

THE IMPACT OF LOCAL CONTENT POLICIES ON SOUTH AFRICA

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the dtic

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Trade, Industry and Competition
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TIPS FORUM 2021

RECONSTRUCTION AND RECOVERY: RETHINKING INCLUSIVE INDUSTRIALISATION IN RESPONSE TO COVID-19

Introduction

- South Africa has relied on localisation policies since the 1990s to achieve multiple objectives
- The findings from international and domestic sector-based case studies reach mixed outcomes about localisation policies, especially about the longer-term effects
- Main purpose of this study:
 - Collate the views and experiences of EU investors in South Africa
 - Contribute towards a greater understanding of the benefits and costs in South Africa
 - Offer policy recommendations

Structure of the presentation

A brief overview
on localisation
policy

Lessons from
localisation
policies in SA

Policy
recommendations



A brief overview on the localisation policy in SA

Making economic sense of common problems

An overview of South Africa's localisation landscape

	Policy/Programme	Incentives	Target industries
Laws & regulations	NIPP	Government procurement access	All industries for procurement >\$10 million
	DIPP	Government procurement access	Defence-related procurement
	PPPFA	Government procurement access	Designated manufacturing & services products
	REIP4	Tender criteria points under Economic Development	IRP renewable energy
	Mining Charter	Points contribution towards Local Procurement	Mining goods (excluding non-discretionary expenditure) and services
	B-BBEE	B-BBEE scorecard points	Embedded across all SA sectors
Incentive programme	APDP	Production incentive for tax breaks, subsidies, government loans, etc.	Automotive sector
Voluntary programmes	Proudly SA	Branding schemes	Various sectors
	Supplier Development Programmes	B-BBEE scorecard points	Various sectors
Source: Author's analysis based on government documents			

The pre-conditions for effective implementation of LCRs

Factors	Characteristics
Market size and reliability	<ul style="list-style-type: none"> • The level of domestic market demand • The degree of predictability and long-term stability of the demand, for example, through target setting and political signals
Policy design and coherence	<ul style="list-style-type: none"> • The clarity and transparency of the rules and regulations pertaining to the LCRs, including definition and implementation procedures • The extent to which LCRs are aligned with and accompanied by complementary industrial policies supporting local manufacturing in the targeted sectors
Restrictiveness	<ul style="list-style-type: none"> • The level or percentage of locally produced content required under the LCRs
Industrial base	<ul style="list-style-type: none"> • The level of technological capabilities in the local supply base, including technical skills, specialisation, and the production capacity of domestic firms

The PPPFA allows the DTIC, in consultation with National Treasury, to designate sectors

$$\text{Local content} = \left(1 - \frac{\text{Imported local content}}{\text{Tender price, excluding VAT}}\right) * 100$$

- The PPPFA is employed to stimulate local demand and scale efficiencies, and achieve secondary objectives
- Close to 100 products have been designated and assigned minimum local content thresholds
- The Office of the Chief Procurement Officer (OCPO) issues an instruction note detailing the processes
- Bidders can apply for an exemption from the LCRs, on a case-by-case basis
- Verification is not mandatory, and can be requested by the procuring agent

