September 2021

WEBINAR SUMMARY
LOCALISATION POLICY OPTIONS

LEARNING FROM PARTNERS AND INVESTORS

INTRODUCTION

As part of the South African Government's Economic Reconstruction and Development Plan, Nedlac partners have agreed to work collectively to reduce the country's non-oil import bill by 20% over the next five years (the "Localisation Initiative")[1]. On 4 August 2021, the EU Chamber of Commerce, and Industry in Southern Africa (EU Chamber) and Business Unity South Africa (BUSA) co-hosted an online business seminar on localisation policy. The seminar brought together recent research on the impact of localisation and import substitution policies from South Africa and internationally.

These studies indicate that localisation policies can have mixed outcomes. Whereas effective local policy regulations can contribute towards increased investment, production, and jobs in some sectors; this can come at the cost of increased prices and a longer-term loss in competitiveness. There is also some concern that poorly constructed local content policies may contravene South Africa's international trade law obligations. Further engagement is needed between domestic and foreign-owned businesses in South Africa to understand the challenges with the implementation of the current policy framework, and to ensure that future policies account for the size and structure of South Africa's industrial base.

1 See Department of Trade Industry and Competition Policy Statement on Localisation for Jobs and Industrial Growth (2021). Accessed on: http://www.thedtic.gov.za/wp-content/uploads/Policy_Statement.pdf

AUSTRIAN BUSINESS CHAMBER · BELGIAN CHAMBER OF COMMERCE for SOUTHERN AFRICA · BUSA BUSINESS UNITY SOUTH AFRICA · BUSINESS IRELAND JOHANNESBURG · EU CHAMBER OF COMMERCE AND INDUSTRY IN SOUTHERN AFRICA · FRENCH SOUTH AFRICAN CHAMBER OF COMMERCE AND INDUSTRY · NSBA Nordic-South African Business Association Growing Relationships. Stimulating Business. · SAPCC SOUTH AFRICAN PORTUGUESE CHAMBER OF COMMERCE · SPANISH CHAMBER OF COMMERCE IN SOUTH AFRICA · SwissCham

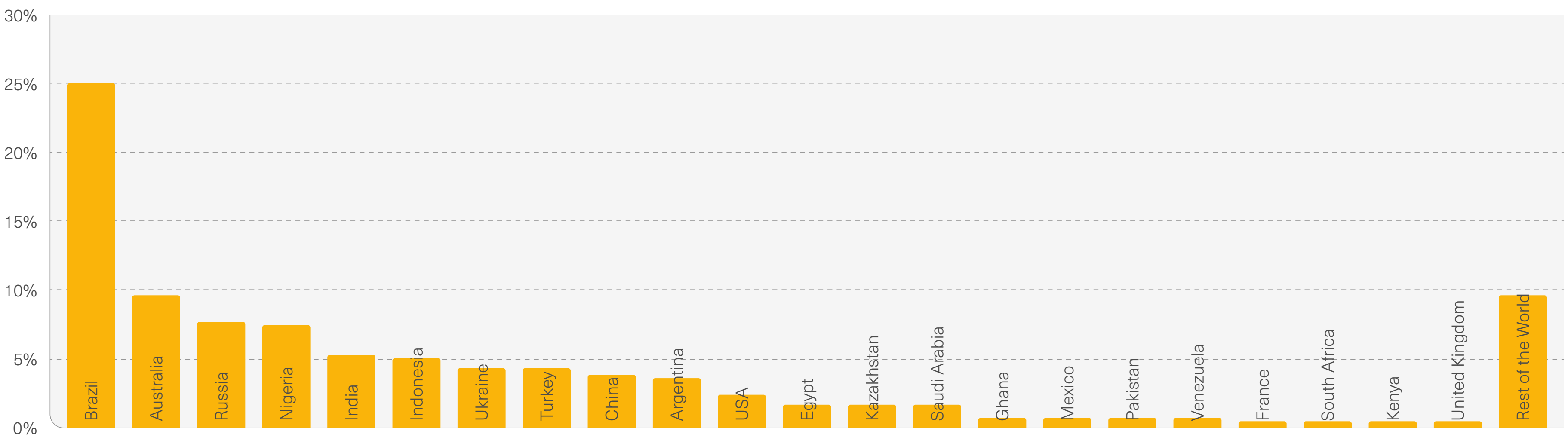
BACKGROUND

Local content measures and regulations are *"policies imposed by governments that require firms to use domestically manufactured goods or domestically supplied services in order to operate in an economy"* (OECD)[2]. Internationally, localisation policies and programmes have been widely used and applied with varying intensity in different economic sectors. Figure 1 shows the share of local content measures currently implemented by various countries as a proportion of the world total. According to Global Trade Alert, Brazil is the most prominent user of local content measures, accounting for more than 25% of globally implemented LCR's, followed by Australia. South Africa accounts for a small but significant share of the total; though this data excludes all existing sector designations under the Preferential Procurement Policy Framework.

