

***“Trade and Investment:  
Mapping the Terrain for key areas of focus”***



**Presentation to the Southern Africa Trust  
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Emerging Market Focus  
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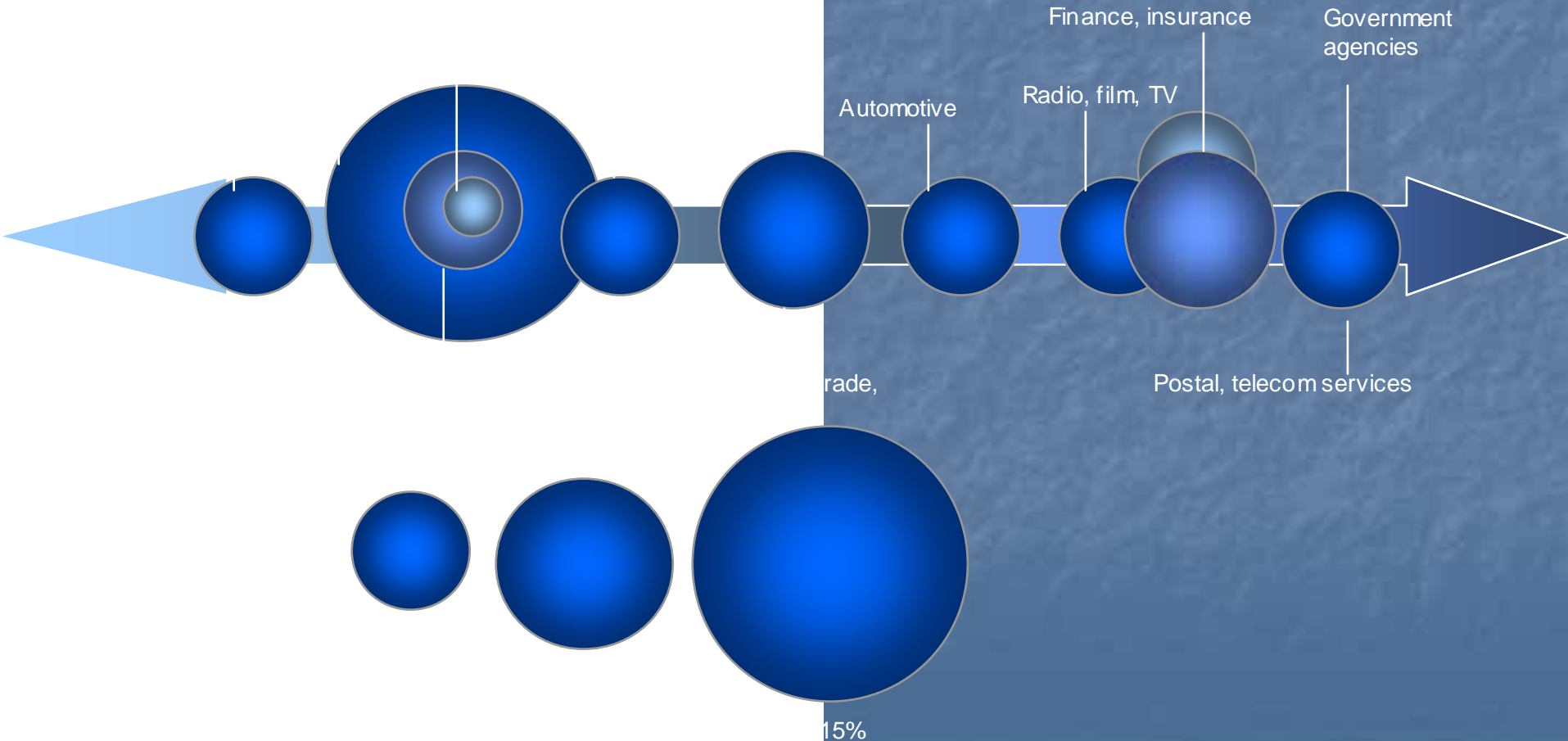
# Executive Summary

- ✓ China's marketizing economy
- ✓ A state-driven industry
- ✓ Barriers to market entry
- ✓ Import profile
- ✓ Export profile
- ✓ Outlook for the sector