Current list of designated sectors, though this can be expanded

Industry/sector/sub-sector	Min LC %	Industry/sector/sub-sector	Min LC %	Industry/sector/sub-sector	Min LC %	Industry/sector/sub-sector	Min LC %
Steel Value-added Products:	100%	Rail Signalling:	65%	Pumps, Medium Voltage (MV) Motor and Associated Accessories:	70%	Air insulated MV Switchgear	50%
Fabricated Structural Steel	100%	Components	40% – 100%	Casting or Frame Fabrication	100%	Instrument Transformers	15%
Joining/Connecting Components	100%	Rail Permanent Way:	90%	Fabrication and winding of the Rotor Core	100%	Busbars	5%
Frames	100%	Rails and rail joints	100%	Accessories	100%	Housing	25%
Roof and Cladding	100%	Ballasts	100%	Assembly and testing of the fully built unit	100%	Switching Devices	5%
Fasteners	100%	Ballastless	100%	Transformers and Shunt Reactors:		Solar PV Components:	
Wire Products	100%	Turnouts/switches and crossings	100%	Class 0	90%	Laminated PV Modules	15%
Ducting and Structural pipework	100%	Railway sleepers:	100%	Class 1	70%	Module Frame	65%
Gutters, downpipes & lauders	100%	Rail fastening and accessories	100%	Class 2	70%	DC Combiner Boxes	65%
Steel Value-added Products	100%	Railway maintenance of way plant & equipment	70%	Class 3	45%	Mounting Structure	90%
Plates	100%	Assembly and testing of fully build units	100%	Class 4	10%	Inverter	40%
Sheets	100%	Bulk Material Handling	85%	Components and conversion activities	50% – 100%	Solar Water Heater Components	70%
Galvanised and Colour Coated Coils	100%	Conveyer Idlers	70%	Two Way Radio Terminals and Associated Equipment:		Industrial lead Acid Batteries	50%
Wire Rod and Drawn Wire	100%	Structural Steel	100%	Portable Radio	60%	Plastic Pipes	100%
Sections	100%	Rubber	100%	Mobile Radio	60%	Polyvinyl chloride (PVC) pipes	100%
Reinforcing bars	100%	Conveyor Belt	100%	Repeater	60%	High density polyethylene (HDPE) pipes	100%
Steel Power Pylons,	100%	Pulleys	60%	Components	20% – 100%	Polypropylene (PP) pipes	100%
Monopole Pylons,	100%	Fire Fighting Vehicle	30%	Set Top Boxes (STB)	30%	Glass reinforced plastic (GRP) pipes	100%
Steel Substation Structures,	100%	Crew Cabin	100%	Residential Electricity Meter:		Pharmaceutical Products:	
Powerline Hardware,	100%	Super Structure	100%	Prepaid Electricity Meters	70%	OSD Tender	70% (volumes)
Street Light Steel Poles,	100%	Assembly	100%	Post Paid Electricity Meters	70%	Family Planning Tender	50% value
Steel Lattice Towers	100%	Working Vessels/Boats (All types):	60%	SMART Meters	50%	Furniture Products:	
Electrical and telecom cables	90%	Components	10% – 100%	Wheely Bins	100%	Office Furniture	85%
Buses (Bus Body)	80%	Conveyance Pipes	80% – 100%	Textile, Clothing, Leather and Footwear	100%	School Furniture	100%
Rail Rolling Stock	65%	Valves products and actuators	70%	Canned / Processed Vegetables	80%	Base and Mattress	90%

Source: List of designated industries, sectors, and sub-sectors for local production (Department of Trade, Industry and Commerce, 2020)

Products also are identified as key components under REIP4

The REIP4 applies a different approach to local content determination

$$\text{Local content} = \frac{\text{Value of local content spend}}{\text{Total project value spend}}$$

- The % of the total project value that represents products and services that have been sourced locally.
- Projects are evaluated using a 70/30 weighting, with local content effectively 8% in the total project value

Non-price Element	Minimum threshold	Maximum target	Weight	Effective %
Job creation	12% - 15%	20% - 80%	25%	8%
Local content	25% - 45%	65%	25%	8%
Ownership	B-BBEE: 12% Local community: 2.5%	B-BBEE: 30% Local community: 5%	15%	5%
Management Control	0%	40%	5%	2%
Preferential procurement	0%	B-BBEE: 60% QSE & EME: 10% Women-owned: 5%	10%	3%
Enterprise development	0%	0.6%	5%	2%
Socio-economic development	1%	1.5%	15%	5%
			100%	30%

LCRs differ by technology type, and have increased with each successive window

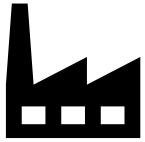
Technology	BW 1		BW 2		BW 3		BW 4	
	Min	Target	Min	Target	Min	Target	Min	Target
Solar PV	35%	50%	35%	60%	45%	65%	45%	65%
Solar CSP	35%	50%	35%	60%	45%	65%	45%	65%
Onshore wind	25%	45%	25%	60%	40%	65%	40%	65%
Biomass	25%	45%	25%	60%	40%	65%	40%	65%
Biogas	25%	45%	25%	60%	40%	65%	40%	65%
Landfill Gas	25%	45%	25%	60%	40%	65%	40%	65%
Small Hydro	25%	45%	25%	60%	40%	65%	40%	65%

