POLICY BRIEF: 5/2017

The role of trade restrictions in promoting local manufacturing in South Africa's motorcycle industry

INTRODUCTION

South Africa's motorcycle industry is waning while other emerging markets are expanding their production activity, usage and trade performance, and are developing integrated value chains for motorcycles. South Africa is a net importer of motorcycles and imports have been declining for the past five years. No local manufacturing is taking place and the domestic industry relies solely on imports. The industry is small in global terms with the number of registered motorcycles at around 366 000 units as of 2015, which is less than 1% of the global share and the number of new registrations is on the decline. The number of industry participants is also dwindling as more local dealers, distributors and importers of motorcycles close down operations.

One of the main reasons is a policy change that came into effect in 2013. This introduced more stringent requirements for the importation of motorcycles, which in turn reduced the number of establishments eligible to import motorcycles. The policy change has benefited the main original equipment manufacturers (OEMs) and their authorised agents and suppliers by eliminating competition from parallel importers, which are now forced to source their motorcycle stock domestically from the OEMs and their respective authorised suppliers. This has affected the profit margins of the parallel importers and resulted in many of them closing.

This brief illustrates how, in the debate between trade protectionism versus openness in industrial development, sometimes policy changes in the form of trade restrictions in a specific industry may lead to unintended consequences. These could have an adverse effect on the domestic industry and the overall economy.

OVERVIEW OF INDUSTRY

The South African government is developing a long-term industrial development master-plan for the automotive sector with a time horizon of meeting its strategic objectives by 2035. This masterplan is meant to chart a new path for the sector by accelerating value addition in production and assembly of motor vehicles (and parts thereof). It is envisaged to include developing the motorcycle industry. The motorcycle industry will be part of this process through upgrading the industry from being entirely import driven to include local and regional manufacturing capacity.

The idea is to gradually move up the global value chain of motorcycle production by increasing the domestic value addition activities from importing Completely Built Units (CBUs) to Semi-Knocked Down and ultimately importing mostly Completely Knocked Down units, with countries in the region potentially playing an increasing role in the production. However, it is yet to be determined whether this will be geared mainly towards meeting local demand or focused on a regional export-led industrial initiative.

The demand for motorcycles in South Africa is decreasing at an alarming rate. In 2015 sales were lower than in 2009 during the global financial crisis. However, after the crisis of 2009 sales recovered and increased by 26.3% before the current shrinking trend commenced in 2013. Motorcycles are the most common type of motor vehicles in many countries around the world – especially in Asia and other African countries.

In some regions, motorcycles are crucial to national economies. This is because a high proportion of such economies are organised around this means of transportation. This is not the case in South Africa. Only 3.4% of the motor vehicles on South Africa's roads are motorcycles.

TRADE & INDUSTRIAL POLICY STRATEGIES

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> ***A crucial lesson in implementing local content policies is that the targets must be realistic and based on plausible economic assumptions.***

Most motor vehicles in South Africa are passenger vehicles, which comprise 65% of the total vehicles registered in the country. This is way beyond the African continent's average of 43%.

For a variety of reasons, motorcycles are not a popular means of transport in South Africa. Therefore the development of local manufacturing of motor-cycles for import replacement purposes would require a strategy to increase local demand for motorcycles to motivate developing a manufacturing base in South Africa. There may, however, be a case to be made to establish it as an export industry based on the significant demand across the African continent.

South Africa's automotive sector is one of the most protected and supported sectors in the country. The motivation is to promote the local manufacturing taking place. However, the motorcycle industry is a relatively open market in terms of tariff protection. Most of the country's motorcycles imports are set at a zero-tariff rates, in particular, motorcycles at the low-end of the market in terms of value (0-250cc engine capacity motorcycles). The more sophisticated motorcycles (with 250cc-800cc and >800cc engine capacity) on the higher end of the spectrum are subject to an average tariff rate of 6.9%. Low levels of protection for the industry are to be expected, bearing in mind no motorcycle manufacturing takes place in South Africa. However, trade restrictions in place in the form of non-tariff barriers (NTBs)[1] have an impact on motorcycles imports.

PARALLEL IMPORTS

South Africa introduced a policy[2], which came into effect in 2013, that resulted in many parallel importers selling discounted motorcycles closing their businesses. Parallel importers offer customers the same motorcycle model as the official distributor working directly with an OEM, at a discounted price. The policy change required that special testing be undertaken and that certificates be linked to the import of the motorcycle or parts. Effectively the policy meant that only franchise importers would be allowed to import motorcycles, leaving the parallel importers either to go out of business or source their stock domestically from the franchise importers.

The danger of having parallel importers is that they often do not invest in the secondary market and import numerous different models which are difficult to support and service. There may also be safety issues as the parallel importers have less of a compliance burden. Working with established companies requires a significant investment on their part in creating job opportunities in the infrastructure of the industry and in servicing of the vehicles. It also offers consumers some protection. The state therefore sees limiting grey imports as desirable. As explained below, there are downsides to this approach, as parallel imports allow for cheaper products to be sold as the importers do not need to factor in the costs of the support infrastructure. There are also lower barriers to entry in the parallel importer market, allowing smaller players to enter as retailers.

