heart of the BTI's 1988 policy document "A Policy and Strategy for the Development of Structural Adjustment of Industry".

According to Black (1993:210), these programmes were aimed at enhancing the competitiveness of local industry via selection and targeting, on the grounds that comparative advantage was not a static concept and could be created by governments. Emphasis was also laid on the role of the state regarding technology transfer policy, with foreign exchange applications being evaluated on criteria such as the amount of royalty payments, restrictive clauses (on exports) and the existence of alternative local sources of technology. As Black (1993:212) notes, these programmes generated considerable conflict between the Department of Trade and Industry (DTI) and the BTI, with the former criticising the complicated and unmanageable programmes, which were clearly unaffordable on the grounds of insufficient staff for their implementation and openness to fraud on the part of exporters.

According to Black (1994:53), the motor industry's structural adjustment programme, commonly dubbed Phase VI[5] of the local content programme, was designed to meet the following objectives:

(i) promotion of investment, job creation and growth;

[5]Earlier phases of the local content programme will be considered in Section 4.2 on the history of the automotive industry in South Africa.

(ii) satisfaction of the country's essential transport requirements;

(iii) improvement of productivity;

(iv) minimising price increases;

(v) maintaining a high level of competition.

Going further to describe Phase VI as the first attempt to address the issue of an overly fragmented industry characterised by low volumes of output and high associated unit costs, Black (1994:53) notes that local content was to be measured by value (ex works price less foreign exchange used). This was in stark contrast to the existing system which measured local content in terms of weight, with emphasis on the use of locally produced components. Phase VI entailed the imposition of a 37.5 per cent excise duty on all locally assembled vehicles, subject to a 50 per cent rebate on local content value (implying that, in effect, no duty was payable if a target of 75 per cent local content was achieved).

Introduced with the aim of encouraging local content and specialisation, Phase VI was nonetheless beset with problems arising from its rapid introduction, which gave little consideration to its likely impact. Duncan (1997:79) notes that inaccurate predictions on exports led to rapid changes in the Phase VI programme soon after it was introduced. Excise duties were rapidly increased when the government realised that revenue collection dwindled as a result of manufacturers being more successful than expected.

According to Duncan (1997:79), Phase VI succeeded in orienting assemblers from heavy local components and high value imports to higher value local sourcing coupled with increased export levels. Not only was the goal of saving foreign exchange attained, but the South African motor industry was also more closely integrated into international motor vehicle production.

However, despite the fact that it is credited with a rapid boost in export growth in both components and fully built up units (FBUs), the major shortcomings of Phase VI stem from

its protective nature and the fact that it encouraged model proliferation. Another major point of contention lay with component manufacturers, who felt deprived of business, owing to the fact that Phase VI allowed car manufacturers to obtain cheaper components from overseas with the foreign exchange credits obtained from exports, and in the process denied them import protection (van Zyl and Kotze, 1994:33). Component manufacturers were also put under severe pressure to restructure, following the introduction of new models under Phase VI.

Car manufacturers also viewed Phase VI as constraining them to licensing agreements with their overseas principals (in respect of the export of FBUs) as opposed to encouraging both manufacturers and component suppliers to concentrate on cost-effective exports, which were the main thrust of the outward-looking focus of Phase VI (Finance Week, Aug 13-19, 1992). As a result of this, the programme has undergone many changes, considered in the subsequent section.

3.5 Trade Liberalisation after 1990

The beginning of the 1990s was marked by the introduction of the General Export Incentive Scheme (GEIS). This was mainly designed to help exporters offset the price disadvantage they faced in international markets, and was implemented through a selective system of liberal tax-free grants. According to McCarthy (1998:70), these grants increased through four phases of higher value added and domestic content, with industries characterised by both high value added and high local content qualifying for a nominal subsidy of 19.5 per cent of export turnover, whilst those firms with low value added and low domestic turnover qualified for only 2 per cent. Hatty (1993:132) further adds that the GEIS also took into account fluctuations in the Rand value compared with a basket of major international currencies. Imported materials benefiting from the duty drawback system were, however, ineligible for any compensation under the GEIS scheme.

The introduction of the GEIS was closely followed in June 1990 by the publication of a study by the IDC entitled "The Modification of the Application of Protection Policy" (IDC, 1990). This report was a major turning point as far as liberalisation was concerned, arguing that the scope for further ISI was limited, necessitating a shift to EOI (Black, 1992:213). In contrast to the BTT's structural adjustment programmes, the IDC report advocated a much more uniform and lower tariff structure, arguing that the prevailing system was defective owing to the cost-raising implications of a relatively high protective structure, as well as the resource misallocation arising from sectoral variations in protection levels (Black, 1992:213-214). The IDC report identified, *inter alia*, the absence of regular tariff reviews, limited further opportunities for ISI, lack of highly skilled personnel to administer selectivity in an effective manner, and the excessive use of cost-raising formula duties as all warranting a process of structural adjustment towards EOI.

Black (1992:214) categorises some of the recommendations of the IDC report as follows:

(i) **Lowering of protection:** The lowering of protection was to be achieved by the replacement of formula duties with more specific anti-dumping measures, supplemented by the gradual downward adjustment of tariffs to pre-determined levels within a 4-5 year time frame. The only exceptions to this would be with regard to industries which would still qualify for protection at similar levels to those prevailing in more established industries.

(ii) **Measures to encourage export expansion:** The supply side measures proposed by the IDC to achieve export expansion included, *inter alia*, lower corporation tax, encouragement of higher domestic savings, realistic exchange rate policy and an improvement in the supply of skilled labour.

Criticism has been levelled against the IDC report on account of its fundamental weaknesses. These stem from a heavy over-reliance on the World Bank neo-classical

orthodox approach to free trade, gleaned from the success stories of the East Asian countries, but widely considered inapplicable to developing countries. Black (1993: 217-223) identifies the following shortcomings:

(i) the report was more concerned with trade rather than industrial policy, and failed to give more attention to complementary supply side measures crucial to export success, such as the attraction of investment and technology into specified sectors, which was vital for accelerated productivity growth and technical change;

(ii) central to the report was the notion of static comparative advantage, while the concept of dynamic comparative advantage and how it would change over time was ignored;

(iii) whereas the IDC report advocated outward orientation on the grounds that there existed little scope for further import substitution, this stance may be criticised as import substitution remains an integral part of all successful industrialisation experiences and, he argues, is a necessary prelude to breaking into export markets;

(iv) the assumption that reduced protection would result in export expansion by the reduction of import prices and exposure to international competition, a notion which, he argues, enjoys little empirical support; according to Helleiner (1990)[6], although there may be gains from improved allocative efficiency, these could easily be offset by the costs of adjustment;

(v) the adoption of uniform levels of protection on the grounds of easier implementation, an argument which lacked merit given ever-present lobbying for

[6]Cited in Black (1993:220).

protection by special cases, and the complex anti-dumping measures which would require skilled expertise to administer;

(vi) the costs of transition, such as the failure of small firms to reap the benefits of liberalisation and entry into export markets, and the loss of employment occasioned by the exit of firms from the industry.

The South African Chamber of Business (SACOB), while offering lukewarm support for "the approach towards greater export orientation, if by export orientation was meant the creation of an outward looking strategy", advocated a more cautious approach, supporting industrial targeting and the retention of selectivity (SACOB, 1991:8).[7]

With specific reference to the motor vehicle industry, September 1995 witnessed the unveiling of the Motor Industry Development Programme (MIDP), a radical departure from the local content programmes exemplified by the Phase VI it replaced. The MIDP was largely a result of the investigations of the Motor Industry Task Group established in 1992. The IDC Report on Measures and Policies Impacting on South African Industry (IDC, 1997c:3) describes the main features of the MIDP as being:

(i) the reduction of tariff protection on imports of FBUs from an effective 115 per cent in 1994 to 65 per cent in July 1995, 61 per cent in January 1996, and ultimately 40 per cent by the year 2002; similarly, duty on completely knocked down (CKD) kits would fall to 49 per cent over the same time span, with the ultimate objective of enhancing international competitiveness;

[7] Cited in Black (1993:216).

(ii) the reduction of the number of locally produced models from the existing 39 to 15 over an 8 year period, with duty-free incentives to enhance high volume selling models at the expense of low volume ones;

(iii) the granting of a duty free allowance of 27 per cent of wholesale vehicle sales turnover to vehicle manufacturers producing on a CKD basis;

(iv) allowing a manufacturer of motor vehicles to import R1 of vehicles or components duty-free for every R1 of local content exported in the form of vehicles; similarly, for every R1 worth of components exported, the exporter would be allowed to import R0.75 worth of motor vehicles and R1 of components duty free;

(v) a small vehicle incentive (SVI), which involved a duty-free allowance granted in respect of motor vehicles below a nett ex factory selling price of R40 000, calculated on the basis of ([R40 000-ex factory selling price] x 0.003 x ex factory selling price);

(vi) an excise duty on FBUs, which in effect penalised the import of expensive vehicles.

The IDC report (1997c:5) observes further that for every R1 of local content FBU exports, the import costs for vehicles after tariffs per R1 of imports free on board (FOB) of local manufacturers in 1996 would be reduced by R0.61. This implies an export incentive (or looking at it differently, an import advantage) of 61 per cent for FBUs. In the same vein, there would be a 35 per cent export incentive applicable in 1996 to components used to offset vehicle imports. The report further adds that, by the year 2002, the incentive to export FBUs and components would have fallen, in accordance with the lowering of tariffs, to 40 per cent and 23 per cent respectively, as compared to an export incentive of 50 per cent of local content under the defunct Phase VI programme.

Other objectives of the MIDP included the facilitation of locally manufactured vehicles and components (MITG, 1994:1). This was done with the aim of enhancing economies of scale and promoting effective capacity utilisation. The MIDP was also envisaged to develop human resources and productivity, with the ultimate aim of ensuring stable employment in the longer term (MITG, 1994:1).

Whereas the reduction in models built within the country will limit the range of exportable components, it must be noted that the uneconomic proliferation of models has resulted in diseconomies of scale. With larger volumes of fewer models, it follows that interested parties such as the National Association of Automotive Components and Allied Manufacturers (NAACAM), the National Association of Automobile Manufacturers of South Africa (NAAMSA) and motorists will be the ultimate beneficiaries.

The financial sector has also witnessed liberalisation. Particularly noteworthy has been the abolition, in 1995, of the financial Rand and the relaxation of exchange controls for both residents and non-residents a year later. A favourable exchange rate has also been enhanced by a large depreciation of the weighted exchange rate since early 1996, accompanied by an acceleration in tariff reduction. The rationale behind this is an attempt to offset the inflationary effects of exchange rate depreciation on consumers and import dependent manufacturers, as well as to sustain the boost in exports occasioned by a fall in the value of the Rand (IDC, 1997b:1-2).

3.6 South Africa and the Uruguay Round

South Africa was one of the 123 countries which ratified the Final Act of the Uruguay Round (UR) of trade negotiations in April 1994. This marked the full reacceptance of South Africa into the world community after years of isolation. Although South Africa joined the UR negotiations after the watershed political events of February 1990, the

country had in fact been a founder member of the original GATT in 1947, where it was bestowed developed country status which prevails to the present day.

The origins of the GATT can be traced to the period immediately after the end of World War II and the Bretton Woods Conference, which established the International Monetary Fund and the International Bank for Reconstruction and Development (the World Bank). The objectives behind the formation of the GATT were threefold. First among these was the provision of a framework to oversee the conduct of trade relations between countries. The second main objective was the provision of a framework for and the promotion of the abolition of trade barriers between countries. The establishment of a code of conduct barring member countries from taking unilateral action on trade matters was the third goal of the GATT.

Negotiations under GATT auspices take the form of multilateral rounds of talks. The latest of these, the Uruguay Round (UR), commenced in Punta Del Este, in September 1986, and was to drag on for a record eight years before the final accord was ratified in Marrakesh, Morocco, in April 1994. This marked the end of protracted trade negotiations, which, given the frustrating lack of progress, at times threatened the entire round with derailment.

The 1994 GATT Treaty succeeded in reinforcing the above principles. This is largely due to the fact that all participating countries had to accede to all the Agreements passed at the conference, unlike in the case of previous rounds when this was done on a selective basis. Significant highlights of the UR were the ratification of the Agreement on Trade Related Intellectual Property Rights (TRIPs), the Agreement on Trade Related Investment Measures (TRIMs) and the formation of the World Trade Organisation (WTO). The UR also succeeded in strengthening improved market access through the gradual reduction and, ultimately, abolition of a large majority of trade barriers. This latter scenario is bound to have profound effects on manufacturing industry in South Africa, and the automotive sector in particular.

The IDC Report (1997c:1) outlines South Africa's UR offer as including, *inter alia:*

(i) the imposition of *ad valorem* tariffs on all agricultural and industrial products, replacing previous QRs and formula duties;

(ii) the rationalisation of the 12 000 odd tariff lines into between 5 000 and 6 000 tariff lines, to be completed within the 5 year adjustment period;

(iii) increasing tariff bindings from 55 per cent to 98 per cent of all tariff lines, effectively ensuring that tariffs could not be raised without WTO authority; any permission so given would exact a price in the form of equivalent tariff liberalisations;

(iv) standardisation of all tariff lines from the existing 80 levels ranging from 0-100 per cent to 6 levels of 0 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent and 30 per cent;

(v) tariffs on raw materials ranging from 0-10 per cent, those on intermediate products and components from 10-15 per cent, and consumer goods from 20-30 per cent;

(vi) the granting of duty free status to tariff sub-headings covering products not manufactured within the Southern African Customs Union (SACU), except when protecting an industry within SACU producing a suitable substitute; in this case the relevant rate of duty would be justified for the sake of simplifying the administration of the Customs Union;

(vii) compliance with the new WTO framework within the 5 year grace period mandatory for all developed countries, for the majority of all South African industries.

One exception to this rule was the clothing and textiles sector, granted a 12 year grace period to attain a maximum tariff of 45 per cent as opposed to the prescribed 30 per cent. Likewise, the motor vehicle sector was granted an eight year period to attain a maximum tariff of 50 per cent.

South Africa's offer to the UR for the automotive industry is shown in Table 3.3.

Table 3.3: South Africa's offer to the WTO of Tariff Reduction in the Automotive Industry

HARMONISED SYSTEM (HS) CODE	DESCRIPTION	NEW TARIFF OFFER (per cent)	CUSTOMS DUTY AS AT 1994 (per cent)
87012 000	Road tractors for semi-trailers	50	100
8702	Motor vehicles for the transport of ten or more persons	50	100
8703	Motor cars and other motor cars designed for the transport of persons (excluding those under heading 8702)	50	100
8704	Motor vehicles for the transport of goods	50	100
8706	Chassis fitted with engines, for the motor vehicles of headings 8701 to 8705	50	100
8707	Bodies (including cabs) for the motor vehicles of headings 8701 to 8705	30	50
8708	Parts and accessories for the motor vehicles under headings 8701 to 8705	30	50

Source: van Zyl *et al.*(1994:3).

It is instructive to note that although South Africa's offer to the UR for the automotive industry was only 50 per cent, the country has in fact been scaling down tariffs at a faster rate, with the 1998 figure being 54.5 per cent. It is ultimately envisaged that the country's tariff rate for this particular sector will stand at 40 per cent, which is in line with the Motor Industry Development Programme's plan. This has caused much concern to the key players in the motor industry, investigated further in subsequent chapters.

The timetable for duty reductions under the MIDP is shown in Table 3.4.

Table 3.4 : Duty Reduction Timetable under the MIDP

Year	Import Duty for FBUs (per cent)	Import Duty for Components (per cent)
1 September 1995	65.0	49.0
I January 1996	61.0	46.0
1 January 1997	57.5	43.0
1 January 1998	54.0	40.0
1 January 1999	50.5	37.5
1 January 2000	47.0	35.0
1 January 2001	43.5	32.5
1 January 2002	40.0	30.0

Source: NAAMSA (1998b).

The country reserves the right to exercise import controls in special circumstances, to provide temporary infant industry protection or to use countervailing duties in the case of dumping by non-WTO members (Jenkins and Siwisa, 1997:16). For the automotive industry, a major consequence of the accession to the TRIMs Agreement has been the abolition of the use of local content requirements, which were especially pervasive in motor vehicle manufacturing in South Africa until 1995.

When the MIDP was launched in 1995, it was stipulated that it would be subject to a Mid-Term Review after 3 years, in order to evaluate its progress and whether it had succeeded in meeting its objectives. This review was carried out in late 1998, and amendments to the programme were proposed, largely because some industry players, especially the component manufacturers, felt that the rapid reduction of tariffs put them at a disadvantage *vis-a-vis* imports. It was also felt that the SVI had not achieved its objective of making vehicles more affordable to the general population, but had instead encouraged model proliferation and sparked off a price war among manufacturers, especially for entry-level vehicles.

Further, despite the MIDP's aim of reducing the automotive industry's adverse trade balance, the deficit at the end of 1997 was still sizeable and the industry remained a net user of foreign exchange. It is noteworthy that in the period between its inception and the Mid-Term Review, a number of component manufacturers were forced out of business. Another unintended consequence was the emergence of intense lobbying by both NAAMSA and NAACAM, in an attempt to force amendments favourable to their members.

The Mid-Term Review proposed that the scaling down of tariffs continue until 2007, albeit at a slower rate, until a maximum of 30 per cent and 25 per cent was achieved for motor vehicles and components[8] (Table 3.5).

Table 3.5: Proposed tariff reduction for the automotive industry (2002-2007)

Year	Tariff on FBUs (per cent)	Tariff on Components (per cent)
2002	40	30
2003	38	29
2004	36	28
2005	34	27
2006	32	26
2007	30	25

Source: Board on Tariffs and Trade (1999).

Other proposed amendments to the MIDP included, *inter alia,* that:

(i) the duty free allowance of 27 per cent be maintained until 2002, after which only those model lines which achieved a certain volume would remain eligible for the allowance until 2007;

[8]Although the proposed changes to the MIDP were gazetted in March 1999, they have yet to be formally promulgated into law. This will take place at the end of 1999.

(ii) the SVI be phased out by 2003, with the R40 000 cut-off point increasing annually by a percentage equivalent to the producer price index for the previous year, until its eventual abolition;

(iii) import rebate credits continue beyond 2002, but on a phasing down basis, with tooling exports retaining their eligibility as MIDP exports in order to ensure the continued viability of component exports.[9]

The changes to the MIDP, while reflecting a slowdown in the reduction of nominal tariffs and the gradual abolition of incentives such as the SVI nonetheless indicate a strong commitment to the UR agreement by the government, which is determined to allow market forces eventually to dictate developments in the automotive industry.