Bid Window 4 identified key components that *could* be localised

Technology	Component	Technology	Component
Concentrated Solar Power (CSP)	Solar concentrators and mounting	Onshore Wind	Meteorological mast
	Heat receiver		Turbine tower
	Heat transfer fluid and handling system		Turbine nacelle (including interior fittings, exterior fittings and drive train)
	Electrical generation system (including generator, steam turbine and ancillary equipment)		Blade
	Condenser and cooling system	Small Hydro	Turbines
	Thermal storage system		Generators
	Distributed control system		Hydro-mechanical plant (penstock and steel gates)
Solar PV	Pumps, motors and auxiliary steam cycle equipment	Biomass	Boilers
	Water treatment plant		Fuel storage and handling system (including conveyors)
	Solar modules		Electrical generation system (including generator, steam turbine and ancillary equipment)
	Mounting frames		Water treatment plant
	Inverters		Gas Engine/turbine and generator
Landfill Gas	Transformers	Biogas	Digester tanks
	Control and Tracking control for tracker frames		Flare
	Gas Engine and generator		
	Gas wells and piping		
	Flare		

Lessons from localisation policies in SA

Firms identified several benefits



Increased investment through setting up assembly and manufacturing plants, as well as complementary investment upstream



Skills development and training, especially for technical skills such as engineering and design



Adoption and adaptation of foreign-based technology



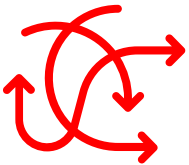
EU firms are leveraging their position in South Africa to enter the Sub-Saharan market, and increase exports

However, the gains from localisation have been undermined by several constraints

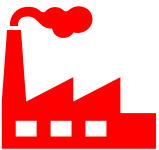
PPPFA



Decline in public sector infrastructure investment



Unclear processes and procedures related to exemptions & verification processes



LCRs are not reflective of SA's industrial base, with limited competitive steel and plastic inputs



Weak complementary policies e.g. SEZs

REIPPPP

Unstable demand due to contractual and auction delays: last auction was 2014, before the RMIPPPP

Flexible approach to REIP4 creates confusion and ambiguity, rather than making the process less complex

Firms unable to meet LCRs & an erosion of capabilities between 2013 & 2015

Non-price criteria complicates procurement and investment decisions

The PPPFA shows mixed outcomes on the cost of products

EU firms	Cost Change	Explanation	Pricing response
Assembler (1)	Increase by 3% to 4%	The cost difference between importing parts and sourcing local parts for assembly	Fully passed onto the customer
Assembler (2)	Decreased (no % assigned)	Importing components is cheaper than importing fully built product	Absorbed by the company to offset other costs of doing business
Manufacturer	Increase by 10%	Includes the high cost of local raw materials	Absorbed by the company given the industry's price competitiveness
OEM, subsidiary	Decreased by 30%	Manufacturing standard OEM parts have become cheaper over time compared to developed countries	Fully passed onto the customer to be competitive
OEM parent company	Increase by 60%	There are limited capabilities in SA to manufacture specialised equipment	Fully passed onto the customer

- Two companies experienced a reduction in cost of production after localization due to (i) long-term investments in developing local capabilities and (ii) import protection.

Through the REIP4, LCRs have generally led to an increase in the cost of production...and prices

EU firms	Cost Change	Explanation	Pricing response
Developer	Increase by 25% - 30%	Not due to LCRs, but retaining international experts for longer. LCR-related cost may be 10%	Partially passed onto the IPP
O&M	None	No LCR at the operations phase	N/A
EPC (1)	Increase by 15% to 20%	High cost of sourcing local parts, components, equipment, and machinery	Fully passed on to the IPP
EPC (2)	Increase by 15% to 20%	Compliance costs related to BEE and Economic Development, including sourcing from local suppliers	Absorbs the cost
OEM	Increase by 40%	High cost of sourcing local goods and services, and lack of price competition	Limited cost pass through due to competitive bidding process
Service Provider	Increase by 10%	High cost of doing business in SA, which includes setting up, BEE compliance and LCRs	Developing cost structure that passes on the costs to the OEM
Tier 1 (1)	Increase by 18% to 40%	High cost of sourcing local parts and components	Partially passed onto the OEM
Tier 1 (2)	Increase by 25%	Opportunity cost of failing to implement REIP4, including auction delays	Absorbed by the company

Key recommendations

Key recommendations

1. More evidence is needed, including detailed cost/benefit analysis and feasibility studies, prior to the extension and expansion of localisation policies
2. Limit designations to sectors and products where there is strong and stable government demand and a proven, but untapped supply of competitive local inputs
3. A regional agreement on government procurement or a common approach to local content, at least within SACU, should be considered, to prevent a race to the bottom
4. The interaction between local content regulations and other policies (e.g. B-BBEE) deserves further exploration
5. Open and constructive dialogue between the public and private sector is needed in the design and implementation of LCRs



The end.

Thank you for listening !

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