ENSAfrica (2013) explains how the parallel import (also known as grey goods) market operates: "a foreign manufacturing company will normally appoint an authorised distributor for its product in South Africa. That distributor is then responsible for sales of the product, after-sales service and, of course, marketing, advertising and all other additional services that go into brand-building. A parallel importer is someone who buys that same manufacturer's product in another country and imports it into South Africa for resale. The reason why the parallel importer bothers to do this is because the product is often so much cheaper abroad that the parallel importer can undercut the authorised distributor and still make a profit."

Therefore there is a conflict between the authorised distributor and the parallel importer, as the parallel imports threaten the authorised distributor's business. ENSAfrica also argues that the OEMs generally prefer not to do business with parallel importers – because not only do they have to deal with complaints from disgruntled authorised distributors, but they also have no control over how the parallel importers handle the brand.

The policy has therefore been regarded as an intervention implemented to protect the businesses of OEMs and the authorised distributors. The debate does not, however, consider the development of a local motorcycle manufacturing industry.

[1]An NTB is a form of restrictive trade in which barriers to trade are set up and take a form other than a tariff. NTBs include quotas, embargoes, sanctions, levies and other restrictions and are frequently used by large and developed economies.

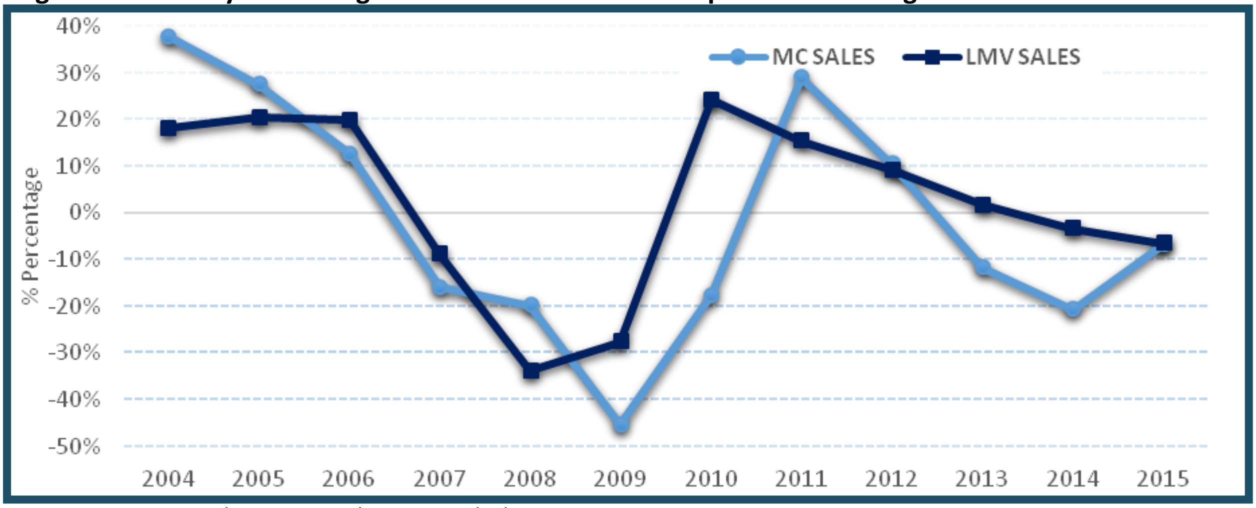
[2]Compulsory Specification for Motor Vehicles of Category L: http://www.nrcs.org.za/siteimgs/vc/L%20Category%20Comp.%20Spec%20(as%20Gaz).pdf%20(VC9098).pdf

What has become clear is that the policy has not only reduced competition from parallel importers but has also led to the decline in the demand for motorcycles imported by the OEMs and their authorised distributors. The introduction of this policy also took place during a period in which the value of the rand declined, making all imports more expensive. Compared to light motor vehicle sales, which are also on a downward trend, motorcycle sales plummeted in the three years to the end of 2015 (Figure 1).

The trend structure of the South African motorcycle industry has changed substantially over time and appears to be cyclical. After 2009, South African imports of motorcycles increased over three consecutive years before they started to decline again (Figure 2). South Africa is a net importer of motorcycles and that has been the case throughout the observed period. In global terms South Africa is a minor player in motorcycle trade and production/ assembly. In both imports and exports South Africa contributes below 1% of the global share of motorcycle trade. Globally South Africa ranks 33rd in imports and 27th in exports of motorcycles.