Since the 1990s, South Africa has relied on local content policies as part of its industrial policy toolkit. Currently, the Preferential Procurement Policy Framework (PPPFA) (2017), through which most state procurement takes place, adopts a sectoral approach towards local content. The PPPFA was employed to stimulate local demand and scale efficiencies (and achieve secondary benefits) and has resulted in close to 100 products being designated and assigned minimum content thresholds by the Department of Trade, Industry and Competition (DTIC), in consultation with the National Treasury.

The Renewable Energy Independent Power Producer Programme (REIPPP) is an exception to the PPPFA and outlines distinct minimum local content thresholds for different renewable energy technologies. The REIPPP applies a different approach in determining local content and measures the percentage (%) of the total value that represents locally sourced products and services. REIPPP projects are evaluated using a 70 / 30 weighting between price and non – price elements with local content requirements accounting for 8% of the total project value. The minimum percentage of local content targeted though this Programme has increased with each successive window.

Figure 1: Share of globally implemented local content measures by country (%) (2021)



Source: DNA Economics analysis of Global Trade Alert[3] data

2 See OECD, Local content requirements

3 The Global Trade Alert database collates information on state interventions taken since November 2008 that are likely to affect foreign commerce. This includes data on local content measures that are currently in force across the world (see: www.globaltradealert.org).

KEY FINDINGS FROM SOUTH AFRICA AND INTERNATIONAL STUDIES

The key results and learnings from the different local and international studies are presented below.

Intellidex study[4]

The study adopted both a qualitative and quantitative approach – including a literature review, a modelling exercise, and a survey of BLSA and BUSA member firms. In doing so, the study seeks to understand the role and impact of localisation in South Africa, identify products that can meet the desired imported substitution thresholds and solicit views from private businesses on the use of LCRs. Table 2 sets out the main findings from the different components of the study.

Table 1: Findings from Intellidex study

From the literature review:	From the quantitative study (modelling review):	From the survey of businesses:
• There is increasing interconnectedness between B-BBEE and localisation. • There are concerns that South Africa is at risk of throttling investments – with possible concerns over the REIPPP. • There are concerns regarding the completeness and clarity of localisation policy.	• Products with a high probability of meeting target: paper, wood, motor vehicles, ceramic products, glass, basic iron and steel, and food and beverages sectors. • Products with a mixed probability of meeting target: metal products and chemicals. • Products with a low probability of meeting target: printing and publishing, textiles, clothing, footwear, rubber and machinery and electronic equipment sectors. • Local content policy needs to reflect an understanding of the capacity and competitiveness of these different sectors and their ability to respond.	• Business does not favour existing localisation policies however there is willingness and interest in localisation under the right conditions. • There are concerns over the DTIC's knowledge and understanding about the ability/capacity of specific sectors to localise. • Capacity onshore, and price, are the top-ranked blockages for companies in buying more onshore, with policy certainty and energy security problems also stifling outcomes. These constraints can result in price increases for domestically sourced inputs (see figure 3 overleaf) • Despite these concerns, goods-producing companies can undertake substitution of 12.6% of imports "right away" under the right conditions, increasing to 32.3% of imports substituted after five years. • Service-producing companies see possible substitution of 5.5% of imported inputs under the right conditions, rising slowly to 11.6% after five years.

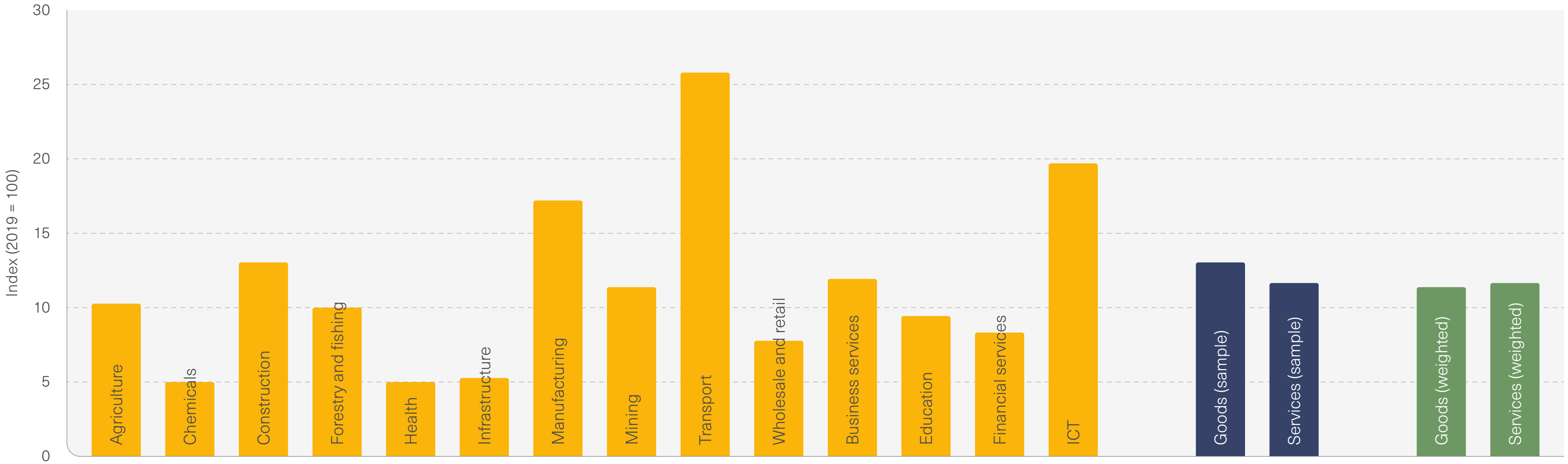
Products with a high probability of meeting a 20% local content target

