



Localisation: What is Realistic?

EU Chamber webinar

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**BUSINESS
LEADERSHIP
SOUTH AFRICA**



Competing reform paths

- Ramaphosa 'strengthened' to do what?
 - Politics, party etc
 - 'Economic reform'
 - Reform plan can be poorly formed in terms of executability
 - Eg Infrastructure Fund/ISA/IIO conflicts baked in
 - Reform path is not simple linear track....

Major debate coming through rest of year on where potential growth will be?

Positive Reforms

Tito paper
 Operation Vulindlela
 Some wider aspects of ERRP (eg Hydrogen)

- *Backing from the President*
- *Public, well understood*
- *Well researched (SARB backing)*

'Negative' Reforms

DTIC Agenda (CompComp, localisation, codification, companies act)
 Bureaucracy/centralisation (IIO etc)

- *Backing from the President*
- *Not well understood, only recently public*
- *Not well researched*



DTIC Agenda

FDI focus (deal blocking, extract concessions)

Broadly based around input coordination rather than output enabling

*Perspective issue – ‘exceptions that prove the rule’
Eg black industrialists programme*

Co-option of success stories (eg citrus)

Requests/targets to organised (local) business

Problem of ‘willing foreigners’ (/FDI – who see it as cost of doing business in SA, vs ‘unwilling locals’ (other costs already evident) can increase political tension between DTIC and local industry bodies and companies

Codification



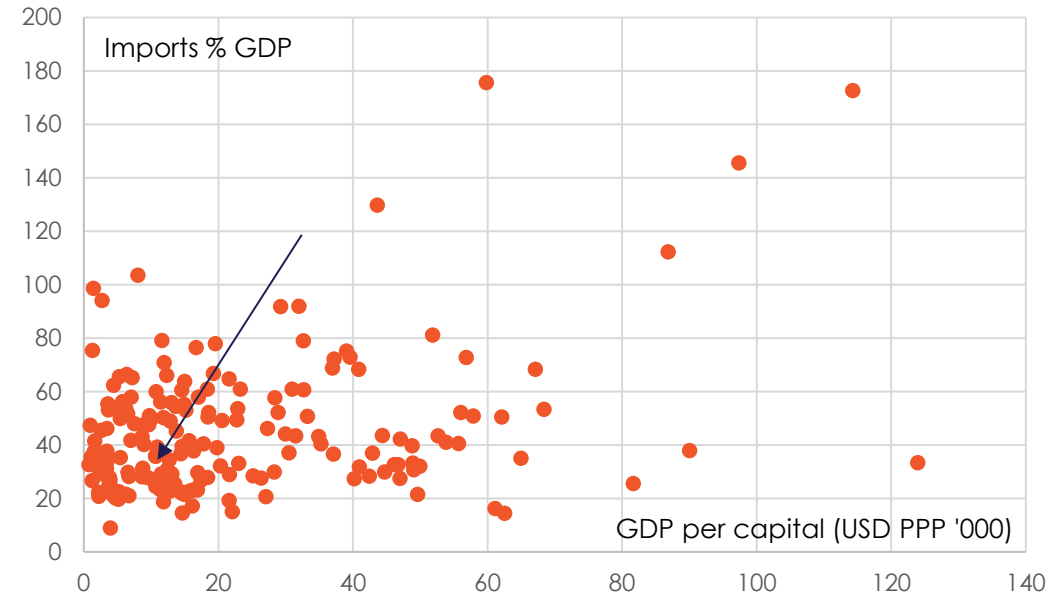
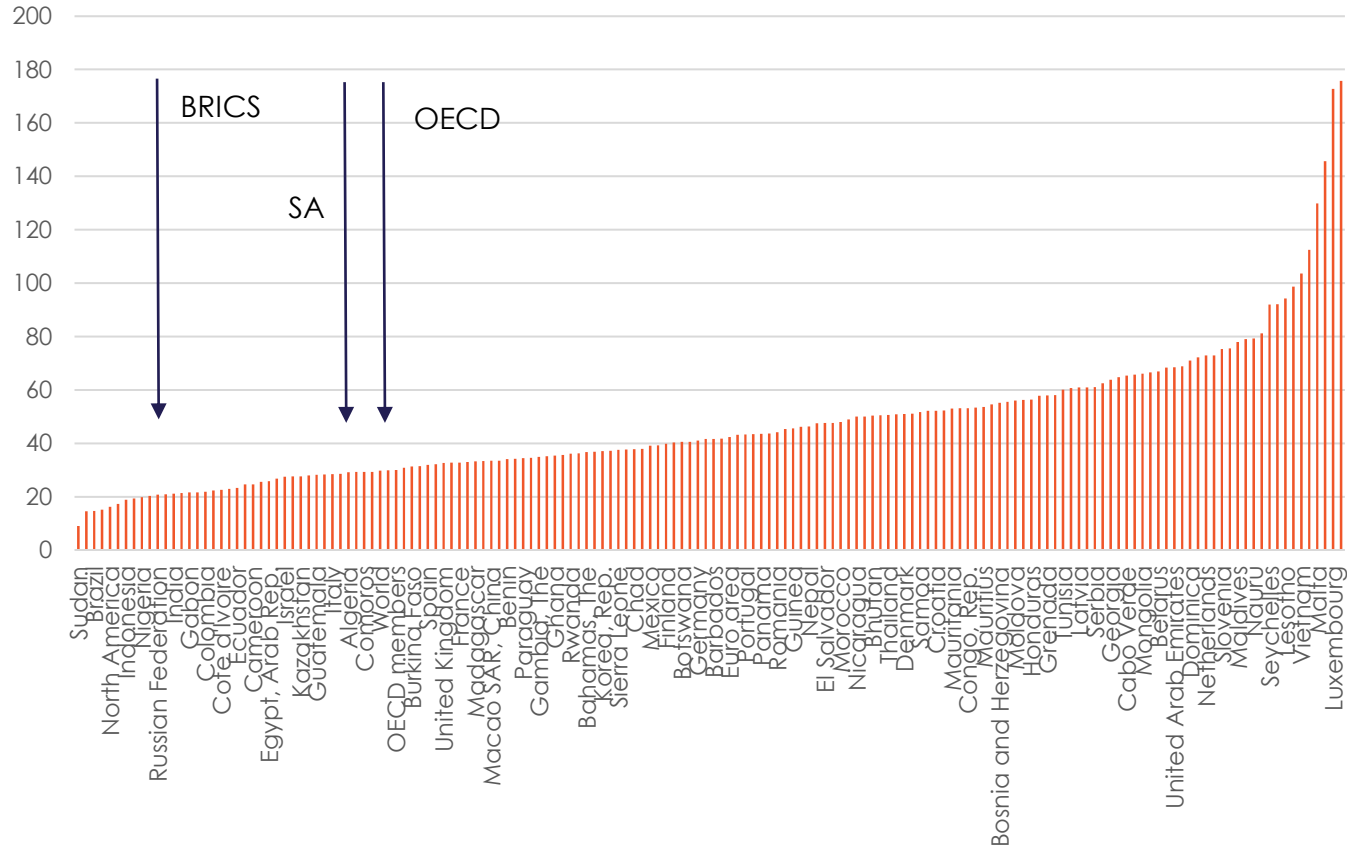
Localisation: Genesis and scope