Considering the pre- and post-UR nominal and effective rates of protection in general, Jenkins and Siwisa (1997:32-33) observe that the manufacturing sector currently enjoys a weighted nominal tariff of 16.6 per cent, compared to 6.4 per cent for the economy as a whole. Post-UR implementation rates for bound nominal tariffs in manufacturing are envisaged to fall to 7 per cent, and for the entire economy to 4 per cent, with the motor vehicle sector experiencing a decrease of 21 per cent. As noted in the WTO Trade Policy Review on South Africa, the process of rationalisation has resulted in a tariff structure with zero or very low tariffs but which could still escalate and therefore increase effective rates of protection (WTO, 1998:xii).

The summary of average weighted import duties is reproduced in Table 3.6.

[9] For detailed information on the proposed changes to the MIDP, see Board on Tariffs and Trade (1999).

Table 3.6: Summary of average weighted import duties

	1994	2002	GATT binding
Consumption goods	34	17	26
Intermediate goods	8	4	11
Capital goods	11	5	15
Average all manufactures	**15**	**7**	**16**

Source: Jenkins and Siwisa (1997:20).

Effective rates of protection, however, still exhibit considerable variance, and show drastic changes in the level of protection for certain industries. According to Jenkins and Siwisa (1997:34), this can be attributed to reduced protection on certain inputs into some industries which had hitherto been protected, and also to a reduced level of output. The overall EPR level declines from 58.9 per cent to 34.7 per cent for the manufacturing sector, and from 11.7 per cent to 7.2 per cent for the whole economy. For the motor vehicle industry, post-liberalisation nominal rates of protection fall to 36.7 per cent from the previous 58.5 per cent, while EPRs decline from 901.1 per cent to 537.7 per cent.

One of the first major casualties of the UR has been the GEIS, abolished in line with WTO rules prohibiting subsidies to exporting firms. Formally wound up in July 1997, it has been replaced by fiscal incentives. According to McCarthy (1998:72), these include accelerated depreciation allowances for firms investing in new manufacturing plant and machinery at an annual rate of 10 per cent for ten years. This compares favourably with the prevailing annual rate of 5 per cent for twenty years. Equipment now faces an accelerated annual depreciation rate of 33.3 per cent over three years as opposed to the present 20 per cent over five years. The introduction of tax holidays for new investment in pre-approved projects meeting certain criteria such as domestic value added, human resource development and foreign exchange conservation is a second fiscal incentive.

Other supply side interventionist measures include customs duty drawbacks and pre-shipment export guarantee programmes for small and medium-scale enterprises, together with support for industrial innovation, human resource development and investment promotion schemes (Jenkins and Siwisa 1997:17).

Jenkins and Siwisa (1997:21) observe that the trade reforms since 1990 have not been part of a general formal structural adjustment programme, and hence have occurred largely in response to the various problems which have arisen in the economy. While the WTO agreement only provided a framework for trade liberalisation in South Africa, the current wave of trade liberalisation has, in recent years, had to comply with WTO rules and regulations. As Matona (1995:15) notes, the GATT/WTO determined pace of liberalisation effectively takes precedence over the cautious and halting approach hitherto adopted by the authorities, implying that trade liberalisation measures will enjoy a measure of credibility due to the country's adherence to WTO tariff bindings and regulations.

As Table 3.6 suggests, however, average tariffs in all categories will be far below the WTO bindings by the year 2002, creating considerable concern that the government will have some leeway for policy reversal while still fulfilling its obligations under the new trade order. The government is, however, adamant that there is no going back on the reforms in place, arguing that the aim of the lower tariffs is to weed out inefficient players in industry, pitting only those with a competitive edge against international producers.

According to Roberts (1998:27), tariff reforms are a necessary part of a broad restructuring of industry which, with some exceptions, is not internationally competitive; the underlying aim of tariff reduction thus is to reorient industry towards a form of competition based on investment in new technologies, human resource development and ultimately improve competitiveness in a manner consistent with rising wage levels and productivity.

In a study conducted by the IDC on the impact of accelerated tariff reduction on South Africa's economy in the context of currency depreciation (IDC, 1997b), it is argued that both the current tariff liberalisation and real currency depreciation will ultimately have a positive effect on both exports and economic growth (IDC, 1997b:16). The immediate impact of currency depreciation is to raise the price of imported inputs. For hitherto highly protected industries, tariff liberalisation could result in greatly increased competition from imports; to alleviate the pain of adjustment for these industries, accelerated tariff reduction could be implemented more gradually than in other sectors, and supply-side measures introduced to minimise adverse side effects (IDC, 1997b:16-17).

Table 3.7: A Summary of Trade Policy Reform in South Africa

Year(s)	Policy change, important commissions, relevant events
1925-1972	**The period of import-substituting industrialisation (ISI)**
1925	Adoption of ISI with the Customs Tariff and Excise Duty Amendment Act
1948	Introduction of QRs
1958	Viljoen Commission recommends continued ISI, but using tariffs rather than QRs or subsidies
1969	South Africa announces its intention to lift QRs, under pressure from GATT and the IMF, but does nothing
1972-83	**The first trade liberalisation episode**
1972	Reynders Commission recommends export promotion
1972	Export incentive measures are introduced
1972-76	Some relaxation of QRs
1975-79	The Rand is devalued
1978	Further assistance to exporters is introduced in line with the van Huyssteen Committee's proposals
1979-80	The Rand appreciates sharply
1983-91	**The second trade liberalisation episode**
1983	Kleu Study Group recommends a move away from ISI
1983-85	The reduction of QRs is resumed
1983	The dual exchange rate system is abolished
1983-85	The external value of the Rand falls sharply
1985	Government white paper recommends a dual approach to industrial policy: ISI and export promotion
1985	Debt crisis; dual exchange rate system is reintroduced
1985	Substantial import surcharges introduced
1987	BTI begins to move proactively toward trade policy reform
1989	QR removal continues
1989	"Structural adjustment" export incentives introduced for clothing, textiles, automobiles and automobile components
1990	General Export Incentive Scheme (GEIS) is introduced
1990	The phasing out of the import surcharge begins; not completed
1991	An accelerated depreciation tax scheme is introduced
Current	**The third trade liberalisation episode**
1994	The conversion of QRs into tariffs is completed
1995	Import surcharges are eliminated
1995	Tariff reduction in line with GATT requirements begins
1995	The financial Rand is abolished
1995	Negotiations with the European Union over trade preferences commence
1996	The SADC free trade protocol is signed
1997	Further exchange control liberalisation is announced

Source: Adapted from Jenkins and Siwisa (1997:50).

3.7 Conclusion

From Table 3.7, it can be seen that the direction of trade policy in South Africa is increasingly being influenced by the neo-liberal approach to international trade, discussed in Section 2.3.2. This approach is the cornerstone of policy recommendations advocated by multilateral organisations like the WTO.

The neo-liberal approach recommends, firstly, the replacement of non-tariff barriers, which serve the purpose of maintaining a country's external balance, with a high uniform tariff. This in turn is scaled down when the country can accommodate the liberalisation without risking a foreign exchange crisis. Lower tariffs also correct any distortions in production and discourage lobbying and rent-seeking behaviour by interest groups (Thomas and Nash, 1992:41). For the automotive industry in South Africa, QRs were replaced by a high uniform tariff of 115 per cent. Since 1995, this high tariff has been subjected to a rapid phase-down (Table 3.4), which is in excess of WTO requirements.

The next step after relaxation of QRs is the reduction of export incentives, such as tax and duty rebates and import and excise duty exemptions. These are perceived by neo-liberal theorists as not having the desired effect on exports, primarily because they are open to fraud (such as over-invoicing and the export of fictitious goods) and rent-seeking behaviour, not to mention the possibility of macroeconomic instability and high debt problems. Export incentives have been outlawed by the WTO. For the automotive industry in South Africa, the duty drawback system has been phased out and replaced by the import-export complementation scheme of the MIDP; the SVI is to be gradually phased out after 2002.

The final stage in the process of liberalisation, according to the neo-liberal standpoint, is exchange rate depreciation, which is predicted to make exports more attractive, reduce the anti-export bias and ultimately boost foreign exchange reserves. However, as will be seen in Table 4.1, this appears not to have been the case for the automotive industry in

South Africa, as the trade balance has consistently remained in deficit, and generally worsened since 1990.

This chapter set out to examine trade policy in South Africa from the mid 1920s to the present (see summary in Table 3.7). It found that, with time, emphasis has shifted from production for a protected domestic market to the aggressive promotion of manufactured exports. In the automotive sector, this has led to the abolition of the local content requirement and the rapid phase down in tariff protection for domestic motor vehicle assemblers and component manufacturers.

The chapter provides important background for the rest of the study, which focuses on the economic implications of trade liberalisation for the automotive industry in the Eastern Cape Province.

CHAPTER 4

THE RISE OF THE AUTOMOTIVE INDUSTRY IN SOUTH AFRICA, WITH SPECIFIC REFERENCE TO THE EASTERN CAPE PROVINCE

4.1 Introduction

The previous chapter served to provide a history of various trade policies undertaken by South Africa from the mid 1920s to the present day. It also examined the various aspects of trade liberalisation that the country has gone through, with specific emphasis on the automotive sector. This chapter will take a more detailed look at the state of the motor vehicle assembly industry and allied component sectors in the Eastern Cape Province. The chapter is purposefully descriptive, and provides important background for the empirical analysis that follows. Section 4.2 provides a brief general history of the automotive industry in South Africa, while Section 4.3 examines the assembly industry in the Eastern Cape in particular. The components sector is considered in Section 4.4, and Section 4.5 looks at employment in the industry as a whole.

4.2 Historical Background

The first motor vehicle arrived in South Africa towards the end of 1896. The influx of imported fully built up units (FBUs) grew rapidly until the post World War I era, when the government adopted an inward-looking import substituting industrialisation (ISI) policy. This, coupled with the increasing cost of shipping FBUs, acted as an incentive to the world's leading motor vehicle manufacturers to establish operations in South Africa.

Ford Motor Corporation and General Motors (GM) were the first motor vehicle manufacturers to establish assembly plants in South Africa (both in Port Elizabeth) in 1924 and 1926 respectively. This was done on the premise that setting up assembly plants close to their intended markets would greatly lower transport costs by increasing the volume of

imports in the form of completely knocked-down (CKD) kits (Adler, 1993:22). This resulted in a phenomenal increase in vehicle sales from 13 547 units to 20 456 units between 1925 and 1929. Nominal sales values rose from £2 573 000 to £5 365 000 in the same period (Julius and Lumby, 1993:12; Duncan, 1993:85).

The onset of the Great Depression in the 1930s resulted in a severe contraction in the fledgling industry. This proved only temporary, however, as by 1937 a peak of 57 536 vehicles worth £10 227 000 was registered. Despite the entry of a third assembly firm, the National Motor Assembly of Johannesburg, in 1939, the outbreak of World War II halted the expansion of imports and sales. This was due to foreign exchange rationing and the channelling of resources to the war effort.

It was not until 1945 that further assembly plants were established in Durban and East London, namely Motor Assemblers and Car Distributors Assembly respectively. The Chrysler Corporation established a plant in Cape Town, closely followed by South African Motor Assemblers and Distributors (SAMAD) in Uitenhage in 1948. There was a heightened demand for motor vehicles, despite the introduction of import quotas for CKD kits. The quotas did not deter the establishment in 1955 of an assembly plant in Cape Town by the British Motor Corporation.

The second phase of automotive industrial development was prompted by the balance of payments crisis in the late 1950s due to the relaxation of import controls. It was realised that assembly firms had neglected manufacturing operations and the local sourcing of components, other than easily produced ones such as tyres, batteries and windscreens. As Adler (1993:32) notes, local sourcing would provide massive foreign exchange savings and enhance further employment opportunities for what had become an important sector of manufacturing industry, with a 10 000 strong workforce in automotive assembly and 82 000 in component manufacturing. These personnel earned nearly £500 000 and £36 million in wages respectively. According to Dix (1995:25), it was further envisioned by the

government of the day that the establishment of a fully fledged motor vehicle manufacturing industry would catalyse the development of steel, engineering and metalworking industries.

It is for these reasons that the Board of Trade and Industry ordered an investigation into the impact on the balance of payments of stimulating the local manufacture of motor vehicles. The publication of the report into the investigation heralded **Phase I** of the local content programme. Introduced in 1961, it aimed at compelling vehicle manufacturers to source from domestic suppliers a list of eleven domestically produced items. These were tyres and tubes, batteries, trim, exhaust systems, paint, glass, seat frames, road springs, carpets and mats, which had to comprise 20 per cent of each vehicle's local content. An incentive was further offered in the form of additional import permits for any manufacturer who attained a local content of more than 20 per cent. Duncan (1997:26) notes that this reduced the drain on foreign exchange from R145.6 million (out of a total expenditure of R941.4 million) in 1960 to R110.6 million out of a total import expenditure of R812 million in 1961.

Phase II of the local content programme, commencing in 1964, raised this minimum level to 25 per cent, as well as making a distinction between assembled and manufactured models. According to Duncan (1993:74), the former had to have a minimum of 45 per cent local content (by weight) to be increased to 50 per cent within 42 months, an incentive being the free issue of import permits. Assembled components faced a sliding scale penalty, with bonus import licences being issued for local content achieved in the previous year. Nonetheless, by the time it was being phased out, Phase II had failed miserably in its goal of stemming the proliferation of assembly operations. By 1970 all manufacturers were required to have achieved a 50 percent local content.

After a year-long moratorium, **Phase III** was introduced in 1971. This envisaged a local content of 66 per cent by weight for manufactured models within a six-year time span, with

semi-manufactured models required to have at least 52 per cent local content. **Phase IV**, introduced in1977, did not impose further local content requirements, but was rather intended as a period in which manufacturers could consolidate their position following the stringent conditions imposed upon them by Phase III (Dix, 1995:28). In this phase, excise rebates were used to encourage production of vehicles with a local content exceeding 71 per cent. **Phase V**, launched in 1979, extended the 66 per cent local content requirement to commercial vehicles, to be achieved within two years.

The early 1980s saw the motor industry face a downturn. This was further exacerbated by the global financial recession and South Africa's own debt crisis, together with labour unrest and political instability.

A 1988 study by the Board on Tariffs and Trade (BTT), which had succeeded the BTI, concluded that, contrary to expectations, there had been no improvement in the net use of foreign exchange by the industry. Dix (1995:31) observes that this scenario arose due to the fact that increasing levels of local content required more sophisticated, capital-intensive components to be sourced locally; the technology and equipment to produce these components were unavailable locally and thus had to be imported. Over-invoicing of components supplied to local firms by parent companies is also a possible reason for the non-improvement of net foreign exchange usage.

Hence, as discussed in Section 3.4, 1989 saw the introduction of **Phase VI**. This involved a shift in the measurement of local content from weight to value, and expected the rationalisation of locally produced models. Whereas the motor industry was ineligible for subsidies under the General Export Incentive Scheme (GEIS), local manufacturers stood to benefit from an import/export incentive scheme. This involved local manufacturers rebating the cost of imported components against the value of their exports. Import/export complementation was further enhanced under the Motor Industry Development

Programme (MIDP), with exporters of vehicles and components earning export credits to offset the import of vehicles and components.

The trade balance for the automotive industry from 1990 to 1997 is shown in Table 4.1.

Table 4.1 Trade balance for the automotive industry (Rbn, current prices)

	1990	1991	1992	1993	1994	1995	1996	1997
Imports	6.3	6.3	6.6	9.1	12.0	16.4	19.2	17.2
Exports	0.8	1.1	1.5	2.3	2.8	4.2	5.1	6.6
Foreign exchange usage	5.5	5.2	5.1	6.8	9.2	12.2	14.1	10.6

Source: Department of Trade and Industry (1998a:13).

It can be seen that, despite the intentions of the BTT, there has been no improvement in the use of foreign exchange by the industry except in 1997, when the deficit fell to R10.6 billion.

Table 4.2: Motor vehicle assembly firms operating in South Africa

Assembler	Ownership	Makes assembled	Percentage share of passenger vehicle market
Automakers	Nissan Sankorp	Nissan Fiat	6.4
BMW SA	BMW AG	BMW Landrover	5.8
Delta	Local/GM	Opel	11.2
DaimlerChrysler SA	DaimlerCrysler AG	Mercedes-Benz Honda	8.1
Samcor	Amic/Ford	Ford Mazda	13.6
Toyota	Local (JSE)/TMC	Toyota	22.0

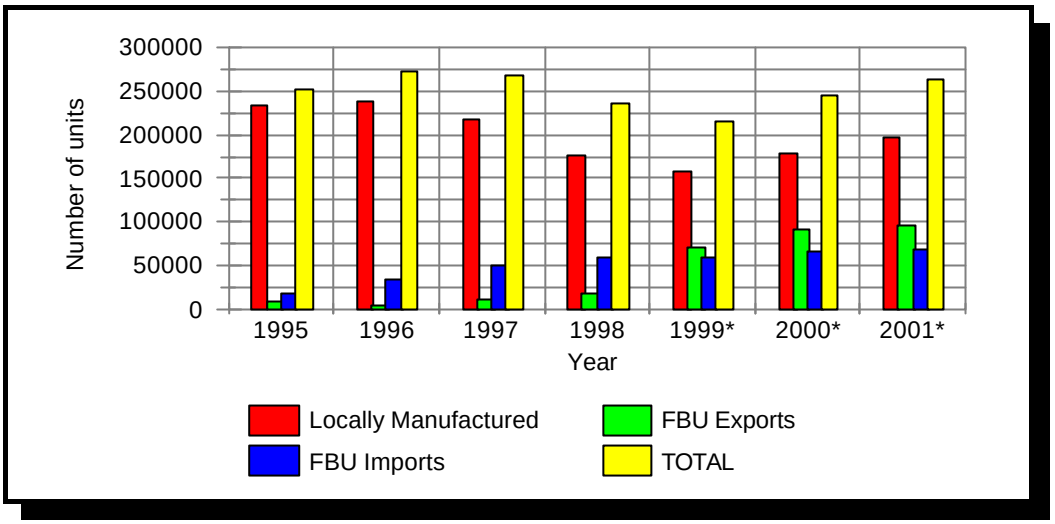
Volkswagen SA	VW AG	Volkswagen Audi	18.7

Source: Black (1998a:4).

As Table 4.2 demonstrates, there are currently seven motor vehicle assembly firms in South Africa that are affiliated to the National Association of Automobile Manufacturers of South Africa (NAAMSA). These firms, together with the few non-NAAMSA members, accounted for the production, import and sale of 203 821 passenger vehicles in 1998, as well as the export of 18 342 units. However, given that these volumes are spread over 22 model variants, and the fact that the South African market is small, the motor industry is unable to attain economies of scale. Model proliferation further puts strain on component manufacturers in terms of tooling costs for so many different types of motor vehicles.