Motor vehicles | Paper | Wood | Glass | Food and beverages | Basic iron and steel

4 Available from: www.hub.blsa.org.za/economicpolicy/localisation-report/

Figure 3 below shows the perceived impacts on input prices across both goods and service producing companies due to existing localisation requirements. Transport experienced the highest increase in input prices, of 26%, with chemicals and health the lowest, at 5%.

Figure 3: Impact of existing rules on input prices (%)



Source: Intellidex business survey

DNA Economics Study[5]

The study presents lessons on the impact of local content policies in South Africa, based on the experience of a limited number of European investors. It distinguishes between the impact of the PPPFA and the REIPPP. The main benefits and constraints relating to the implementation of these two programmes are summarized in Table 3.

Table 3: Benefits and constraints to localisation in South Africa

Benefits from localisation:	Constraints (under the PPPFA):	Constraints (under the REIPPP):
• Increased investment through setting up assembly and manufacturing plants, as well as complementary upstream investment. • 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.	• A lack of steady and sustainable demand as a result of the decline in public sector infrastructure investment. • Unclear processes and procedures related to exemptions and verification processes. • LCRs do not account for the structure of SA's industrial base, and especially, the availability and competitiveness of critical steel and plastic inputs. • Weak complementary policies (e.g., SEZs) and overlapping transformation policies (e.g., B-BBEE).	• Unstable demand due to contractual and auction delays: last auction (before the RMIPPPP) was in 2014. • Flexible approach to REIP4 creates confusion and ambiguity, rather than making the process less complex. • Firms have been unable to meet existing LCRs, yet targets have been increased despite the loss of domestic capabilities (e.g., wind towers) between 2013 and 2015. • Non-price criteria complicate procurement and investment decisions. • LCRs have generally led to an increase in the cost of production, and in this case, likely contribute to higher electricity prices.