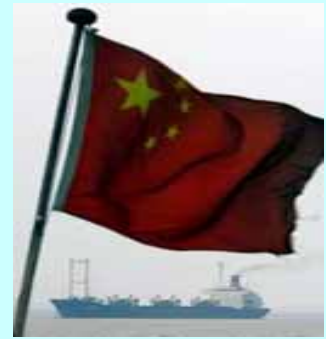
# China's "Marketizing" Economy

## Government controlled

- Closed to foreign investment
- Limited/no competition
- High state involvement



# A State-Driven Industry



- **China's steel industry is considered a strategic sector by the PRC Government. Current discussions over iron ore pricing reflect this**
- **China's stainless steel production capacity was insignificant during the 1990s as import-supplied demand for SS grew. By 2000, China consumed 1.8Mt of SS while only producing 480,000t.**
- **A Government financed drive for self-sufficiency was a focus of the Tenth Five Year Plan (2000-2005), as investment pushed capacity to 4.7Mt/a by 2005**
- **National SS champions include TISCO and Baosteel. These two firms manufacture 42% of stainless steel in China.**
- **CISA reports that China had 1637 stainless steel enterprises in 2005**

# Barriers to Market Entry

- **Increasing difficulty for exporters to gain market traction due to rising competition from domestic players**
- **Some importers have complained as to the lack of transparency in policy directions and customs procedures when exporting to China**
- **A large number of int. SS firms have chosen to hedge against this uncertainty by investing in operations in China**
- **Professional consulting firms are most often used to obtain the necessary Licenses for trading & distribution**

# Import Profile

- **Import of 2-3Mt/a of SS per annum since 2000. Previously, CR Flats but now HR Flats, Long and Pipe products.**
- **SS exporters will increasingly be challenges to export to china due to its move up the manufacturing value chain and ability to satisfy its own demand needs.**
- **Looking forward, China will still rely on imports to cover stainless steels with special finishes, high-end niche products**



# Export Profile

- **SS exports are mainly in hollow, kitchenware and flatware - 68% of total export value in 2004. In 2000 the figure was 84%**
- **The rapid increase in the export of flat rolled products, tubes and seamless pipes accounted for the rise in exports from 10.7% in 2000 to 23% in 2004**
- **Main export destinations include the US, Germany, HK, Japan and the UK. Other destinations are relatively minor but growing**
- **Between 2000- 2004, South Africa's share of SS imports from China rose from 4-10%**
- **South Africa's imports of SS supplied by China accounts for just 0.6% of the value of China's SS exports to this country**

# Outlook for the SS Sector in China

- High levels of fixed asset investment in infrastructure - consumes 50% of SS production. Albeit slowing, strong growth will continue
- Manufacturing growth in the automotive and consumer product sectors will also drive demand at 10%+ per annum
- However, supply will outstrip demand come 2008 / 9
- By 2010, 3.3Mt/a more melt shop capacity -total manufacturing capacity of 8.15 Mt
- President of TISCO estimates that total SS production capacity may reach 16.3Mt / a by 2010
- Question of Beijing's ability to constrain over-investment in the provinces ....

# RECOMMENDATIONS

## Threats from a cross cutting perspective

- The Chinese economic system is in transition from a communist to a social market economy with pockets of the economy that are “marketised” but a mixture of market conditions and state intervention apply in many others;
- The state (central, provincial and local) participates in capital formation, manipulation of input costs and directs bank financing;
- Preferential interest and tax rates, subsidies contingent on exports and favourable financing of target industries apply;
- The Chinese government officials intervene in the economy in a way inconsistent with market principles;

# RECOMMENDATIONS CONT.

- Subsidies are non-transparent;
- Investment practices lead to the creation of unsustainable and surplus capacity;
- Pricing is non-transparent and divorced from market discipline because of interventions and support;
- China is obliged to do away with trade related investment measures but that progress seems to be slow;
- The undervalued Chinese currency contributes considerably to competitiveness in international markets.
- The Chinese economy is 9 times South Africa's and its population 28 times that entails a huge difference in capacity to trade in China's favour.

# RECOMMENDATIONS CONT.

- These cross cutting threats are such that it is recommended that the negotiation of a bi-lateral FTA or PTA with China is resisted at least until such time as the Chinese economy becomes fully marketised; it fully complies with WTO conventions; and a market determined exchange rate has replaced China's presently undervalued currency.