Since 1997, a culmination of domestic and foreign events, such as currency depreciation, industrial action, not to mention the emerging market crisis and financial market instability, has seen the market for passenger vehicles decline from over 273 000 units to an estimated 215 000 units at the end of 1999, although the situation is forecast to improve after 2000 (Figure 4.1).

Figure 4.1: The local market for passenger cars



Notes:

(1) Figures for 1999-2001 are NAAMSA projections.

(2) FBU imports are both NAAMSA and non-NAAMSA.

Source: NAAMSA (1999a).

Figure 4.1 demonstrates that since the introduction of the MIDP in 1995, the volume of FBU imports has greatly exceeded that of exports, although it is expected that this gap will narrow from 1999 onwards, when the majority of assemblers increase their export volumes.

Table 4.3 serves to illustrate volume performance by model lines of motor vehicles currently produced in South Africa from 1992 to 1997.

Table 4.3: Volume performance by passenger vehicle model lines

Annual production volume	Number of model lines					
	1992	**1993**	**1994**	**1995**	**1996**	**1997**
0- 9 999	10	8	8	10	9	12
10 000-19 999	9	8	8	7	8	7
20 000-29 999	0	0	1	3	3	2
30 000 +	1	1	1	1	1	1
Models manufactured in the year	**20**	**17**	**18**	**21**	**21**	**22**

Source: Department of Trade and Industry (1998a:18).

Since the early 1990s, exports of both components and motor vehicles have dramatically risen, a factor which can partly be attributed to the import/export complementation arrangements of Phase VI and the MIDP, as well as assembly firms becoming increasingly integrated into the operations of their overseas-based parent companies (see Chapter 5). The value of component and vehicle exports is shown in Table 4.4.

Table 4.4: Motor vehicle and component exports (FOB values, Rm in current prices)

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999***
Components	287	523	832	1 307	1 550	2 450	4 051	5 367	6 732	7 500
Vehicles	381	392	419	581	695	900	750	1 600	2 100	5 500
TOTAL	**668**	**915**	**1 251**	**1 888**	**2 245**	**3 350**	**4 801**	**6 967**	**8 832**	**13 000**

Note: 1999 figures are NAAMSA forecasts.

Source: NAAMSA (1999a).

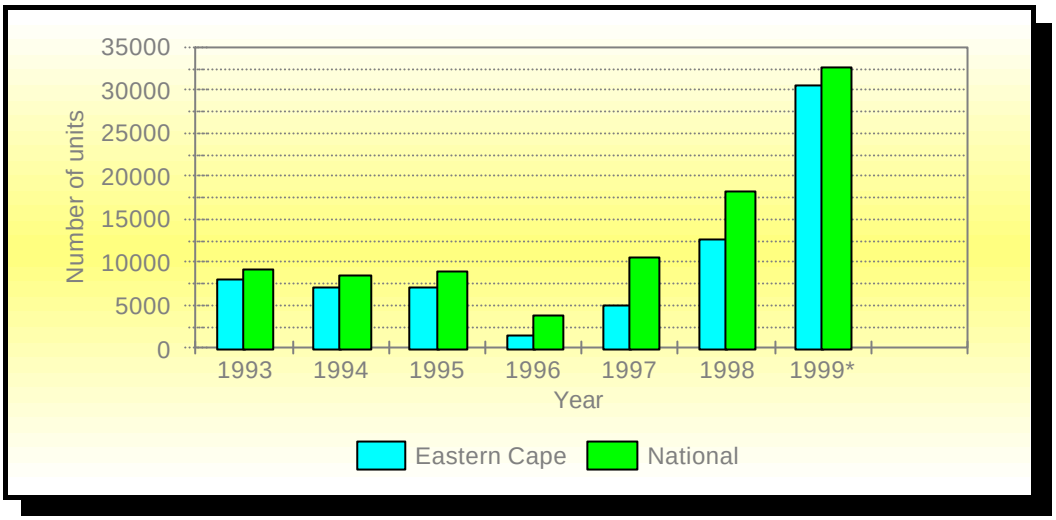
4.3 The Motor Vehicle Assembly Industry in the Eastern Cape[10]

A 1997 Report on Provincial Industrial Development by the Industrial Development Corporation (IDC) identifies the automotive industry in the Eastern Cape as contributing 39.9 per cent of the total manufactured output of motor vehicles in South Africa, together with 24.1 per cent of total manufacturing employment in the Province (IDC, 1997d:4). The manufacture of motor vehicles, parts and accessories alone is reported to add almost 50 per cent of the total manufacturing value added of all goods in the Province (Hosking and Lloyd, 1999, cited in Hosking, 1999:8).

Within the Province, vehicle assembly is dominated by Volkswagen of South Africa (VWSA), Delta Motor Corporation and DaimlerChrysler South Africa (DCSA). Between them, the three firms accounted for 42.5 per cent of all new passenger vehicle sales countrywide in 1998, and 68.6 per cent of exports. The volume of exports by VWSA, Delta and DCSA vis-a-vis national export volumes is shown in Figure 4.2.

[10]This category does not include SAMCOR which, while principally a motor vehicle assembler and member of NAAMSA, has a plant in Port Elizabeth wholly dedicated to manufacturing engines for export. SAMCOR's assembly activities are to be found in Pretoria.

Figure 4.2: Passenger vehicle exports from Eastern-Cape based assemblers



Note: 1999 figures are for the year to September.

Source: NAAMSA (1990-1999j).

From Figure 4.2, it can be seen that passenger vehicle exports from Eastern Cape-based vehicle assemblers have largely been the driving force behind the phenomenal increase in exports since 1996. This can be attributed to the lucrative export contracts for the supply of both FBUs and CKD kits awarded by parent companies. The downturn in exports in 1996 arose due to the cessation of VWSA's contract to export over 10 000 units to China. However, from 1998 onwards, in particular, there has been a marked improvement in export volumes from the Province as a result of the assembly firms becoming increasingly integrated into their parent companies' global networks, and also because of the incentives which the import/export complementation scheme of the MIDP present (see Chapter 5). There are indications that if the current export levels are maintained, then the number of passenger FBU exports will more than double those of 1998, although still falling well below the 70 000 units envisaged by NAAMSA (see Figure 4.1).

4.3.1 Volkswagen of South Africa (VWSA) Pty

VWSA is a wholly owned subsidiary of the giant German automobile manufacturer Volkswagenwerk AG. Located in Uitenhage, just north of Port Elizabeth, VWSA was created when the German firm took over the operations of SAMAD. The company is not only the biggest motor vehicle assembly concern in the Eastern Cape, but is also the largest employer in the Port Elizabeth-Uitenhage metropolis, directly employing 5 000 people. Besides manufacturing vehicles under the Volkswagen marque, the company also produces cars under the Audi marque, and is responsible for the import of FBUs under the two brands (Table 4.5).

Table 4.5: Models manufactured and imported by VWSA[11]

MAKE	SMALL	MEDIUM	LARGE
VOLKSWAGEN			
CitiGolf	1	2	-
Polo	1	2	-
Golf	-	2	2
Jetta		2	2
AUDI			
A4	-	1	2
A6*	-	-	2
A8*	-	-	2

*Denotes imported FBUs.

Source: NAAMSA (1998a).

VWSA's share of nationwide total retail sales between 1990 and1998 is shown in Table 4.6.

[11] Small cars are classified as those with a cylinder capacity of 1 400cc and below, while medium sized cars have a cylinder capacity of between 1 400 and 2 000cc, and large cars 2 000cc and above.

Table 4.6: VWSA's share of national passenger vehicle sales

YEAR	NO. OF VEHICLES	PERCENTAGE OF NATIONAL TOTAL
1990	41 012	19.6
1991	39 757	20.1
1992	33 111	18.1
1993	35 172	18.2
1994	35 412	18.6
1995	53 925	22.8
1996	57 691	23.1
1997	50 176	20.1
1998	43 266	21.2

Source: NAAMSA (1990-1998a).

The phenomenal increase in vehicle sales from 1994 to1995 can be attributed to the introduction of the Volkswagen CitiGolf, an inexpensive reliable car, which quickly established a niche for itself in the entry-level range and which in its year of launch was billed the most affordable car in South Africa. 1995 also witnessed rapid growth in nationwide car sales.

With regard to exports, VWSA has in the past secured lucrative contracts to supply vehicles overseas. Between 1993 and1996, for instance, the company exported a total of 12 500 cars to China. With the cessation of the contract, however, VWSA was faced with idle plant capacity, by 1996 producing only 80 000 out of a possible 120 000 cars annually. With only 40 per cent of its plant capacity being utilised, the firm was awarded a contract by the parent company in 1998 to assemble and export 60 000 fourth generation Volkswagen Golf cars to right hand drive export markets. The value of this export order in foreign exchange terms alone represents 12 per cent of the total value of South Africa's manufactured goods in 1997 terms, and 20 per cent of net gold exports (Eastern Province Herald, 12 May 1998).

This was envisaged to more than double the existing annual output of 58 000 cars, increase employment by 1 000 and expand the production line at a cost of R150 million (Eastern Province Herald, 12 May 1998). This contract was extended later in the year to cover the entire lifespan of the series. In February 1999, VWSA announced a further R300 million capital investment at its Uitenhage plant with spin-offs going to local manufacturers and motorists, who would benefit from the introduction of the fourth generation Golf into the domestic market (Eastern Province Herald, 23 February 1999). This development serves to reaffirm VWSA's importance as a world class supplier of FBUs to the VWAG Group, despite the disadvantage posed by South Africa's geographical location (Maergner, 1998).

4.3.2 Delta Motor Corporation

Delta Motor Corporation was formed in 1987, when General Motors divested itself of its loss-making South African interests in the wake of the international imposition of economic sanctions against the country. The resulting management buyout made Delta wholly locally-owned. However, in early 1998, General Motors reacquired a 49 per cent stake in the company.

Delta operates two large manufacturing plants in Port Elizabeth, located at Struandale and in Kempston Road. The former is wholly dedicated to the manufacture of cars under the Opel marque under licence from Adam Opel AG of Germany, and is reported to be the first new automobile assembly plant to be opened in South Africa in twenty years (Engineering News, March 21, 1997). Kempston Road also manufactures Isuzu LDVs (which fall outside the scope of this study). Besides its manufacturing operations, Delta also acts as the local franchise holder for the import of Swedish Saab vehicles and Japanese Suzukis. Delta directly employs a 4 500 strong workforce, with a further 18 000 people dependent on the company through supplier and related industries in the Port Elizabeth metropolis (Engineering News, March 21, 1997).

The Opel automobiles manufactured by Delta can be classified into three different models, the Corsa, Kadett and Astra. These in turn vary considerably with regard to levels of trim and engine size, resulting in a total of nine different models. There are also five different imported models (Table 4.7).

Table 4.7: Models manufactured and imported by Delta

MAKE	SMALL	MEDIUM	LARGE
OPEL			
Corsa*	1	-	-
Kadett	1	2	1
Astra	1	2	1
SAAB			
900SE	-	-	1
9000	-	-	-
SUZUKI			
Samurai	1	-	-
Vitara		2	1

* includes the Corsa LDV which, while produced on the same platform, is classified as a commercial vehicle.

Source: NAAMSA (1998a).

From the above table, it can be seen that Delta mainly targets the medium sized category, although if levels of trim and accessories are taken into account, the small car category boasts a larger variety. With a large majority of these vehicles priced at under R100 000, Delta's main focus is therefore high volume, low priced vehicles.

Delta's market share of nationwide motor vehicle sales rose from 10.4 per cent in 1990 to 12.5 per cent in 1997, with lows of 9.0 per cent being registered in 1993 and 1996 (Table 4.8).

Table 4.8: Delta's share of national passenger vehicle sales

YEAR	NO. OF CARS SOLD	PERCENTAGE OF NATIONAL TOTAL
1990	21 774	10.4
1991	20 959	10.6
1992	12 277	9.5
1993	17 324	9.0
1994	20 660	10.8
1995	24 215	10.2
1996	22 554	9.0
1997	29 971	12.5
1998	20 258	9.8

Source: NAAMSA (1990-1998a).

In 1997, Delta embarked on a three year R1.2 billion expansion programme with the objectives of introducing new products and expanding existing facilities in an exercise aimed at increasing plant capacity to 105 000 passenger and commercial vehicles annually, and raising market share to between 15 and 17 per cent (Engineering News, March 21 1997).

Whereas Delta has a modest share of national passenger vehicle exports, the company focuses mainly on the exports of original equipment components to the global GM/Opel network. The company is one of the few GM/Opel original equipment manufacturers fully integrated into the parent company's network, with component exports reaching a value of R500 million in 1996.

In late 1998, Delta announced that it had secured two lucrative component supply contracts. The first of these was a year long R20 million contract to supply Opel Germany with automotive press tooling dyes. Following closely on this announcement was the disclosure that it had been awarded a two year R100 million contract to supply General Motors Brazil with seat components for the Opel Corsa range. This contract, to be fulfilled

in conjunction with Port Elizabeth-based component firm Dorbyl Automotive Technologies, is expected to create 100 extra jobs in the city (Cartoday, 1998c). Other positive spinoffs associated with this contract include the attainment of scale economies in the production of metal seat frames and the supply of steel, developments which place the firm at the heart of global sourcing strategies by General Motors.

4.3.3 DaimlerChrysler South Africa (DCSA) Pty

DaimlerChrysler South Africa (DCSA) is the successor to Mercedes-Benz of South Africa. The name change was a result of the parent company Daimler Benz AG of Germany merging with American automobile manufacturer Chrysler to form DaimlerChrysler AG. DCSA is the only Eastern Cape automotive concern located outside the Port Elizabeth-Uitenhage area, based in East London, and was originally formed as Car Distributors Assembly. The company manufactures and imports a wide range of vehicles under the Mercedes-Benz and Honda marques, as well as assembling the Mitsubishi Colt LDV.

DCSA is the smallest of the Eastern Cape based vehicle manufacturers affiliated to NAAMSA in terms of sales. While the firm has traditionally targeted the upper echelons of the automobile market, especially in the import of FBUs, there has, in recent years, been a shift to smaller cars which have a higher volume of sales. 1993 marked the onset of the company's export programme, which was sanctioned by the parent company Mercedes-Benz AG. This has seen the company, while registering a modest share of nationwide automotive sales, exporting a number of motor vehicles to the rest of Africa (800 Mercedes-Benz and Honda), Australia and Europe (1 200 Mercedes-Benz) in 1997, from a modest total of 42 vehicles in 1991. This is mainly a result of integration into the worldwide Mercedes-Benz manufacturing network (South African Transport, March/April 1997:68).

The different models of cars manufactured and imported by DCSA are classified in Table 4.9.

Table 4.9: Models produced and imported by DCSA

MAKE	SMALL	MEDIUM	LARGE
MERCEDES-BENZ			
C CLASS	-	1	5
E CLASS**	-	-	5
S CLASS*	-	-	3
OTHER*	-	-	2
HONDA			
BALLADE	-	3	-
OTHER*	-	-	5

* denotes imported FBUs.

** imported in CKD form, with final assembly taking place in East London.

Source: NAAMSA (1998a).

DCSA's contribution to nationwide car sales is shown in Table 4.10.

Table 4.10: DCSA's share of national passenger vehicle sales

YEAR	VOLUME	PERCENTAGE OF NATIONAL TOTAL
1990	14 340	6.8
1991	15 756	8.0
1992	18 240	10.0
1993	19 895	10.3
1994	20 725	10.9
1995	26 718	11.3
1996	25 182	10.1
1997	21 699	9.1
1998	17 791	8.7

Source: NAAMSA (1990-1998a).

The Mercedes-Benz component export programme for 1997 mainly consisted of leather trim and seat covers which the company supplies to the global DaimlerChrysler network. Other

notable components manufactured included exhaust manifolds and catalytic converters, electrical components, brake linings and brake pads, glass, alloy wheels, plastic bumpers and sill plates, at a cost of R960 million (South African Transport, March/April 1997:67).

In November 1998, DCSA's parent company DaimlerChrysler announced a R900 million investment programme aimed at expanding production at the East London plant. It was envisaged that this programme would boost the assembly of the Mercedes-Benz C-Class range both for domestic and right-hand drive export markets. Besides making use of DCSA's spare plant capacity, the programme was expected to have a significant local content and create an additional 10 000 jobs in the Eastern Cape Province alone (Cartoday, 1998b).

This investment was raised to R1.3 billion in October 1999, when the firm unveiled its plans to make the East London plant a major export centre (Cartoday, 1999b). The bulk of this investment (mainly in new paint and body shops, computer systems and automation) is principally aimed at boosting current production and exports of the current C-class model. In addition, DCSA announced that the firm had been awarded exclusive rights to supply the world with the right-hand drive version of the forthcoming C-class model, with production of 40 000-45 000 units per annum expected to start from August 2000 (Cartoday, 1999d).

For VWSA, Delta and DCSA, all these developments imply some degree of rationalisation of production platforms. This is necessary if economies of scale and high export volumes are to be achieved, with the resulting export credits being used to offset the cost of importing low-volume models. Both VWSA and DaimlerChrysler have reduced the number of model platforms and focused on high-volume models, with the latter discontinuing assembly of the E-class, and VWSA concentrating on the Golf IV and Jetta IV range besides the CitiGolf and Polo models.

4.4 The Components Sector

Automotive components form an integral part of the motor industry. According to Hoffman and Kaplinsky (1988:106-108), they can be classified in a continuum as follows.

(i) **Generic components:** these include nuts, bolts, screws, fasteners and the like, physically small in size and common to many industries but which generally comprise less than one per cent of total component cost.

(ii) **Bulky non-mechanical parts:** examples of these are exhaust mufflers, glass, stampings, seats, radiators and fuel tanks. They have little technological content and, owing to their relatively high transport-to-value ratio, are usually manufactured close to their final market (the assembly firms).

(iii) **Items of trim and wiring:** these comprise wiring harnesses, window winders, exterior trim, interior upholstery, spark plugs, points and windscreen wipers, all of which have a low technological content and low transport costs.

(iv) **Electro-mechanical and systems components:** these technologically complex items include carburettors, clutches, starter motors and ignition systems, brakes, shock absorbers and steering mechanisms.

(v) **Core technologies:** examples of core technologies are engines, transmissions and gearboxes, the production of which requires heavy design costs, labour-intensive assembly and economies of scale in production.

The components sector in South Africa has generally evolved around automotive assembly plants. In the early stages of the development of the motor industry, component producing firms mainly manufactured simple parts like tyres, glass and batteries. According to Duncan (1997:164), in the years before World War II, component firms enjoyed little or no

protection, in comparison to the motor vehicle assemblers. However, in the post World War II era, the components sector diversified into engineering, metalworking and upholstery (Duncan, 1997:164). With time, component manufacturing firms have diversified into the production of more complex items like catalytic converters, engines and transmission assemblies.