5 Available from: www.euchamber.co.za/wp-content/uploads/2020/10/Local-Content-Report-Final-October-2020.pdf

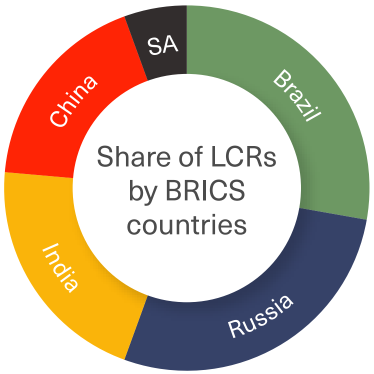
Herbert, Smith and Freehills Study

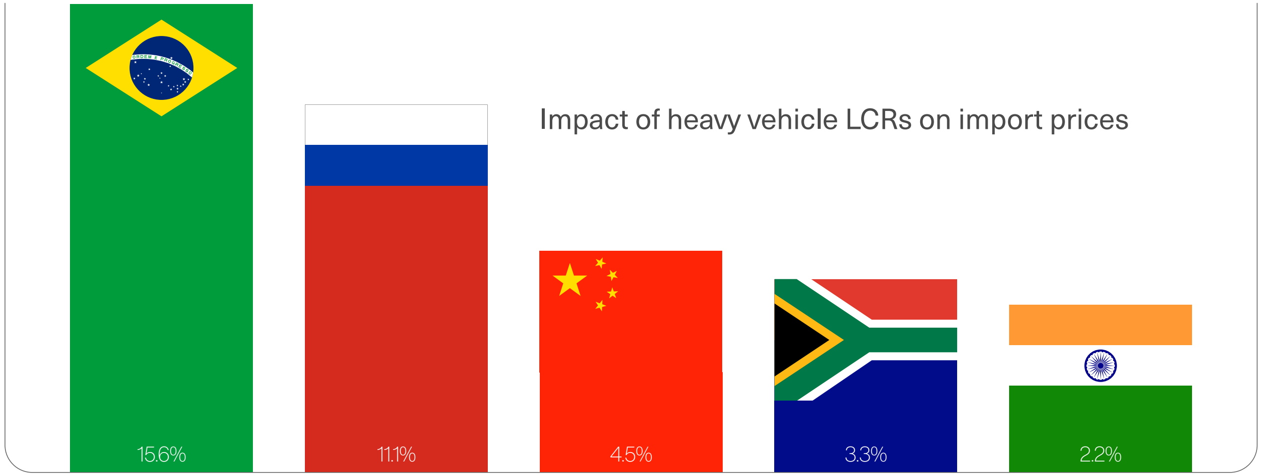
This study highlights that depending on the formulation and implementation of South Africa's proposed localisation policies, there is a risk that these measures may contravene South Africa's international trade law obligations. In particular, there is some concern that in order to give effect to the proposed policies, the DTIC may rely upon measures which seek to shelter local industries by reducing reliance upon, and competition from, imports. In this regard, to the extent that the DTIC (or Government) creates barriers to cross-border trade in goods and services by employing domestic content requirements or restrictions on imports, this may result in a contravention of the World Trade Organisation's (WTO) General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), or the Agreement on Trade Related Investment Measures (TRIMs). The SADC-EU EPA and the African Continental Free Trade Area (AfCFTA) Agreement also set out non-discriminatory obligations. This may make South Africa vulnerable to international or regional dispute resolution proceedings.

ECIPE Study[6]

The ECIPE study estimates the economic impact of LCRs in the heavy-duty vehicles' subsector. ECIPE collected information on LCRs from Brazil, Russia, India, China, and South Africa (the BRICS countries), and classified them by three different dimensions: their different types, their scope, and their level of impact. This database was then used to undertake economic analysis for the BRICS countries. The key findings from this study are as follows:

- 72 different LCRs are identified: Brazil and Russia with 20 measures; India 15; China 13 and South Africa 4.
- Most LCRs are related to government procurement, financial support, and business operations, as well as to export measures.
- LCRs that are related to financial support and business operations have generally a high impact.
- Brazil and Russia apply the most distortive LCRs for heavy vehicle, resulting in an estimated increase in their import price of 15.6% and 11.1% in these countries respectively.
- LCRs in China and South Africa result in import price increases of 4.5% and 3.3% respectively, while those in India are least distortive, raising prices by 2.2%.
- The identified LCRs are estimated to restrict imports of heavy vehicles by -21% and -12% in Brazil and Russia, compared to India, China, and South Africa, where the reduction in imports is estimated to be between -9.3% and -3.7%.
- Whilst LCRs increase output in the targeted sector, this occurs at the expense of other closely related industries which experience a decline in production.
- Careful consideration must be given to the use and growth of LCRs and their significance in respect of international trade obligations.





6 Available from: www.ecipe.org/publications/the-economic-impact-of-local-content-requirements/

Policy implications

Together, these studies raise a number of important and common issues for the design and implementation of local content regulations in South Africa. Specifically:

- Localisation should not be a fundamental policy goal in itself – rather, it should be a second-order policy which aims to support job creation.
- Sustainable localisation cannot be achieved in the absence of supporting policies, which must consider education and skills development, reliable electricity supply, the interconnectedness of export markets, immigration, and the reduction of red tape.
- The interaction and overlaps between local content regulations and other domestic polices (e.g. B-BBEE) deserves further exploration.
- Localisation must be viewed as a step-by-step process, working its way from the assembly of offshore -produced components to local licensing for OEMs, and then to pure local content production. The role of SMMEs in each step of the chain must be considered.
- More evidence is needed, including detailed cost / benefit analysis and feasibility studies, prior to the extension and expansion of localisation policies.
- Greater attention must be afforded to the tradeoffs that exist between prices, quality, and jobs. Evidence-based and predictable policies will ensure that these trade-offs are well understood by all.
- Designations should be limited to sectors and products where there is strong and stable government demand and a proven, but untapped supply of competitive local inputs.
- Government should adopt a risk-averse stance on localisation requirements that may slow or impede investment, including FDI.
- 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 e.g. firms relocating from Botswana to SA.
- Attention must be given to the potential conflicts created between LCRs and international trade law and agreements.

To address these issues, further and more detailed dialogue is needed between the public and private sector on the design and implementation of LCRs. These consultations should include all investors in South Africa, both domestic and foreign.

EU CHAMBER OF COMMERCE AND INDUSTRY IN SOUTHERN AFRICA

Published by the EU Chamber of Commerce & Industry in Southern Africa
info@euchamber.co.za