# RECOMMENDATIONS CONT

- **Threats arising from aspects specific to the Chinese and South African stainless steel sectors:**
- China embarked on an aggressive self sufficiency drive in stainless steel production that raised production from about 0.5Mt by the end of the nineties to 3.2Mt in 2005 and the predicted potential for 2010 to 8.1Mt (it could even be 16 Mt). South Africa's capacity is stagnant around 600 000 Mt.
- There is an apparent inability at the centre of Chinese government to calm down run away capacity expansion;
- China's import gap is set to narrow and it is to become a net exporter in many intermediate stainless steel products;
- Tariff rates on primary and intermediate stainless steel products are rather low on the Chinese and South African sides rendering the need for tariff concessions somewhat superfluous;
- South Africa's downstream stainless steel industries are under attack of Chinese competitive advantages in these products,

# RECOMMENDATIONS CONT.

- China is rapidly making inroads in the South African market for downstream stainless steel products rendering the high(er) South African tariffs essential as a last ditch resistance in safeguarding local producers in the absence of alternative trade remedies;
- South Africa stands to lose out in the Chinese market from its present positive trade position;
- South Africa is threatened by marginalisation in the markets of third countries because of increasing Chinese competition;
- **The above threats render any tariff concessions on stainless steel products to China as dangerous and it is recommended that no bi-lateral concessions on stainless steel products should be contemplated in favour of China.**

# RECOMMENDATIONS CONT

- **Opportunities from a cross cutting perspective**
- Opportunities of a cross cutting nature are to be found in the sustained high growth in the economy of China that makes that country a prominent modern day creator of wealth. South Africa shares in the prosperity that is generated by the Chinese economy and should devise means to continue to do so.
- **Opportunities arising from aspects specific to the Chinese and South African stainless steel sectors.**
- High growth in China's stainless steel demand demonstrates that opportunities may arise despite, or as a consequence, of China's self sufficiency drive;
- Trade in stainless steel products between South Africa and China is increasing at present with the balance in favour of South Africa;
- South Africa could decide to request tariff concessions from China even at the present comparatively low applied rates. It is recommended that such a request for tariff concessions should be compiled in close liaison with existing and/or potential exporters.

# RECOMMENDATIONS CONT

## **Guidance on opportunities to be exploited**

- The Chinese market should be entered in partnership with Chinese counterparts. Apart from many other reasons to facilitate entry into the Chinese market, partnerships of this nature help in dealing with the bureaucracy and with NTB's. Such partnerships are usually in the form of a JV and in many instances are accompanied by investment in China as opposed to pure import/export operations.

## **Opportunities offered with or without a PTA/FTA**

- Opportunities to be exploited with or without a FTA are limited. Growing trade shows that opportunities are being exploited in the trade in intermediate products (but that are to become more difficult because of the rapid development of the Chinese stainless steel industry. Potential downstream opportunities are limited to catalytic converters and exhaust systems.
- Viewed from the import side the picture is quite different. Aggressive exporting by China and a propensity to import on the South African side could result in deep Chinese import penetration with little regard to the current or any future South African import tariffs.

# RECOMMENDATIONS CONT.

## **What is needed to take advantage of them?**

- Catalytic converters and exhaust systems are both competitive as the result of the MIDP. According to the MIDP, automotive exports by China to South Africa may open up avenues for Chinese imports of automotive components from South Africa.
- It is important to note that little stainless steel downstream products are exported if not linked to a special dispensation like the MIDP or favourable personal tax benefits as in the case of ocean going tank containers. The message is that some supply side or demand pull scheme or a combination of both is needed for opportunities to arise in downstream stainless steel manufacture and export.

# RECOMMENDATIONS CONT.

## Issues that may complicate trade negotiations

The trade negotiations can be expected to be complicated by:

- The threats of a cross cutting and from a sector perspective.
- Lack of clarity on the outcomes of the NAMA that introduces a degree of uncertainty with respect to future MNF tariff levels that may render bi-lateral concessions pre-mature.
- South Africa's limited range of stainless steel export products especially down stream products. As opposed to this, China will be able to propose a wide range of products carrying high South African tariffs in any request for concessions on its part.. Glaring asymmetry is therefore present in the export potential of the two countries.

# RECOMMENDATIONS CONT.

## **Possible negotiation strategies that China negotiators may employ,**

- It would be logical for China to seek concessions on down stream products in view of its broad industrial strategy. (However, should negotiations on a trade agreement happen only in two or three years time, China by then could have won a place to its satisfaction in the South African market that relegate the priority of stainless steel products, if any, in its quest for concessions from South Africa.)

## **Possible negotiation strategies that SACU negotiators should consider.**

- The threats overshadow the limited South African opportunities to such an extent that the benefits of a trade agreement are so marginal as opposed to the potential disadvantages that the negotiation of an agreement inclusive of stainless steel should be resisted. The granting of concessions by China without any demands from South Africa because of the overwhelming asymmetry in trade potential between the two countries could possibly be entertained.



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