As Duncan (1997:65) observes, the beginning of the 1960s, which coincided with the introduction of local content programmes, marked a change in the trend of establishing component manufacturing firms. Whereas local firms had in the past acted as importers and distributors of overseas (mainly European) components, the European MNCs set up locally based manufacturing concerns in partnership with their local agents. This not only facilitated the domestic manufacture of components under licence, with components bearing brand names of the foreign principals, but also allowed for a measure of technology transfer. Barnes (1999:7) notes that the introduction of local content programmes and the increasingly closed nature of the economy assured locally based component manufacturers (whether competitive or not) of a ready market in the form of domestic motor vehicle assemblers.

However, with the advent of the MIDP, new demands have been placed on these local component manufacturing firms, which now have to conform to specified performance targets in order to satisfy local assemblers, or face the risk of losing business to foreign MNC component manufacturers.

According to the DTI (1998a:5-7), both import and export values and volumes of components have continued to increase, with component firms facing increased competition from imports under the MIDP's import/export complementation scheme, forcing them to expand exports and link up with other domestic or foreign firms, in an attempt to improve production efficiencies.

The value of component exports is shown in Table 4.11.

Table 4.11: Exports of components (FOB values, Rm in current prices)

	1994	1995	1996	1997	Percentage of 1997 total
Stitched leather seat covers	464	1 019	1 259	1 408	27.5
Catalytic converters	197	388	485	835	16.3
Tyres	132	219	296	342	6.7
Road wheels and parts	77	175	227	325	6.4
Automotive tooling	165	259	279	309	6.0
Engine parts	61	112	137	285	5.6
Silencers/exhaust pipes	181	76	170	151	3.0
Engines	11	10	86	111	2.2
Glass	59	49	71	105	2.1
Radiators	44	44	107	93	1.8
Batteries	31	53	60	88	1.7
Shock absorbers	18	38	53	56	1.1
Filters	-	13	42	55	1.1
Body parts and panels	48	18	39	39	0.8
Brake parts	11	23	29	38	0.7
Clutches/shaft couplings	2	16	21	33	0.6
Ignition/starting equipment	25	4	16	30	0.6
Car radios	1	7	4	29	0.6
Gauges/instruments/parts	22	18	28	29	0.6
Jacks	14	13	21	24	0.5
Other components	528	731	621	730	14.3
Total Component Exports	**2 091**	**3 318**	**4 051**	**5 115**	**100**

Source: Department of Trade and Industry (1998a:11).

From Table 4.11, it can be observed that despite the increase in value of component exports, the bulk of these exports, such as leather covers, are relatively peripheral items as far as a motor vehicle's value added is concerned. They are also labour-intensive in production, and

with the exception of catalytic converters, automotive tooling and engine parts, require little technological deepening.

Most of the component sector's exports are destined for the European Union member states, with Germany being the largest single customer (Table 4.12).

Table 4.12: Geographical destination of component exports (percentages)

Country/Region	1995	1996	1997
By country			
Germany	45.0	47.1	48.9
United Kingdom	6.4	8.0	9.5
Zimbabwe	4.4	5.9	6.5
United States	4.2	5.0	6.4
Belgium	8.0	6.2	4.6
Netherlands	1.9	3.0	2.4
Australia	0.7	1.3	2.3
France	0.6	0.7	2.1
Zambia	1.7	1.9	2.1
Other	27.1	20.9	15.3
By Region			
EU	67.7	69.7	70.7
Africa (excluding SADC)	3.0	1.1	1.2
SADC	10.2	13.5	12.7
North America	4.7	5.3	6.0

Source: Department of Trade and Industry (1998a:12).

Component manufacturing firms can be classified as follows:

(i) Original equipment manufacturers (OEMs): these are essentially the motor vehicle assembly firms, and they produce parts for use within their own plants or for

export, especially when they are integrated into the global network of their overseas-based parent companies.

(ii) **Original equipment suppliers (OESs):** these tend to be controlled by the OEMs and collect parts/sub-assemblies and systems from other (second- and third-tier) producers, assembling them into modules which are mostly supplied to OEMs or, in some instances, exported.

(iii) **After-market producers:** after-market producers mainly manufacture parts for domestic and foreign markets. These parts are principally for the repair of motor vehicles, or for export to countries where the models in question are no longer in production. This category also includes the reconditioning of automotive parts.

There are a number of component manufacturing firms in the Eastern Cape Province. The larger ones in particular are affiliated to the National Association of Automotive Component and Allied Manufacturers (NAACAM), although several smaller firms also exist. Almost without exception, component manufacturing is concentrated in the Port Elizabeth/Uitenhage metropolitan area, within close proximity to assembly firms. Most of the larger firms are either subsidiaries of local firms or MNCs, or produce under licence from the latter. In addition, the larger firms also operate one or more manufacturing plants within a single town or region.

The nature of operations undertaken by Eastern Cape-based firms range from beneficiation of raw materials through to engine manufacturing, both for the domestic market and export, and a number of firms have positioned themselves to take advantage of incentives and benefits under the MIDP since its inception. The South African Motor Corporation (Samcor), for instance, secured a lucrative R1.6 billion contract to supply 1 600cc fuel injected engines to Ford Motor Corporation's European plants (Eastern Province Herald, 2 June 1998), while as noted in Section 4.3.2, Delta Motor Corporation is involved in the

export of tooling and seats to Europe and South America. Most component firms also export through the vehicle assemblers, and in so doing share or sell export credits earned under the import/export complementation scheme of the MIDP.

Barnes (1999:11) argues that the domestic OEM/OES and after-market are no longer sufficient for the continued survival of component firms nationally, and with MNCs controlling international marketing networks, there has been a trend towards domestic assemblers being used as a conduit for component exports and/or establishing close relationships with foreign MNCs. This is usually achieved through the sale of equity stakes, or sub-contracting relationships. Entry into production agreements with major overseas component producers is an act of survival on the part of domestic component producers, since it allows them to fit in with global supply chains (Maphologela, 1999, cited in Hosking, 1999:13). This aspect will be examined more closely in Chapter 5.

4.5 Employment

The significance of the labour force engaged in production in South Africa's automotive industry is borne out by the fact that, by 1993, this sector accounted for 5.9 per cent of total manufacturing employment (CSS, 1993).

As the automotive industry began to take root in the post World War I era, the government of the day perceived it, and other industrial sectors, as a panacea for the nagging problem of finding employment for thousands of "poor whites" (Duncan, 1997:83). Employers in the automotive sector were encouraged, formally and informally, to employ white labour wherever possible. As a result, non-white labour was excluded from employment in assembly plants. However, this situation changed with the outbreak of World War II. The vast majority of white male workers were drafted into the military, and the resulting vacuum led to the gradual absorption of black, Indian and coloured labour. Although they largely performed menial tasks, their numbers rapidly increased after the end of the war.

The increase in numbers occurred mainly because white labourers began shunning the repetitive and monotonous assembly operations in favour of more lucrative job opportunities in the rapidly expanding economy. With white labour increasingly expensive to hire, employers began to turn to labourers of other races, especially to perform the tasks that whites found demeaning. Efforts to exclude non-white labour from all but the most rudimentary operations intensified, especially with the introduction of the Industrial Conciliation Act of 1956, which legalised job reservation (Julius and Lumby, 1993:12).

Job reservation involved the demarcation of work types according to race group. The intention, ostensibly to safeguard the welfare of employees of any race, only served to exacerbate racial tensions within the industry. Rising numbers of labourers employed also brought about increased levels of unionisation, and led to the birth of a strong labour movement. According to Duncan (1997:86), the advent of the 1980s saw organised labour begin to pose a real challenge to the government and management of assembly operations, through a series of wildcat strikes. These were generally centred on issues such as wages, working conditions and retrenchments, although the strikes usually bore strong political overtones. The Eastern Cape-based vehicle assemblers were particularly hard hit by continuous waves of strike action, which deeply affected levels of profitability and led to the eventual divestiture of some firms.

The 1990s have witnessed relatively peaceful conditions prevailing in the sector, especially with the establishment of the National Bargaining Forum. This involves industry-wide negotiations across the assembly sector by stakeholders, namely the National Union of Metalworkers of South Africa (NUMSA) and the automobile manufacturers (Duncan, 1997:102). While this has led to a gradual rationalisation of job grades, establishment of a minimum wage and a moratorium on retrenchments, the industry is still beset by worrisome strike action. This was manifested in the national strike called by NUMSA in August 1998, which targeted both assembly and component firms alike, and which was perceived to have put into question the viability of choosing South Africa as a manufacturing base.

The relationship between unionised labour and management still remains, to a large extent, adversarial, with labour voicing opposition particularly with regard to job losses and the perception that employers are manipulating the MIDP to achieve their own ends (Cartoday, 1999a).

Employment levels in the assembly and component sub-sectors remains volatile, which is indicative of the pressures the industry faces (see Chapter 5). While employment dropped from 1990 to 1993, before picking up between 1993 and 1995, the steady decline thereafter is indicative of rationalisation of operations and cost reduction, which has also seen the closure of a number of firms (NAAMSA, 1998d).

Table 4.13: Labour force in the motor vehicle assembly and component sectors

YEAR	VEHICLE ASSEMBLY	COMPONENTS	TOTAL
1990	43 800	44 300	88 100
1991	36 900	43 600	80 500
1992	38 700	36 400	75 100
1993	37 200	33 700	70 900
1994	32 700	40 800	73 500
1995	38 600	45 100	83 700
1996	38 600	43 500	82 100
1997	37 000	41 700	75 400
1998	33 700	41 700	73 700

Note: Employment figures rounded off to the nearest 100.

Source: NAAMSA (1999a).

4.6 Conclusion

This chapter set out to describe the evolution of the automotive industry in South Africa and provide background on the motor vehicle assembly firms operating within the Eastern Cape Province. It briefly described the evolution of the components sector and considered

the changing nature of employment in the industry. The chapter may be seen as important background to the rest of the study, which aims to analyse trends in the Eastern Cape automotive industry, especially after 1990.

CHAPTER 5

TRENDS IN THE EASTERN CAPE AUTOMOTIVE INDUSTRY WITH SPECIAL REFERENCE TO THE EFFECTS OF TRADE LIBERALISATION SINCE 1990

5.1 Introduction

The previous chapter provided an overview of the evolution of South Africa's automotive industry from the turn of the century to the present day. It also examined the motor vehicle assembly and component sectors in the Eastern Cape Province. This chapter specifically analyses trends in the Eastern Cape automotive industry, with special reference to the effects of trade liberalisation since 1990. It is based on the findings of two surveys: one of the motor vehicle assembly firms in the Province, and a second covering all component exporting firms in the Province affiliated to the National Association of Automobile Component and Allied Manufacturers (NAACAM), together with the South African Motor Corporation (SAMCOR) engine plant (see Appendices 1-3). Three non-exporting component manufacturing firms were omitted from the survey.

5.2 The motor vehicle assembly industry

As discussed in Section 4.3, there are three motor vehicle assemblers based in the Eastern Cape. Volkswagen of South Africa (VWSA)[12] and Delta Motor Corporation are based in the Port Elizabeth/Uitenhage metropolitan area, while the DaimlerChrysler manufacturing plant is based in East London.

Both of the respondents reported an annual turnover of over R500 million, and each had a labour force of between 2 000 and 4 000 personnel. The following sub-sections analyse

[12] VWSA declined to participate in the survey on the grounds that, as a wholly owned subsidiary of VW AG, they were constrained from disclosing information regarding profits and other issues of a sensitive nature.

the economic performance of the respondent firms and their views on the effects of trade liberalisation.

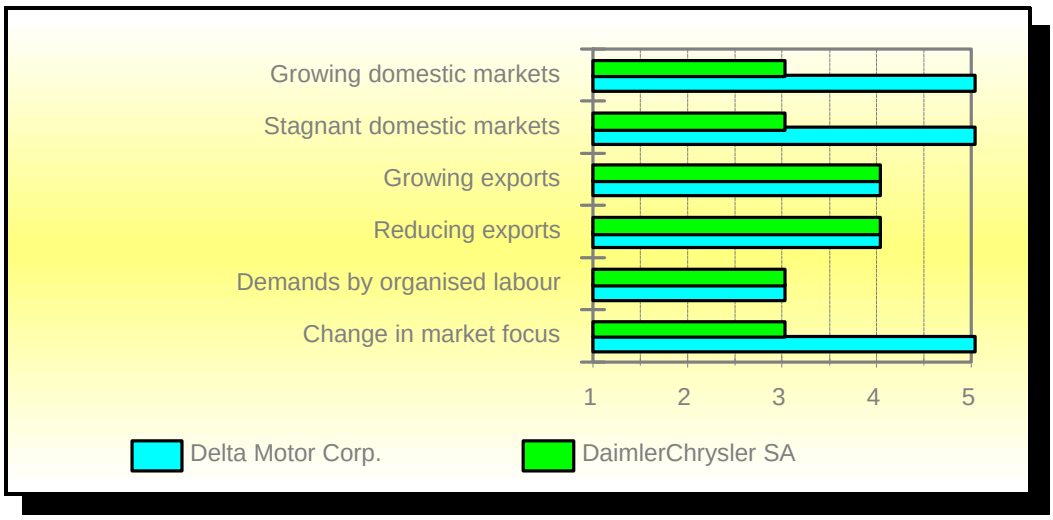
5.2.1 Economic performance of assembly firms

The firms which participated in the survey were requested to rank on a scale of 1 (representing unimportant) to 5 (for very important) how the following factors influenced their employment practices:

(a) growth in domestic markets;
(b) stagnation in domestic markets;
(c) growth in exports;
(d) reduction in exports;
(e) demands by organised labour;
(f) change in market focus.

The results are represented in Figure 5.1.

Figure 5.1: Factors influencing employment practices of assembly firms



n=2

Source: Interviews.

From Figure 5.1, it can be seen that Delta perceived the growth or stagnation of domestic markets to be of utmost significance in determining employment levels, whereas DaimlerChrysler felt it was only moderately important. As noted in Section 4.3.2, a possible explanation for this could be that Delta mainly targets the domestic market for FBU sales, and is constrained from exploring new export markets overseas owing to spare capacity at other General Motors facilities and the restriction of export destinations[13]. DaimlerChrysler, on the other hand, is increasingly becoming an important location for certain models in the Mercedes-Benz range of passenger vehicles, as noted in Section 4.3.3.

Of significant importance to both respondents was the growth or reduction of exports, whereas demands by organised labour were not very important in the determination of employment levels. It can be seen that Delta placed great significance on changing market focus, whereas DaimlerChrysler felt it was moderately important. Once again, a possible explanation for this, as observed in Section 4.3.2, could be the fact that despite constraints on sales of FBUs to other markets, Delta is increasingly becoming integrated into the General Motors global component sourcing network and supplies certain components to various assembly plants worldwide. DaimlerChrysler, on the other hand, has fewer assembly locations, and these are almost invariably located within the European Union.

The firms were also asked to indicate their principal export markets. The respondents disclosed that they primarily exported to the European Union, SADC countries and the rest of Africa. In addition, DaimlerChrysler identified North America as an important destination for fully built up (FBU) and component exports. Delta further identified South America (Brazil) as a major destination for components.

The survey further sought to identify factors which influenced turnover the most. These were ranked on a scale of 1 (for unimportant) to 5 (for very important) and are as follows:

[13]This situation is not uncommon among global vehicle assemblers; Toyota Motor Corporation of Japan also restrict exports by Toyota SA to particular countries, especially in Southern Africa.

(a) increased domestic market share;

(b) stagnating domestic market share;

(c) decreasing domestic market share;

(d) growth in exports;

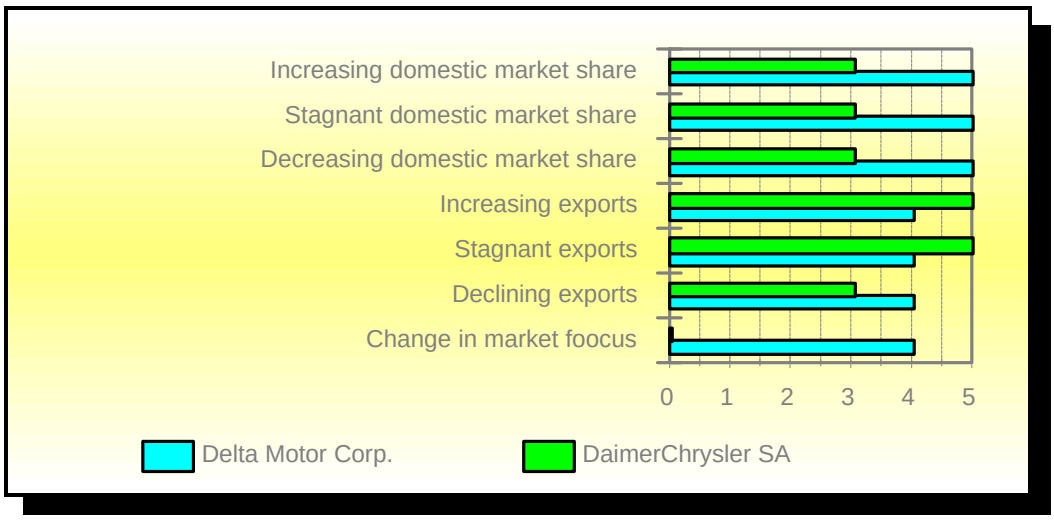
(e) stagnating exports;

(f) declining exports;

(g) changing market focus.

The findings are depicted in Figure 5.2

Figure 5.2: Factors influencing turnover of assembly firms



n=2

Sourc

e: Interviews.

From Figure 5.2, it can be seen that whereas Delta ranked the state of domestic market share (increasing, stagnating or decreasing) as very important in determining annual turnover, DaimlerChrysler felt that all these factors were only moderately significant. In addition, Delta placed the state of exports (increasing, stagnant or declining) as quite important in determining turnover. DaimlerChrysler, however, perceived increasing or stagnating exports as very important in determining annual turnover, while decreasing

exports were seen as quite important. This outcome reflects the earlier response on factors influencing employment, as Delta's FBUs are mainly destined for the local market as opposed to DaimlerChrysler, which has a large export programme in place. Delta also saw changing market focus as quite an important determinant of annual turnover, whilst DaimlerChrysler did not volunteer an opinion. This is interesting, given that DaimlerChrysler is increasingly becoming more export focused, as noted in Section 4.3.3.

It was difficult to ascertain the respondents' profitability trends between 1990-1998, as they felt this information was of a sensitive nature and, owing to their nature of ownership, they were under no obligation to reveal any details. While questions relating to investment expenditure were unanswered for the same reasons, it can be affirmed from Sections 4.3.2 and 4.3.3 that both respondents have in the past two years spent heavily on capital, in order to meet the challenges placed on them by liberalisation under the MIDP.