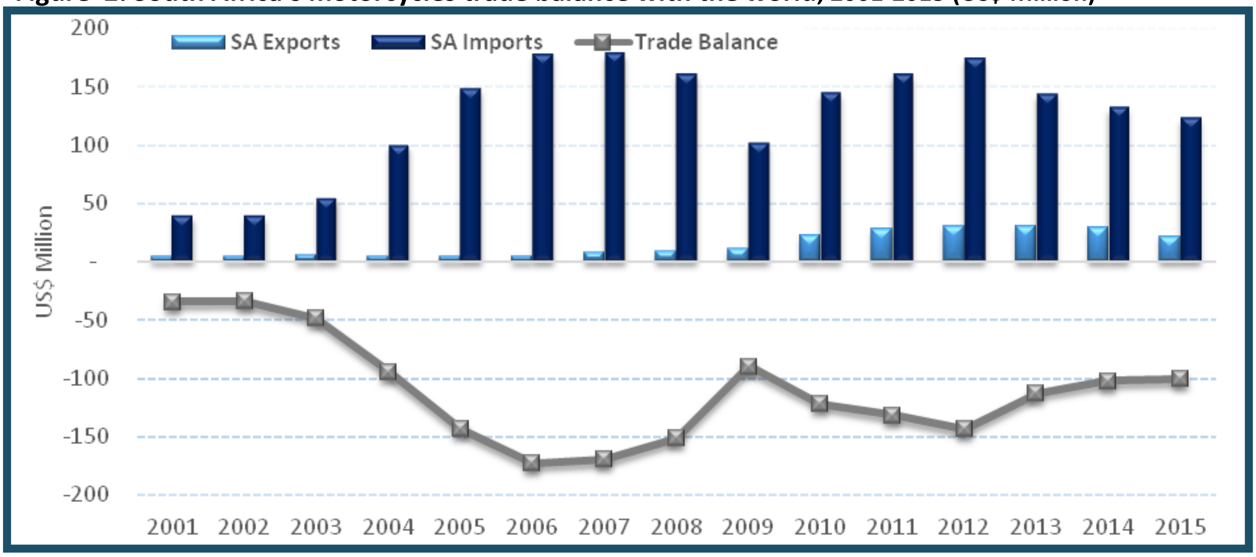
Since 2013, all imported motorcycles are categorised as ‘new’ motorcycle imports that are shipped in predominantly as CBUs and not as ‘used or parallel’ imports. The extended trade deficit in motorcycles over the years is indicative of a domestic market that is heavily reliant on imports to meet the current domestic demand and possibly re-exports. The country’s leading trading partners are Germany (in value terms) and China in terms of volume of units. From China, South Africa sources the low-end motorcycles at an average unit value of US$421 (R5,787)[3] per motorcycle compared to the high-end imports from Germany valued at an average price of US$8,241 (R113,292) a motorcycle. Since 2011 South Africa’s imports from China have decreased by 7% whereas imports from Germany have increased by 10%.

Figure 1: Motorcycles and light motor vehicles sales comparison: annual growth rates 2004-2015*



Note: MC – Motorcycles; LMV – Light Motor Vehicles.
Source: National Association of Automobile Manufacturers of South Africa (NAAMSA), Association of Motorcycle Importers & Distributors in South Africa (AMID) and own calculations (2016).
**In 2015 there were a total of 399 562 units of LMVs sold compared to 293 907 units in 2004. There were 30 154 units of MCs sold in 2004 and 22 103 units sold in 2015.*

Figure 2: South Africa’s motorcycles trade balance with the world, 2001-2015 (US$ Million)



Source: ITC calculations based on UN Comtrade statistics, 2016 (Trade Map, www.trademap.org/Index.aspx)

The introduction of these trade restrictions have therefore served to dampen the market and have not created a stimulus for local manufacturing.

It could be argued that with the change in policy, imports from China declined because there were fewer parallel importers which traded mostly in low-end motorcycles from China; and the increase in Germany's imports in value could be attributed to increased market share, demand and/or prices of motorcycles of a particular brand from that market.

The introduction of these trade restrictions has therefore served to dampen the market and has not created a stimulus for local manufacturing. Considering this issue with an industrial policy lens would require an alignment between the policy change and the development of this nascent industry aimed at introducing local manufacturing of motorcycles in the country by protecting OEMs and their authorised suppliers. Over time this would allow them to build internal capacity and upgrade their domestic activities within the industry's global value chain from being only a distribution channel in the country to a more sophisticated production and assembly operation, such as the light motor vehicle market. However, the evidence in this brief reveals a gap in alignment as the industry has seen no local manufacturing introduced by the main players since 2013; rather their sales have dropped and the motorcycle industry has struggled in the past five years.

CONCLUSION

Prior to the introduction of the new technical specifications, the industry showed potential, with increasing demand for low-end motorcycles. The result of these new requirements without the concomitant support for domestic manufacturing has led to weakening an industry with considerable growth potential.

South Africa has illustrated over the decades its capability and capacity to manufacture and assemble advanced automotive products. Given the government support and private investment that has been mobilised around the automotive sector, developing a productive motorcycle industry would not be impossible. The evidence indicates that the policy change far from promoting the growth of the motorcycle industry led to a fall in trade, sales and even job losses in the domestic industry.[4]

The automotive masterplan under development will require policymakers to engage rigorously with all industry stakeholders to develop a comprehensive package of policy interventions that should consider building a manufacturing base for the industry that leads to increasing demand and trade of motorcycles for South Africa and the region.

[3]*Based on R/$ Exchange Rate - $1 = R13.75 on 04.08.2016.*

[4]*TIPS conducted interviews with a number of firms and associations in the industry that related numerous examples of importers and dealerships which have closed down in the past five years.*

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