5.2.2. Effects of trade liberalisation on assembly firms

One of the objectives of the survey was to determine the nature of the respondent firms' level of integration into their parent companies' global networks and whether this had in any way resulted in increased exports since 1990.

DaimlerChrysler South Africa reported that, as a fully owned subsidiary of DaimlerChrysler worldwide, it was fully integrated into its parent company's network, and this had resulted in increased exports of both FBUs and components.[14] Delta is now fully integrated into the global network of its largest minority shareholder, General Motors (GM). It reported increased exports after 1995, especially of components, due to active lobbying at GM Worldwide Purchasing, which sources components from all GM subsidiaries and affiliates throughout the world.

[14] For instance, DaimlerChrysler South Africa is the sole source of leather upholstery for the Mercedes-Benz C-Class series produced all over the world.

The survey also sought to determine the source of duty drawback certificates, which are a feature of the Motor Industry Development Programme (MIDP) import/export complementation scheme. It was established that both Delta and DaimlerChrysler obtain these certificates from the export of FBUs and components. In addition, Delta shares these duty drawback certificates with component manufacturers which supply its manufacturing plants with parts.

One other important question related to the benefits of the MIDP that had accrued to the motor vehicle assemblers, namely:

(a) increased exports;
(b) increased employment;
(c) ensuring survival in the face of international competition;
(d) forcing firms to be internationally competitive;
(e) the transfer of technology.

Both respondents concurred that an important consequence of the MIDP was that the assembly firms had been forced to work towards being internationally competitive by investing heavily in capital expenditure to upgrade their assembly plants, as noted in Sections 4.3.2 and 4.3.3. Delta further indicated that the MIDP had resulted in increased exports of components due to the awarding of export contracts to Europe and South America. Neither of the respondents, however, were of the opinion that increased employment, technology transfer and the ensuring of survival in the face of international competition were benefits of the MIDP.

The final question in this section dwelt on the adverse effects encountered as a result of the introduction of the MIDP. The respondents both felt that liberalisation had resulted in increased competition from imported FBUs. However, only DaimlerChrysler was of the opinion that reduced market share, reduced local content and reduced employment levels could be attributed to the introduction of liberalisation under the MIDP.

From the responses to the survey, it can be surmised that despite the perceived ill-effects that trade liberalisation is believed to have had on the motor vehicle assembly industry, both DaimlerChrysler and Delta have integrated themselves well into their parent companies' global networks and stand to reap the benefits of on-going liberalisation of the industry, especially with increased exports of FBUs and components. These findings will be analysed further in Section 5.5 with reference to the theory.

5.3 The components sector

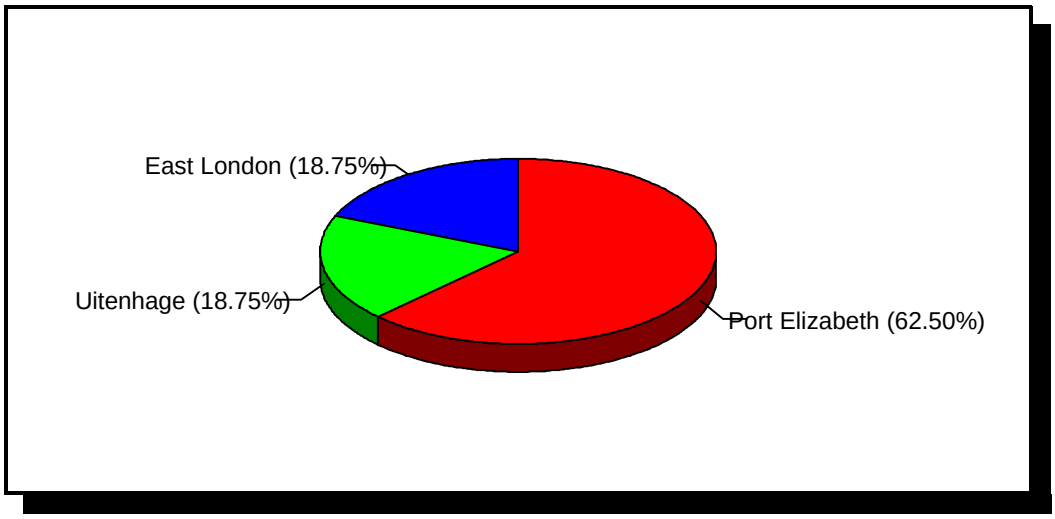
As noted in Section 1.3, there are twenty component exporting firms affiliated to the National Association of Automobile Component and Allied Manufacturers (NAACAM), situated in the Eastern Cape, which were included in the survey. It was established that one firm had since shifted its focus to the production and export of non-automotive items. Three firms did not respond to the questionnaire and hence information from sixteen firms was obtained for the study.[15]

5.3.1. General background of respondent firms

The vast majority of the respondent firms (62.5 per cent) are based in Port Elizabeth, while 18.8 are situated in Uitenhage and the same in East London (Figure 5.3).

[15] One of the component exporting firms, Dorbyl Automotive Technologies, has nine manufacturing concerns located in Port Elizabeth and Uitenhage. For the purposes of the study, all were considered as a single entity.

Figure 5.3: Geographical location of component exporting firms



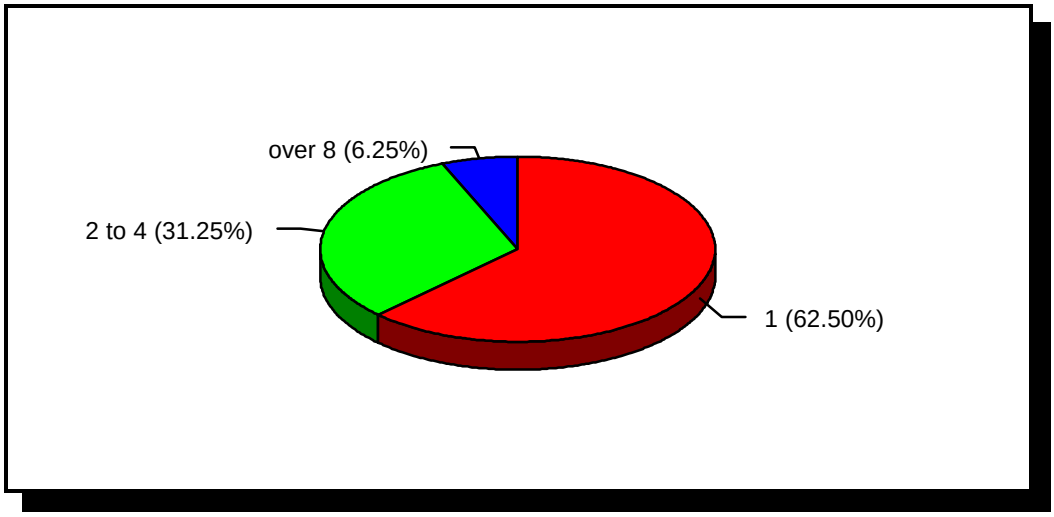
n=16

Source: Interviews.

As noted in Section 4.4, component manufacturers tend to be located within close proximity to the motor vehicle assembly plants in order to reduce transport costs, especially of bulky or delicate parts. Figure 5.3 demonstrates that the majority of component manufacturers in the survey were clustered around the Port Elizabeth/Uitenhage metropolitan area (as are VWSA and Delta), while the remainder were to be found in East London (home to DaimlerChrysler).

The survey further established that, of the 16 firms, a large majority (62.5 per cent) had only a single manufacturing plant, whereas 31.3 per cent had between 2 and 4 plants. Only 6.3 per cent of the firms had more than 8 manufacturing concerns within the Province (Figure 5.4).

Figure 5.4: Number of manufacturing plants per component exporting firm



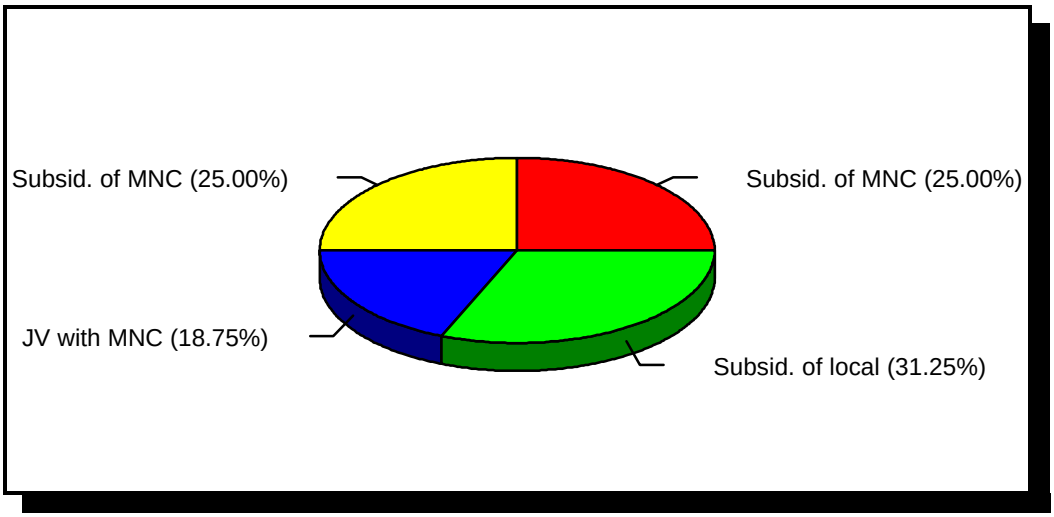
n=16

Source: Interviews.

The nature of ownership among the component exporting firms varied from wholly locally owned to subsidiaries of multinational corporations (Figure 5.5). It is noteworthy that, in the Eastern Cape Province, the number of multinational corporation (MNC) subsidiaries or joint ventures is somewhat lower than that of wholly locally owned firms or subsidiaries thereof.[16] A likely ramification of this scenario is that the scope for technology transfer is limited and restricted to design specifications by the MNCs; in addition local firms often have to pay exorbitant royalties to the foreign MNCs (Barnes, 1999:7). As argued in Section 2.3.2, MNCs are a conduit for the diffusion of technology, besides purchasing raw materials and intermediate inputs. MNCs are also important in that they enhance skill development among the local labour force.

[16] One of the respondents, Shatterprufe (Pty), has since undergone a major ownership change, with its majority equity stake being bought from its principal shareholder, South African Breweries, by a foreign MNC. This is in line with the general trend observed by Barnes (1999:7-8), whereby the number of local firms with local ownership is rapidly diminishing in favour of wholly owned subsidiaries of MNCs.

Figure 5.5: Nature of ownership of component exporting firms

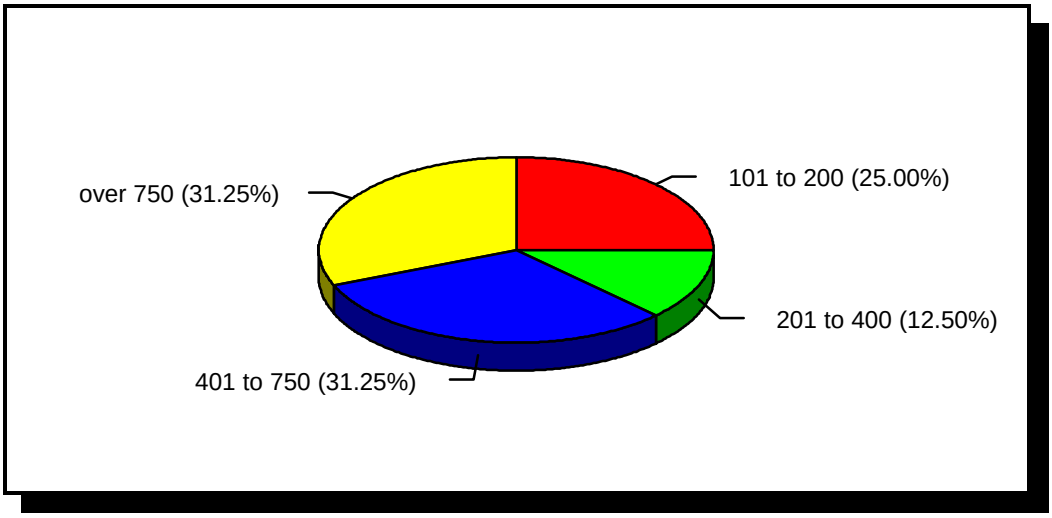


n=16

Source: Interviews.

With respect to employment, it is interesting to observe that none of the respondents had less than 100 employees. 25.0 per cent had between 101 and 200 personnel, whereas 12.5 per cent employed 201 to 400 people each. 31.3 per cent of the firms surveyed were in the 401 to 750 employee category, while a similar percentage employed more than 750 people each (Figure 5.6). This is probably a result of the labour intensive nature of the components sector (due to low levels of technological deepening), and further underscores the importance of the sector to employment in the Province. It is also possible that there were no firms with less than 100 personnel because smaller firms do not tend to be members of NAACAM.

Figure 5.6: Employment levels among component exporting firms



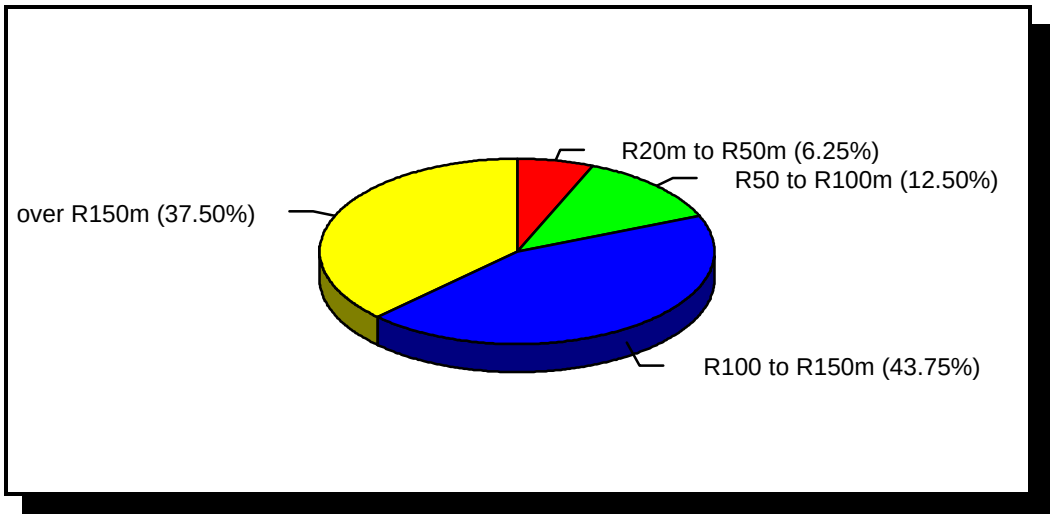
n=16

Source

: Interviews.

The survey of component exporting firms also sought to ascertain the annual turnover range for respondents. It found that, for the Eastern Cape-based exporters, 6.3 per cent reported an annual turnover in the region of R20 million to R50 million. 12.5 per cent of respondents had an annual turnover of between R50 million and R100 million. 43.8 per cent had an annual turnover between R100 million and R150 million, and 37.5 per cent an annual turnover exceeding R150 million, thus reinforcing the view that the automotive components sector is of considerable significance within the Province (Figure 5.7).

Figure 5.7: Annual turnover of component exporting firms



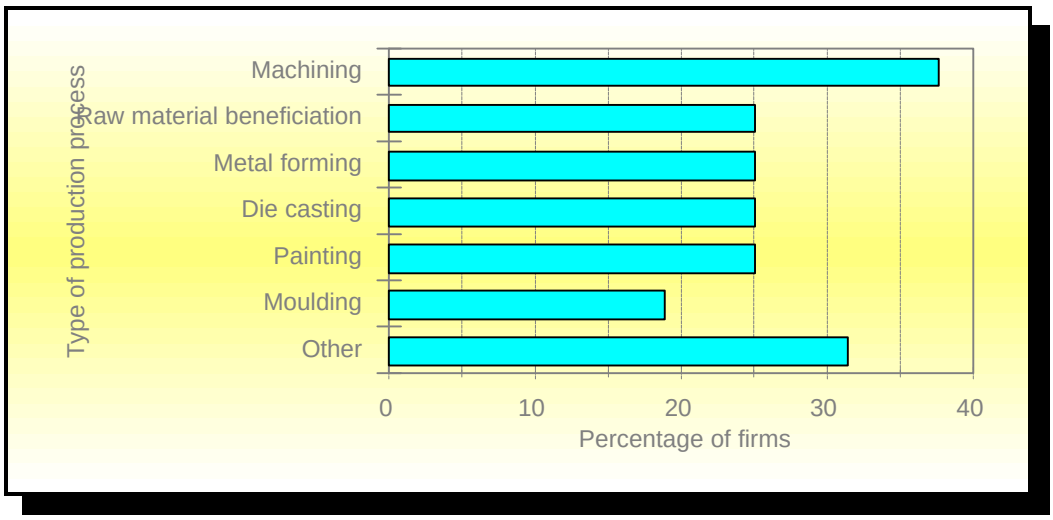
n=16

Source: Interviews.

In their various activities, component manufacturers engage in a host of production processes, ranging from beneficiation of raw materials (which have a low value added) to processes which give the finished product a high value added. The survey categorised production processes into beneficiation of raw materials, metal forming, machining/tooling, die casting, moulding and painting. These categories are by no means mutually exclusive since a single firm could engage in one or more processes.

The survey established that 25.0 per cent of the respondents engaged in raw material beneficiation while a similar percentage were involved in both die casting and metal forming. For 18.8 per cent of the respondents, the principal activity was moulding, while 25.0 per cent of the sample performed painting processes. Other production processes, such as electrical wiring, battery manufacturing, glass production and the manufacture of automotive lighting systems were the main activities of 31.3 per cent of respondents (Figure 5.8).

Figure 5.8: Production processes of component exporting firms

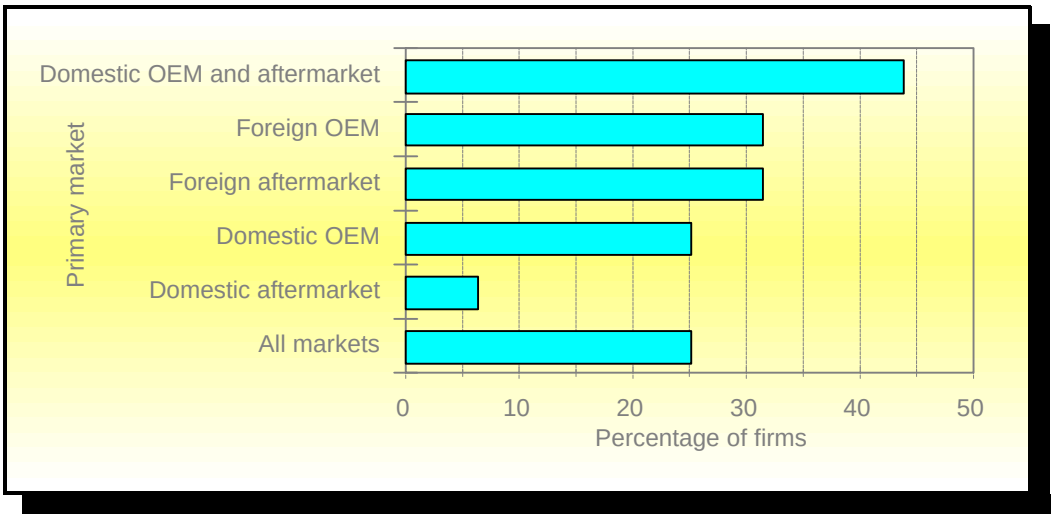


n=16

Source: Interviews.

The destination of output from the component exporting firms also varies, with products from some firms feeding primarily through into domestic motor vehicle assembly and/or the aftermarket, directly exported or both. In the sample of component exporting firms in the Eastern Cape, it was found that 25.0 per cent of respondents had their output feed through mainly into domestic OEMs, while output from 31.3 per cent was destined for foreign OEMs. 6.3 per cent of respondents had their output destined primarily for the domestic aftermarket, while 31.3 per cent of the sample had the foreign aftermarket as the main destination for output. The survey established that 43.8 per cent of the sample produced mainly for both the domestic OEM and aftermarket, while 25.0 per cent of manufacturers identified all markets as the main destination for their products (Figure 5.9). This highlights the importance of domestic assembly operations for a significant number of component firms, despite being involved in export activity.

Figure 5.9: Primary markets for component exporting firms



n=16

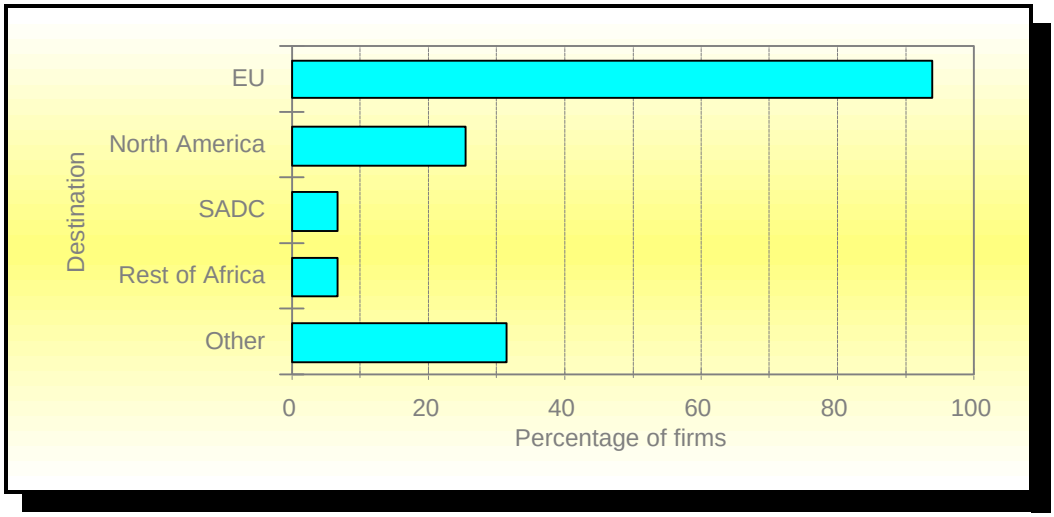
Source: Interviews.

Firms were also asked to indicate their primary export destinations. 93.8 per cent of the respondents identified the European Union as one of their principal export markets. North America was a principal market for 25.0 per cent of firms, while SADC countries and the rest of Africa each were principal destinations for 6.3 per cent of firms (Figure 5.10). Countries such as Australia, India, Sweden, Brazil and other Latin American states were other important destinations.

These results may be compared with the components sector nationally (Table 4.12). The survey findings reveal that, like the sector nationally, the European Union is the most significant export destination. However, for Eastern Cape-based exporters, unlike nationally, SADC countries and the rest of Africa are relatively insignificant in comparison to North America and other countries. This could possibly be due to the fact that most component manufacturers have, in order to ensure their continued survival in the face of international competition, entered into agreements with overseas (mainly German) assembly firms to supply their global chains, hence most output is destined for the European and North American markets. This finding also contrasts with the observation by Hosking (1999:13)

that Africa is typically the export market allocated to component manufacturers in Port Elizabeth/Uitenhage by their overseas principals.

Figure 5.10: Principal destinations of component exports



n=16

Source: Interviews.

5.3.2 Economic performance of component exporting firms

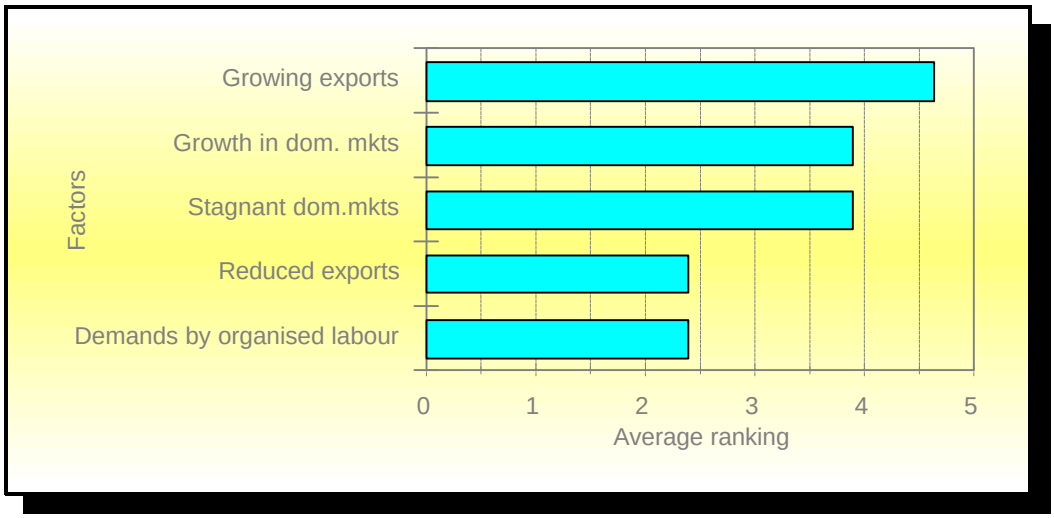
The second part of the survey for the components sector dwelt on the economic performance of the sampled firms. This was mainly qualitative, and asked the respondents to rank, on given scales, various aspects of their operations.

The respondents were asked to rate on a scale of 1 (insignificant) to 5 (very important), which of the following factors most influenced their employment practices:

(a) growth in domestic markets;
(b) stagnation in domestic markets;
(c) growth in exports;
(d) reduction in exports;
(e) demands by organised labour;
(f) change in market focus.

This is illustrated in Figure 5.11.

Figure 5.11: Factors influencing employment practices of component exporting firms



n=16

Source: Interviews.

Figure 5.11 reveals that the most significant determinants of employment among the component firms surveyed are growth in domestic and export markets, reinforcing the importance of the domestic market for their survival. While stagnation in domestic markets was seen as fairly significant, reduced exports have not been of much importance. The most striking finding, however, is the relative insignificance to the firms of labour demands. This contradicts the general perception that unreasonable labour demands usually drive away investment in manufacturing. It is also interesting to note that none of the firms saw changing market focus as a determinant of employment trends.

The firms were also asked to rank, on a scale of 1 (insignificant) to 5 (very significant) which of the following factors most influenced their turnover:

(a) increased domestic market share;

(b) stagnating domestic market share;

(c) decreasing domestic market share;

(d) growth in exports;

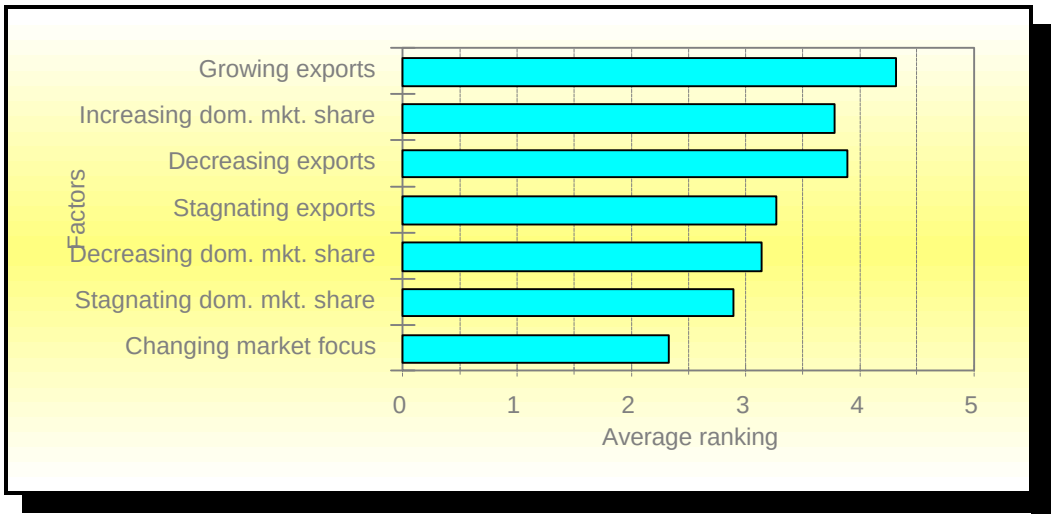
(e) stagnating exports;

(f) declining exports;

(g) change in market focus.

This is illustrated in Figure 5.12.

Figure 5.12: Factors influencing turnover of component exporting firms



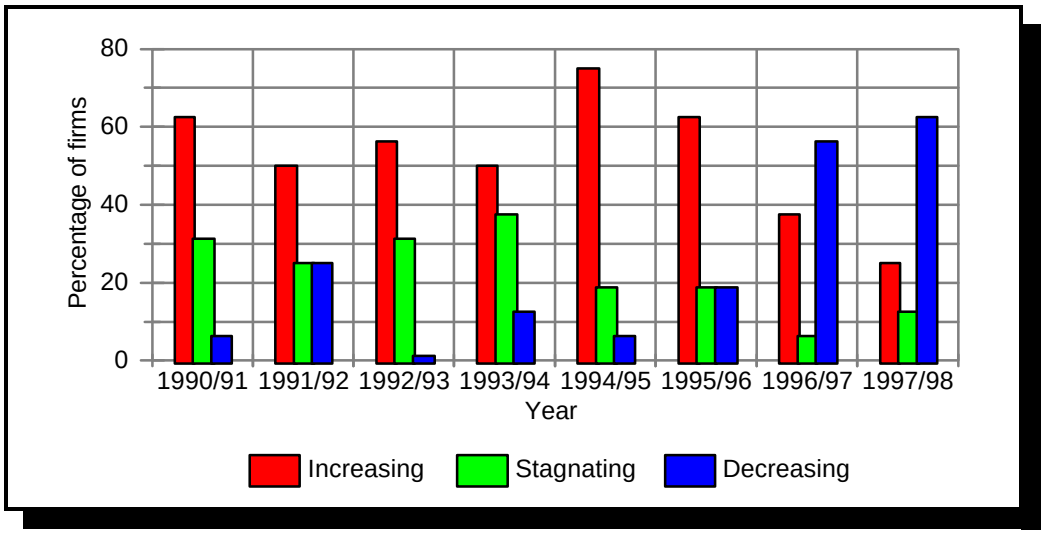
n=16

Source: Interviews.

Once again, it can be seen that the main factors influencing turnover among the firms in the sample are growth in both exports and domestic market share, while declining export levels and domestic market share have a fair measure of significance. Changing market focus, in this instance, is not seen as very significant.

The respondents were further asked to indicate on a scale of 1(for increasing), 2 (for stagnating) and 3 (for declining) their firm's profitability trends from the period 1990-1991 to 1997-1998 (Figure 5.13).

Fgure 5.13: Profitability trends of component exporting firms 1990-1998



n=16

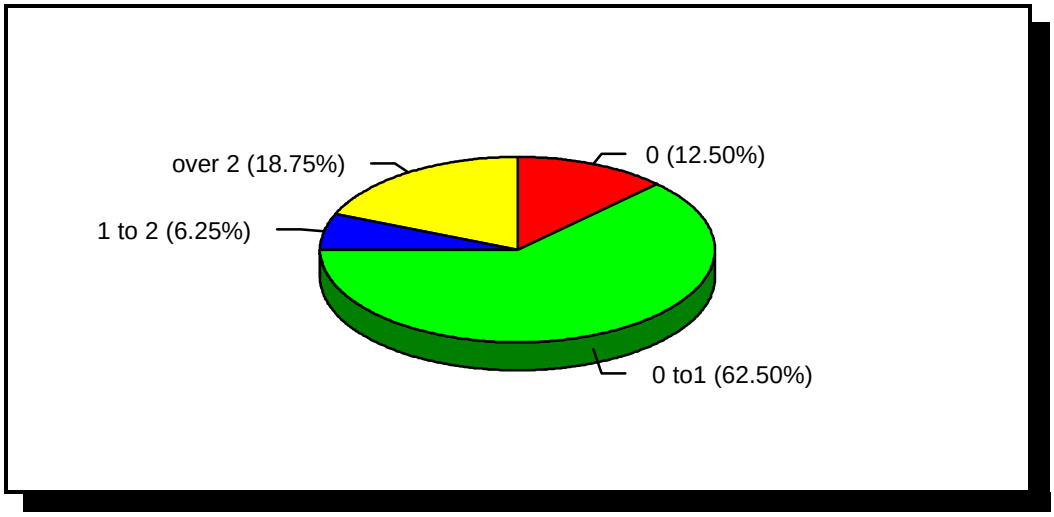
Source: Interviews.

Figure 5.13 reveals a very mixed picture on the profitability of firms in the sample. For instance, the number of firms experiencing reduced profitability rose sharply from1990/91 to 1991/92, fell dramatically in 1992/93, then rose again in 1993/94, only to decline in the 1994/95 period. However, from 1995/96 onwards (coinciding with the introduction of the MIDP), the general trend has been towards a larger number of firms reporting decreased profitability. These findings do not differ markedly from those of Barnes (1998), who points out that, notwithstanding the fact that some individual firms have managed to improve their profitability, the general impression is one of an industry under immense pressure from competition.

These trends should be understood in the context of the effects of the MIDP, which in the short term is expected to impact adversely on local component manufacturers, who, owing to low volumes of FBUs sold in the domestic market, cannot compete with international suppliers (Black, 1998b). This is because under the import/export complementation scheme vehicle assemblers are able to source components from overseas using credits earned from exporting FBUs.

The survey also aimed to evaluate the level of research and development (R&D) undertaken by firms in the components sector (Figure 5.14).

Figure 5.14: Percentage of turnover channelled towards research and development (R&D) by component exporting firms



n=16

Source: Interviews.

From Figure 5.14, it can be seen that 12.5 per cent of the component exporting firms in the Eastern Cape spent nothing on R&D, while the vast majority (62.5 per cent) spent between zero and 1 per cent of annual turnover on R&D. Only 6.3 per cent of firms spent between 1 and 2 per cent of annual turnover, while 18.8 per cent devoted more than 2 per cent of annual turnover to R&D activities. The low level of R&D expenditure among the firms surveyed is broadly consistent with that of South Africa's manufacturing sector at the national level, which is not generally known for its R&D activity. Joffe *et al.* (1995:239) observe that, by 1995, R&D expenditure within the country stood at slightly more than one per cent of gross domestic product (GDP), and was moreover heavily concentrated in armaments and atomic energy. Duncan (1997:171) adds that whatever little R&D took place in the automotive industry revolved around adapting components to suit the local terrain or changing parts to suit the needs of local assemblers. The relatively low level of

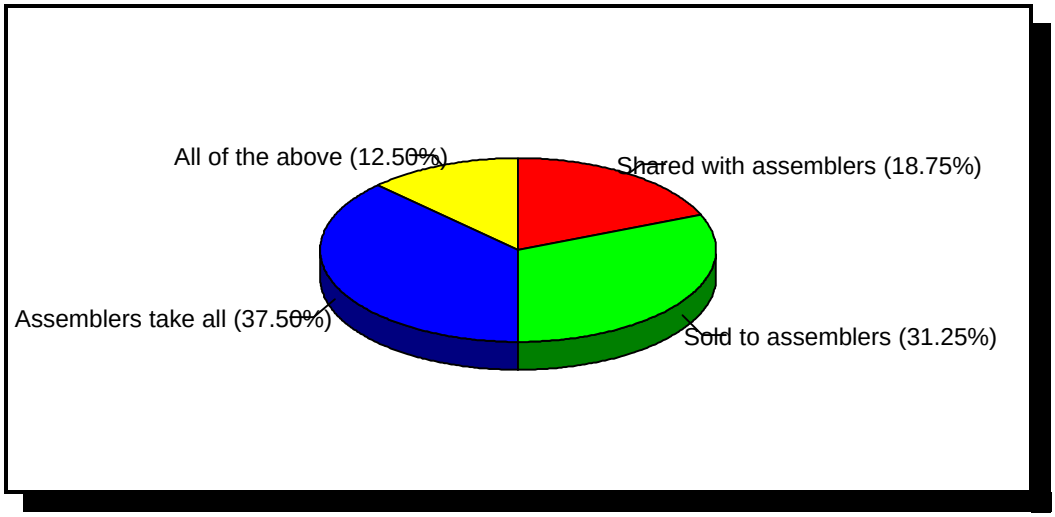
R&Dactivityamong local component manufacturers may also be due to growing foreign ownership, a factor which acts as a disincentive to expenditure in this sphere, since technology can be sourced from the parent company.

5.3.3 Effects of trade liberalisation on component exporting firms

The final part of the survey attempted to evaluate the effects of liberalisation on the component firms in the sample. The respondents were asked what they did with the duty drawback certificates gained from exporting components. As explained in Section 4.2, these drawback certificates were the result of export credits earned via the MIDP's import/export complementation scheme, under which component manufacturers could either sell or share their credits with motor vehicle assemblers; alternatively component manufacturers could export their goods through the assemblers, in which case the latter would be the sole beneficiaries.

The survey established that 31.3 per cent of the component exporting firms sold their duty drawback certificates to motor vehicle assemblers, while 37.5 per cent shared their drawback certificates with motor vehicle assemblers. 12.5 per cent of the firms stated that the assembly firms benefited entirely from the duty drawback certificates, while for 18.8 per cent of respondents, all three scenarios were applicable (Figure 5.15).

Figure 5.15: How component exporting firms deal with duty drawback certificates



n=16

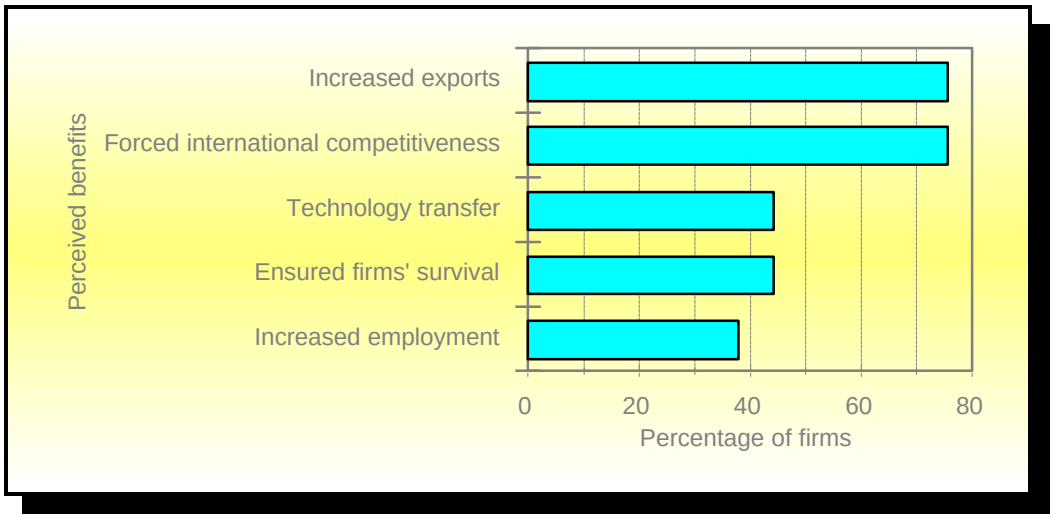
Source: Interviews.

The respondent firms were further asked to state their perception of the benefits that the MIDP had on their firms. They were specifically asked which of the following they saw as benefits:

(a) increased exports;
(b) increased employment;
(c) ensuring survival in the face of international competition;
(d) firms forced to be internationally competitive;
(e) technology transfer had resulted.

This is depicted in Figure 5.16.

Figure 5.16: Component exporting firms' perceptions of the benefits of the MIDP



n=16

Source: Interviews.

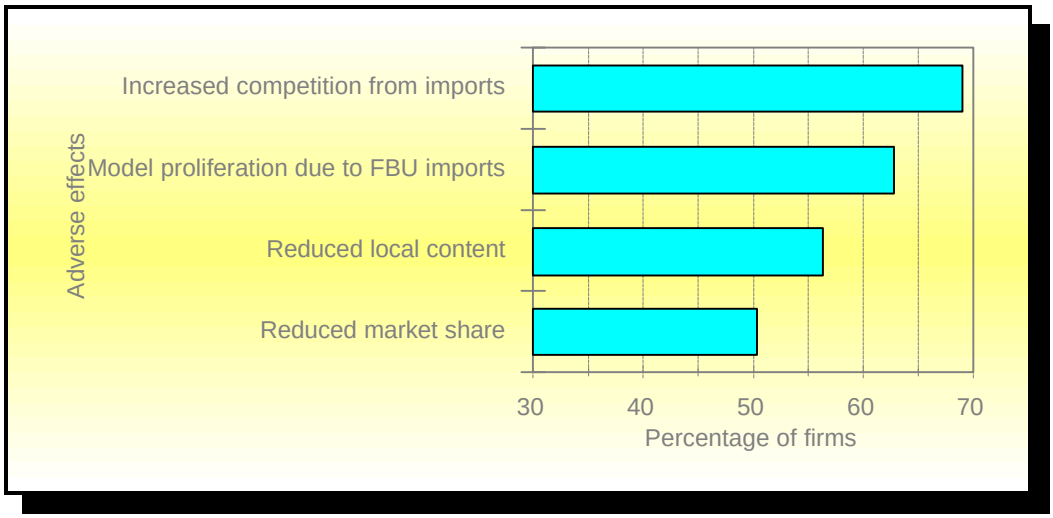
68.8 per cent of the firms felt that the MIDP had led to increased exports, while 31.3 per cent saw it as having led to increased employment in the components sector. According to 37.5 per cent of respondents, the MIDP was crucial in ensuring their survival in the face of international competition, while 68.8 per cent of the respondents felt the MIDP had forced them to become internationally competitive. 37.5 per cent of the component exporting firms felt the MIDP had resulted in technology transfer. 6.3 per cent of the firms felt that the MIDP had no benefits whatsoever, while 12.5 per cent perceived all of the factors listed as positive spinoffs associated with the introduction of the MIDP.

The firms were also asked to identify any adverse effects they felt arose from the introduction of the MIDP. They were specifically asked to identify which of the following adverse effects they felt applied to their firms:

(a) model proliferation from increased importation of FBUs;
(b) reduced market share;
(c) reduced local content;
(d) increased competition from imports.

This is shown in Figure 5.17.

Figure 5.17: Adverse effects suffered as a result of the MIDP



n=16

Source: Interviews.

The survey established that 62.5 per cent of component exporters felt that the MIDP had resulted in uneconomic model proliferation, while for 50.0 per cent of the firms, the MIDP had brought about a reduction in market share. This is significant, especially given that with the restructuring of the vehicle assembly sub-sector, there has been an increase in the number of model variants, which consequently raises tooling costs. With parts for these models being increasingly imported, there has been a reduction in demand for locally manufactured components. It was further stated by 31.3 per cent of respondents that the MIDP had resulted in reduced local content, especially for the assembly sub-sector, while 43.8 per cent of the sample saw the MIDP as causing increased competition from imports, an inevitable outcome given the flexibility in sourcing of components. 25.0 per cent identified all of the above as negative consequences of the MIDP, while 18.8 per cent reported that they had not suffered any adverse effects with the introduction of the MIDP. With the components sub-sector in the Eastern Cape being a microcosm of the sector nationwide, it is not surprising that these findings concur with the general perception that

component manufacturers have not benefited much from the introduction of the MIDP (see, for example, Nicolau, 1999:19-20).

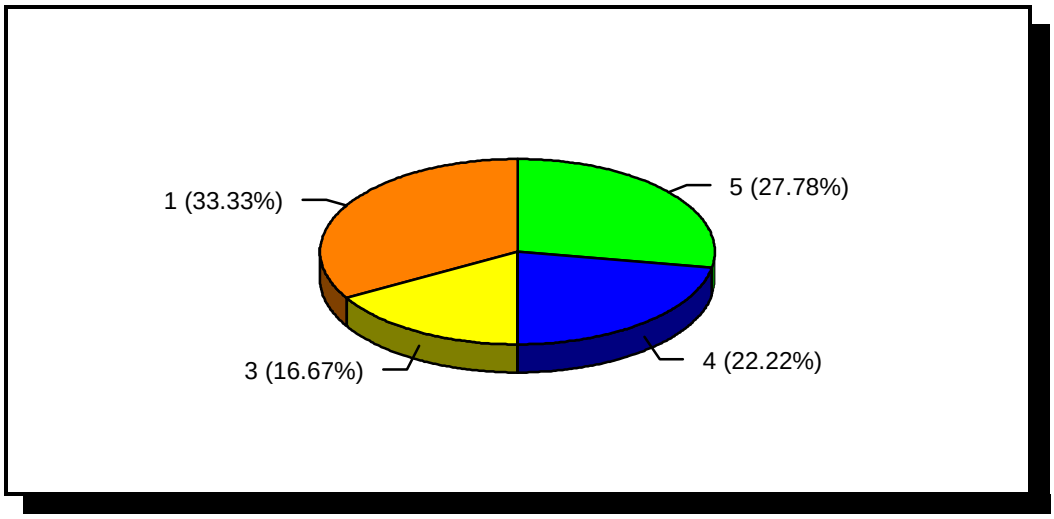
These results will be analysed further in Section 5.5, in light of the theory presented in Chapter 2.

5.4 Employment

One of the areas where the survey for both the motor vehicle assemblers and component exporters sought to elicit the views of respondent firms in the automotive industry was that of labour.

The automotive industry has in the past few years witnessed a marked increase in labour unrest, especially since the introduction of the MIDP, which has brought about reduced levels of tariff protection and rationalisation of production, factors which labour perceives to have resulted in job losses. Respondents were asked to rank on a scale of 1 (for insignificant) to 5 (very significant) the impact that labour unrest had on their operations and ability to fulfil export orders (Figure 5.18).

Figure 5.18: Automotive firms' perception of labour unrest



n=18

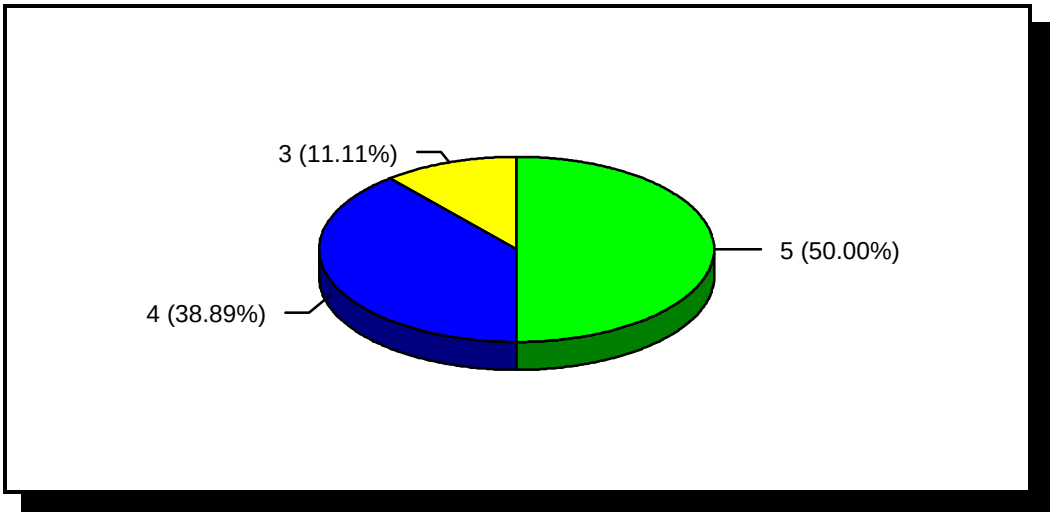
Source: Interviews.

33.3 per cent of the assembly and component firms felt the impact of labour unrest was insignificant, while 16.7 per cent saw it as having a moderate impact. On the other hand, 22.2 per cent of respondents felt that the impact of labour unrest was quite significant, while 27.8 per cent were of the opinion that labour unrest affected the fulfilment of export orders significantly. It may be surmised that the firms most affected by strike action are the labour-intensive component manufacturers, as well as the assembly firms with substantial export orders in place; component manufacturers whose production processes are more capital-intensive tend not to have their operations disrupted as much by industrial action on the part of their employees.

One of the major challenges facing the manufacturing industry in the country is to improve the level of skill formation among the labour force. It is unlikely for the labour force to be productive and innovative if the levels of literacy and numeracy are low, a defining characteristic of South Africa's labour force. This position is further exacerbated by the fact that South African firms show a lack of interest in human resource development (Joffe *et al.*, 1995:188-189).

Respondents to both surveys were asked to rank on a scale of 1 (for insignificant) to 5 (very significant) their commitment to improving the skill level of their labour force (Figure 5.19).

Figure 5.19: Automotive firms' commitment to employee skill formation



n=18

Source: Interviews.

It is interesting to note that, contrary to perceptions on the general disinterest South African firms have toward skills formation, 50.0 per cent of the respondents profess to be fully committed to it, with 38.9 per cent being quite committed to improving the lot of their labour force. Only 11.1 per cent of the respondents were moderately committed to skill formation. While it is unlikely that a firm would indicate a lack of interest in developing the skills of its employees, the findings nonetheless contrast sharply with the contention of the National Union of Metalworkers of South Africa (NUMSA) that automotive firms perceive human resource development as a cost and thus are not doing enough to educate and train their labour force (Cartoday,1998d).

5.5. Analysis of the surveys

The purpose of this section is to analyse the findings of the surveys for the Eastern Cape-based motor vehicle assemblers and component manufacturers in the light of the theoretical impact of trade liberalisation.

At the outset, it must be borne in mind that the automotive industry in South Africa evolved largely due to the import-substituting policies adopted by successive governments. As noted in Section 4.2, foreign direct investment in this sector was largely undertaken to capitalise on tax concessions and production for a captive market, since importation of FBUs was penalised by high tariffs.

As noted in Section 3.7, trade liberalisation in the automotive sector took the form of the abolition of quantitative restrictions (QRs), and their replacement with tariff barriers, which are in turn being rapidly scaled down with the ultimate aim of achieving a maximum tariff of 30 per cent by the year 2007 (Tables 3.4 and 3.5). Trade liberalisation, long advocated by neo-liberal theorists, is intended to allocate resources efficiently, with countries importing cheaply goods which would have been locally produced at a greater cost. Advocates of trade liberalisation also argue that besides reducing unproductive rent-seeking behaviour, manufacturing firms are forced to become internationally competitive by producing quality products which would withstand competition from imports. Diffusion of technology by MNCs is also extolled as an advantage of allowing freer trade.

With the advent of trade liberalisation and the lowering of import tariffs, motor vehicle assemblers have had to face the reality of increased competition from FBU imports (see Figure 4.1), but also reduced local market share in domestic sales, especially of entry-level vehicles. However, accompanying this scenario has been a marked rise in the export of FBUs, a result of the Eastern Cape based assemblers, like those in other regions, having one form of export contract or the other with their parent companies or foreign shareholding firms. The increase in exports has not only led to some rationalisation of models manufactured but has also enabled them to take advantage of export credits earned under the MIDP; as noted in Section 3.5, these credits have facilitated the importation of lower

volume, higher priced luxury models, thus freeing assembly lines for high-volume production of fewer models. There has also been some form of technology transfer, evidenced in the level of capital investment undertaken by the vehicle assemblers, and very recently, some moves towards greater use of local materials.[17]

These findings broadly concur with those of the Industrial Development Corporation's Sectoral Prospects on Growth Guidelines for 80 South African Industries for the period 1997-2001 (IDC, 1998), which forecasts increased importation of FBUs following a lowering of tariffs. With the current rationalisation of model lines and the envisaged trend towards higher volumes of fewer model lines, stronger emphasis is being placed on export markets, especially given that domestic demand for motor vehicles still remains insufficient (IDC, 1998:24.10). Envisaged integration of assembly operations into international networks of parent/licensor companies is also evident.

Responses from the survey of component exporting firms reveals a somewhat different picture, indicating that trade liberalisation has not been particularly beneficial to the sector, reinforcing the view by Bell (1993), noted in Section 2.4, that the immediate impact of import liberalisation is likely to be an increase in imports, with any stimulatory effect on exports being delayed and possibly weak.

While some firms have reported increased export activity and moves towards being internationally competitive[18], the general impression is that of a sub-sector under immense pressure. Indeed, as pointed out by the National Association of Automobile Manufacturers of South Africa (NAAMSA), the ultimate aim of the MIDP is to force restructuring in the

[17] For instance, local assembly of the Golf IV, originally from wholly imported completely knocked-down kits with no local content, now uses components such as safety glass from a variety of local sources (Laing, 1999, cited in Hosking, 1999:17).

[18] One of the respondents to the components sub-sector survey, Precision Exhaust Systems, was, for the seventh year running, one of the recipients of the 1999 General Motors Supplier of the Year award, for achieving world-class levels of quality and technology (Cartoday, 1999c).

local component manufacturing sector, to ensure it is more focused and has a globally competitive range of products that can be exported; only those firms which are truly competitive would have major export contracts, earning credits which would be used to offset import duties on components which cannot be manufactured cost effectively within the country (NAAMSA, 1998b).

Further, while the IDC forecasts for the components sub-sector envisage increased volumes of a narrower range of components for domestic consumption due to the production of fewer models, and increased export volumes to service vehicles in their various destinations (IDC, 1998:24.15), the prospects for increased exports seem elusive. With the possible exception of the platinum group of metals, an important component of catalytic converters[19] (which are increasingly being used in an attempt to lower pollution of the environment), the sub-sector is still considered uncompetitive due to the high costs of raw materials, not to mention distance from major component markets. It must be borne in mind that with the current low production runs per model and model proliferation (due to availability of a wider range of imported models), component manufacturers face high retooling costs, which make the attainment of scale economies an elusive target.

5.6 Conclusion

This chapter set out to analyse trends in the automotive sector in the Eastern Cape. It found that, by and large, it is the motor vehicle assembly sector which has benefited more from reduced protection and liberalisation, especially under the MIDP. The firms in this sub-sector have positioned themselves to compete globally by embarking on intense export-driven manufacture of vehicles and components. The benefits of production for export have far outweighed any disadvantages.

[19] South Africa produces 70 per cent of the world's platinum, and about 8 per cent of the world's output of catalytic converters (Hosking,1999:13).

The components sub-sector, on the other hand, displays trends that are consistent with those manifested nationally, with most firms experiencing decreasing profitability and declining exports, especially when liberalisation proper took off. This is evidently due to the rapid decline in protection, which has made the sub-sector face stiff competition from cheaper imports. Model proliferation and the fact that vehicle assemblers are able to source components from overseas directly under the import/export complementation scheme of the MIDP have further exacerbated this scenario. Thus, for the components sub-sector, the costs of liberalisation appear to have outweighed any benefits.

CHAPTER 6

CONCLUSIONS

6.1 Introduction

The automotive industry in the Eastern Cape Province, and by extension nationally, is at the crossroads. Not only has this hitherto highly protected sector had the cloak of protective tariffs rapidly removed, but importers of fully built up (FBU) vehicles have capitalised on liberalisation to increase greatly the number of vehicles destined for the domestic market.

It appears that the industry is struggling to retain its domestic market share while at the same time trying to achieve a measure of export growth, without which it seems likely to face a major crisis. Export growth has in itself proven difficult as the domestic automotive industry, plagued by low volume output, geographical disadvantage and high production costs, does not offer much competitive advantage when compared with other automotive exporting countries like Brazil or Australia. Indeed, it is instructive to note that the bulk of export activity, especially by motor vehicle assemblers, appears to be taking place as a result of the local subsidiaries' parent companies facing insufficient production facilities overseas.

These factors, together with the findings that liberalisation under the MIDP has not been entirely successful in making the motor vehicle assembly and component sectors internationally competitive, pose a challenge to the industry and policy makers to ensure that the industry does not face a premature demise.

6.2 Overview of the arguments

As noted in Section 3.2, South Africa's manufacturing sector developed through import-substituting industrialisation (ISI) behind a protective barrier of punitive tariffs and quantitative restrictions (QRs). For the automotive industry, the result was an increase in local assembly operations by overseas manufacturers producing vehicles for a captive domestic market. Not only did this encourage model proliferation and the uneconomic low volume production of motor vehicles, but component manufacturers were faced with ever increasing tooling costs incurred in an attempt to cater for a wide variety of models.

Since the early 1990s, there appears to have been a shift in thinking behind policy making within the country. Current trade policy is broadly informed by orthodox neoclassical economic theory. As argued in Section 2.3.2, the thrust of neoclassical policy is the wholesale deregulation of markets, with the scaling down of tariffs largely aimed at efficiently allocating resources and forcing industries to be internationally competitive. The financial implications of this are that resources are saved by importing cheaply what could have been produced locally at a greater cost. However, as noted in Section 3.5, this notion fails to take into account the costs of transition associated with trade liberalisation and entry into export markets, and the accompanying loss of employment occasioned by the exit of firms from the industry (Black, 1993:220).

These costs appear to be particularly relevant for the automotive industry in the Eastern Cape, where, as the findings in Section 5.3.2 indicate, tariff reduction and the liberalisation of imports have caused component manufacturers not only to shed jobs but also to face reduced profitability. The dominant trade union in the industry, the National Union of Metalworkers of South Africa (NUMSA), has been at the forefront in criticising the MIDP on the grounds that it exacerbates unemployment; NUMSA sees tariff policy as just one leg of an overall strategy to achieve efficiency and economies of scale, and argues that it should not be used as a means in itself (Kgobe, 1998; see also Hirsch and Hanival, 1998:39).

Whereas import liberalisation has resulted in a somewhat strong export response, especially for motor vehicle assembly, as the results of the survey in Chapter 5 suggest, there are also

indications that many firms in the components sub-sector have been adversely affected by trade liberalisation.

As seen in Section 2.3.3, the more heterodox or revisionist perspective puts forward a strong case for government intervention to be selective in nature, motivating investment in capability development. Moreover, as noted in Section 2.4, it is argued that the role of the state should largely focus on specific policies aimed at influencing innovation, diffusion and enhancement of technological capabilities (Wright, 1995:15). However, the results of the survey, noted in Section 5.3, suggest that liberalisation has not encouraged research and development (R&D) or technology transfer, with any technological effort largely going into the minor modification of parts to suit local environmental conditions. Technology transfer has occurred primarily through licencing (and its accompanying royalty payments).

While revisionists do not dismiss out of hand the notion of export oriented industrialisation, they argue that this should be largely limited to the provision of a framework for the acquisition of technology, innovation and human resource development. It is encouraging to note that South Africa has realised the importance of technology and has put in place a host of initiatives, such as the National Research and Technology Foresight Programme, Innovation Fund, the Support Programme for Industrial Innovation (SPII) and the Technology and human Resources for Industry Programme[20] (THRIP), all aimed at the formulation of a coherent technology policy. It remains to be seen, however, whether these efforts will impact positively on the manufacturing sector as a whole, and the automotive industry in particular.[21]

6.3 Which way forward for the automotive industry?

[20] One of THRIP's notable achievements to date, which is relevant to the automotive industry, has been the development by the University of Stellenbosch, in conjunction with Port Elizabeth based component manufacturer Gemtec, of a Volkswagen inlet manifold for export to China (Financial Mail, 1 October 1999).

[21] For a detailed discussion on these and other initiatives by the South African government in this regard, see Hirsch and Hanival (1998: 45-60).

The automotive industry in the Eastern Cape, and by extension nationally, is currently in a precarious position. Many ideas have been mooted in an attempt to suggest ways of ensuring the survival of an industry which is the mainstay of economic activity in the Province and whose contribution to national motor vehicle output is substantial.

As noted in Section 3.6, the country has reduced its tariffs beyond the levels required by the World Trade Organisation (WTO). It must be pointed out that a return to the previous high levels of protection and local content requirements as well as other policy reversals are out of the question. Any move in this direction aimed at alleviating the declining fortunes of the sector is likely to send conflicting signals not only to the established vehicle assemblers and component manufacturers, but also to potential new entrants into the industry. Given that the majority of players in the industry have based their investment decisions on the MIDP as it currently stands, any radical policy shift could well see a wave of disinvestment which, for the Eastern Cape, would be simply catastrophic.

It also seems clear that a secure future for the automotive industry lies in rapidly boosting high volume exports. In the Eastern Cape Province, motor vehicle assemblers have achieved a measure of success in this regard, with two out of three firms having definite and substantial export orders in place, largely due to the fact that they are now well integrated into their parent companies' global networks. At the moment, the same cannot be said for the component manufacturers, however, for as seen in Figure 5.14, the general trend seems to be loss of profitability due to increased competition from imports, a situation which is likely to continue in the short to medium term before the sector's trade deficit narrows (IDC, 1998:24.15).

Nonetheless, it is worth noting that the dominant association in the sector, the National Association of Automobile Component and Allied Manufacturers (NAACAM), has taken the initiative to promote its member firms' products overseas actively in an attempt to secure export agreements, as well as the facilitation of market access, technology transfer,

joint ventures and financing, among other things. This is being done jointly with the Department of Trade and Industry and is scheduled to take off in late 1999. It will be interesting to see what results emerge from this endeavour.

Another alternative for the automotive industry is rationalisation and a subsequent thrust into export markets, which would entail the cessation of low volume model production in favour of high volume model platforms. As seen in Section 4.3, in 1998, the Eastern Cape-based motor vehicle assemblers between them had eight different model platforms produced locally. The internationally acknowledged benchmark for minimum efficient scale ranges from 200 000-250 000 units per manufacturer annually, spread over at most two models (Black, 1994:31). Since this is a measure which no South African assembler comes close to, it stands to reason that rationalisation is not altogether an unreasonable course of action. Model proliferation is still abundant, and has in fact worsened with the introduction of the MIDP.

While rationalisation appears inevitable for the industry's survival, there is still debate on how it should be carried out. Simply allowing uneconomic operations to close down is not considered a viable option, especially in the Eastern Cape, where the level of unemployment is very high. As seen in Section 3.6, the MIDP Mid-Term Review suggests a system of incentives for motor vehicle manufacturers achieving a minimum number of units per platform, and penalties for firms which do not comply with this number. This appears to be a more feasible option than letting firms shut down. It is gratifying to note that some of the Eastern Cape-based manufacturers have made headway in this regard, by rationalising the number of model platforms in order to concentrate on high volume production of fewer model variants.[22]

[22]Volkswagen of South Africa (VWSA), for instance, is in the process of phasing out the Golf and Jetta III Series in favour of a production line wholly dedicated to the production of the new Golf and Jetta IV range, both for the domestic market and export.

Labour stability is another aspect that needs to be assured if South Africa is to remain an attractive destination for foreign direct investment (FDI) in the automotive industry. A study into the future of the automotive industry in South Africa observes that the underlying causes of labour unrest witnessed in the industry, especially in the recent past, revolve around wages, working conditions, employee benefits, retrenchment and to a lesser extent participation in policy making and implementation (Cartoday, 1998f). While it is accepted that labour has legitimate concerns, especially with regard to job losses accompanying reduced tariff protection and the failure of the MIDP to meet most of its stated objectives, the time has come for the traditionally adversarial management-labour relationship to be discarded in favour of constructive dialogue. This is essential if the industry hopes to attract increased FDI and persuade already established players not to abandon the country for other manufacturing destinations.

There appears to be a fair degree of negative sentiment regarding the future viability of the automotive industry both in the Eastern Cape Province and nationally, especially in light of the perception that the MIDP has not met its intended objectives, and the spectre of further reduced incentives once the Mid-Term Review is formally promulgated. The onus therefore lies on all the stakeholders in the industry to come together and facilitate the enabling environment which will be necessary to ensure the survival of motor vehicle assembly and component production into the next millennium.

APPENDIX 1: LIST OF MOTOR VEHICLE ASSEMBLY AND COMPONENT FIRMS SURVEYED

Assembly Firms

DaimlerChrysler South Africa (DCSA) (Pty) Ltd

Delta Motor Corporation (Pty) Ltd

Component Firms

Alloy Wheels International (SA) (Pty) Ltd

Armstrong Hydraulics (SA) (Pty) Ltd

Autoplastic (Pty) Ltd

Bosal Afrika (Pty) Ltd

BTR Automotive Drivetrain Systems Ltd

Dorbyl Automotive Technologies Ltd

First National Battery Ltd

GEMTEC (Pty)

Hella (South Africa) (Pty) Ltd

Isringhausen of South Africa (Pty) Ltd

Kromberg and Schubert SA (Pty) Ltd

M&R Foundries Ltd

Payen Components SA Ltd

Precision Exhaust Systems (Pty) Ltd

SAMCOR Manufacturing (Pty) Ltd

Shatterprufe (Pty) Ltd

APPENDIX 2: QUESTIONNAIRE FOR THE MOTOR VEHICLE ASSEMBLY INDUSTRY IN THE EASTERN CAPE PROVINCE

SECTION 1 GENERAL BACKGROUND

1.1 What is your firm's annual turnover? (Please tick the closest choice)

(a) R100 million to R150 million_____

(b) R150 million to R 250 million_____

(c) 250 million to R500 million_____

(d) over R500 million_____

1.2 How many people are directly employed by your firm? (Please tick the closest choice)

(a) 1000 to 1500 personnel_____

(b) 1000 to 2000 personnel_____

(c) 2000 to 4000 personnel_____

(d) over 4000 personnel_____

SECTION 2 ECONOMIC PERFORMANCE OF SURVEYED FIRMS

2.1 On a scale of 1 (for unimportant) to 5 (for very important), what factors influence the trends in your firm's employment practices? (Please tick all that apply)

(a) Growth in domestic markets_____

(b) Stagnation in domestic markets_____

(c) Growth in exports_____

(d) Reduction of exports_____

(e) Demands by organised labour_____

(f) Change in market focus_____

2.2 What are your firm's principal export markets? (Please tick all that apply)

(a) The European Union_____

(b) SADC countries_____

(c) Rest of Africa_____

(d) North America_____

(e) Other (Please specify) _____

2.3 On a scale of 1 (for unimportant) to 5 (for very important), how would you rank the factors influencing your firm's turnover?

(a) Increased domestic market share_____

(b) Stagnating domestic market share_____

(c) Decreasing domestic market share_____

(d) Growth in exports_____

(e) Stagnating exports_____

(f) Declining exports_____

(g) Change in market focus_____

(h) Other (Please specify)_____

2.3 On a scale of 1 (for increasing), 2 (for stagnating) and 3 (for decreasing), how would you rank your firm's profitability trends in the following time periods?

(a) 1990 to 1991_____

(b) 1991 to 1992_____

(c) 1992 to 1993_____

(d) 1993 to 1994_____

(f) 1994 to 1995_____

(g) 1995 to 1996_____

(h) 1996 to 1997_____

(i) 1997 to 1998_____

2.4 What percentage of your firm's turnover is channelled towards Research and Development (R&D)?

(a) zero_____

(b) zero to 1%_____

(c) 1.0% to 2.0%_____

(d) over 2.0%_____

2.5 Labour unrest, especially in the 1990s, has been quite pronounced in the automotive industry. On a scale of 1 (for insignificant) to 5 (for very significant), how would you rate the impact of labour unrest on your firm's annual turnover and fulfilment of export orders?_____

2.6 Skills formation is regarded as an integral part of human resource development. On a scale of 1 (for minimal) to 5 (for very significant), how would you rate the commitment of your firm to the upgrading of its labour force's skills? _____

2.7 What is the level of investment expenditure undertaken by your firm in the following periods?

(a) 1990 to 1991_____

(b) 1991 to 1992_____

(c) 1992 to 1993_____

(d) 1993 to 1994_____

(e) 1994 to 1995_____

(f) 1995 to 1996_____

(g) 1996 to 1997_____

(h) 1997 to 1998_____

(i) 1998 to date_____

2.8 What is the quantity of exports of passenger cars by your firm in the time periods enumerated in Question 2.8?

SECTION 3 EFFECTS OF TRADE LIBERALISATION ON SURVEYED FIRMS

3.1 To what extent is your firm integrated into the global network of your parent company? Has this in any way resulted in an increase in exports? If so, why?

_____

_____

_____

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_____

_____

3.2 An important feature of trade liberalisation on the automotive industry, especially with the MIDP, has been the introduction of the import/export complementation system. What is your firm's main source of duty drawback certificates? (Please tick all that apply)

(a) Duty drawback certificates accrue mainly from exports of FBUs_____

(b) Duty drawback certificates accrue mainly from exports of components_____

(c) Duty drawback certificates accrue from exports of both FBUs and components___

(d) Duty drawback certificates are mainly purchased from component manufacturers__

(e) Duty drawback certificates are shared with component manufacturers_____

3.3. What is your perception of the benefits of the MIDP that have accrued to your firm, and by extension the motor vehicle assembly industry? (Please tick all that apply)

(a) It has led to increased exports_____

(b) It has resulted in increased employment_____

(c) It has ensured survival in the face of international competition_____

(d) It has forced firms to be internationally competitive_____

(e) It has resulted in technology transfer_____

3.4 Has your firm, and by extension the entire motor vehicle assembly industry sector, suffered any adverse effects owing to the introduction of the MIDP? If so, which?

(a) Model proliferation from increased importation of FBUs_____

(b) It has resulted in reduced market share_____

(c) It has resulted in reduced local content_____

(d) It has led to increased competition from imports_____

3.5 Do you have any other pertinent comments to make regarding the survey?_____

_____

_____

_____

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THANK YOU FOR HAVING TAKEN THE TIME TO FILL IN THE QUESTIONNAIRE

APPENDIX 3: QUESTIONNAIRE FOR THE COMPONENTS SECTOR IN THE EASTERN CAPE PROVINCE

1. GENERAL BACKGROUND

1.1 In what part of the Eastern Cape Province are your operations principally located?

(a) Port Elizabeth_____

(b) Uitenhage_____

(c) East London_____

(d) Other (Please specify)_____

1.2 How many manufacturing plants does your firm operate within the Eastern Cape Province?(Please tick one.)

(a) one_____

(b) 2 to 4_____

(c) 5 to 8_____

(d) over 8_____

1.3 How many personnel does your firm employ?(Please tick one)

(a) 0 to 100_____

(b) 101 to 200_____

(c) 201 to 400_____

(d) 401 to 750_____

(e) over 750_____

1.4 What is your firm's annual turnover?

(a) R0 to R20 million_____

(b) R20 million to R50 million_____

(c) R50 million to R100 million_____

(d) R100 million to R150 million_____

(e) over R250 million_____

1.5 What production processes does your firm principally engage in? (Please tick all that apply)

(a) Raw material beneficiation_____

(b) Metal forming _____

(c) Machining/tooling_____

(d) Die-casting_____

(e) Moulding_____

(f) Painting_____

(g) other (please specify)_____

1.6 Which of the following do you consider your primary market to be? (Please tick all those that apply)

(a) Domestic OEM_____

(b) Foreign OEM_____

(c) Domestic aftermarket_____

(d) Foreign aftermarket_____

(e) Domestic OEM and aftermarket_____

(f) Foreign OEM and aftermarket_____

(g) All markets_____

1.7 What is the ownership structure of your firm? (Please tick one).

(a) Wholly locally owned_____

(b) Subsidiary of local company_____

(c) Joint venture with foreign multinational corporation_____

(d) Subsidiary of foreign multinational corporation_____

SECTION 2 ECONOMIC PERFORMANCE OF SURVEYED FIRMS

2.1 On a scale of 1 (for unimportant) to 5 (for very important), what factors influence the trends in your firm's employment practices?_____

(a) Growth in domestic markets_____

(b) Stagnation in domestic markets_____

(c) Growth in exports_____

(d) Reduction of exports_____

(e) Demands by organised labour_____

(f) Change in market focus_____

2.2 What are your firm's principal export markets? (Please tick one.)

(a) The European Union_____

(b) SADC countries_____

(c) Rest of Africa_____

(d) North America_____

(e) Other (Please specify)_____

2.3 On a scale of 1 (for unimportant) to 5 (for very important), how would you rank the factors influencing your firm's turnover? (Please tick all those that apply)

(a) Increased domestic market share_____

(b) Stagnating domestic market share_____

(c) Decreasing domestic market share_____

(d) Growth in exports_____

(e) Stagnating exports_____

(f) Declining exports_____

(g) Change in market focus_____

2.4 On a scale of 1 (for increasing), 2 (for stagnating) and 3 (for decreasing), how would you rank your firm's profitability trends in the following time periods?

(a) 1990 to 1991_____

(b) 1991 to 1992_____

(c) 1992 to 1993_____

(d) 1993 to 1994_____

(e) 1994 to 1995_____

(i) 1995 to 1996_____

(ii) 1996 to 1997_____

(iii) 1997 to 1998_____

2.4 What percentage of your firm's turnover is channelled towards Research and Development (R&D)?

(a) zero_____

(b) zero to 1%_____

(c) 1.0% to 2.0%_____

(d) over 2.0%_____

2.5 Labour unrest, especially in the 1990s, has been quite pronounced in the automotive industry. On a scale of 1 (for insignificant) to 5 (for very significant), how would you rate the impact of labour unrest on your firm's annual turnover and fulfilment of export orders?_____

_____

_____

_____

2.6 Skills formation is regarded as an important part of human resource development. On a scale of 1 (for insignificant) to 5 (very significant), how would

you rate the commitment of your firm to developing skills among its labour force?_____

SECTION 3 EFFECTS OF TRADE LIBERALISATION ON SURVEYED FIRMS

3.1 An important feature of trade liberalisation on the automotive sector, especially with the MIDP has been the introduction of the import/export complementation system. How does your firm deal with the duty drawback certificates obtained from exports? (Please tick one)

(a) Certificates are sold to OEMs_____

(b) Certificates are shared with OEMs_____

(c) OEMs benefit entirely from duty drawback certificates_____

3.2. What is your perception of the benefits of the MIDP that have accrued to your firm, and by extension the components sector? (Please tick all those that apply)

(ii It has led to increased exports_____

(ii It has resulted in increased employment_____

(ii It has ensured survival in the face of international competition_____

(ii It has forced firms to be internationally competitive_____

(ii It has resulted in technology transfer_____

3.3 Has your firm, and by extension the entire components sector, suffered any adverse effects owing to the introduction of the MIDP? If so, which?

(1) Model proliferation from increased importation of FBUs_____

(2) It has resulted in reduced market share_____

(3) It has resulted in reduced local content_____

(4) It has led to increased competition from imports_____

3.4 Any other comments which you feel might be of value to the research?

_____

_____

_____

_____

_____

_____

THANK YOU FOR HAVING TAKEN THE TIME TO FILL IN THE QUESTIONNAIRE

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