- DTIC ask to business for 20% of non-petroleum imports to be substituted for local content over the next five years.
- No existing studies looking at macro-level, top down on localisation in South African context.
- Terms of reference:
 - What does the 20% target mean in context?
 - Is it realistic?
 - What do BUSA/BLSA members think?



Localisation in context

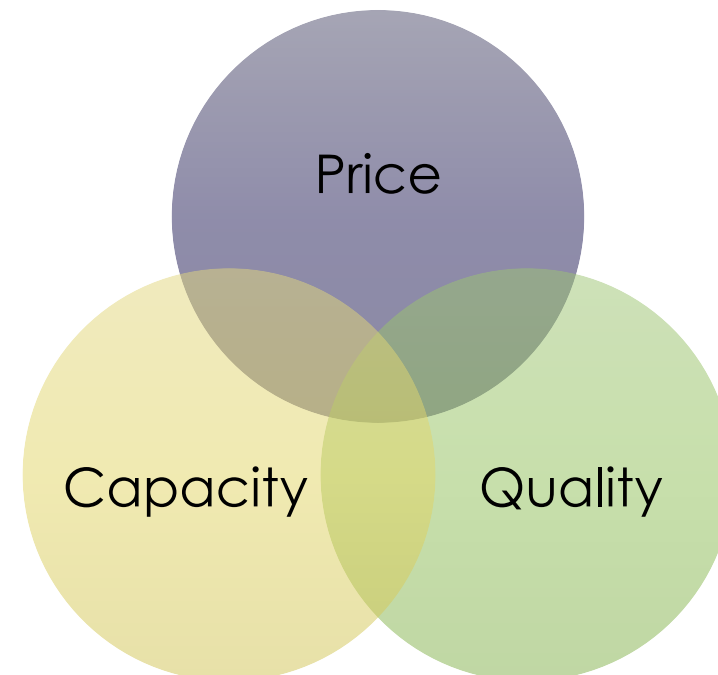
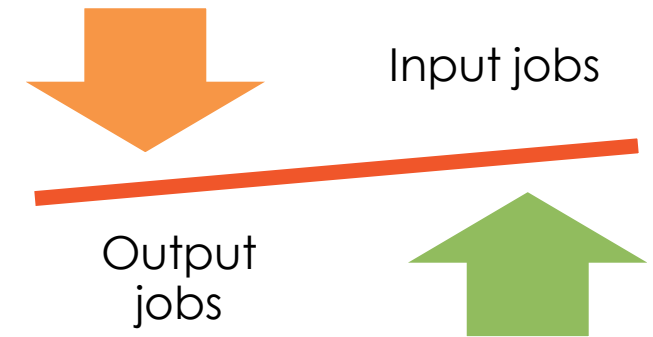
Imports (G&S) % GDP





Is localisation good?

- Nuanced issue to discuss in the political economy
- Development maximisation should be the goal – ie, jobs growth
- Localisation policy focus is on **inputs** – jobs to produce things
- Should be on **outputs** – cheaper energy, better infrastructure faster, more competitiveness, consumer choice – more jobs in the end
 - [Also what is wrong with infrastructure programme]
- Need a general equilibrium view of jobs





Literature review

- Maps industrial policy since 1994 and the increasing role localisation has played
 - Maps the distinct but increasingly interconnected nature between B-BBEE (supply chains, onshore focus) and localisation (designation etc)
- Highlights the trade offs: price, capacity and quality
- Trade offs overcome with subsidies (eg, vehicle sector) but not available currently given fiscal situation
- Success cases looked at (REIPPP, policy certainty, political support)
- Country case studies:
 - Vietnam – Export-orientation with appropriate policies works
 - Brazil – Too aggressive a stance cuts off key investment goods – didn't work
 - United States – Playing to strengths and domestic productivity is key



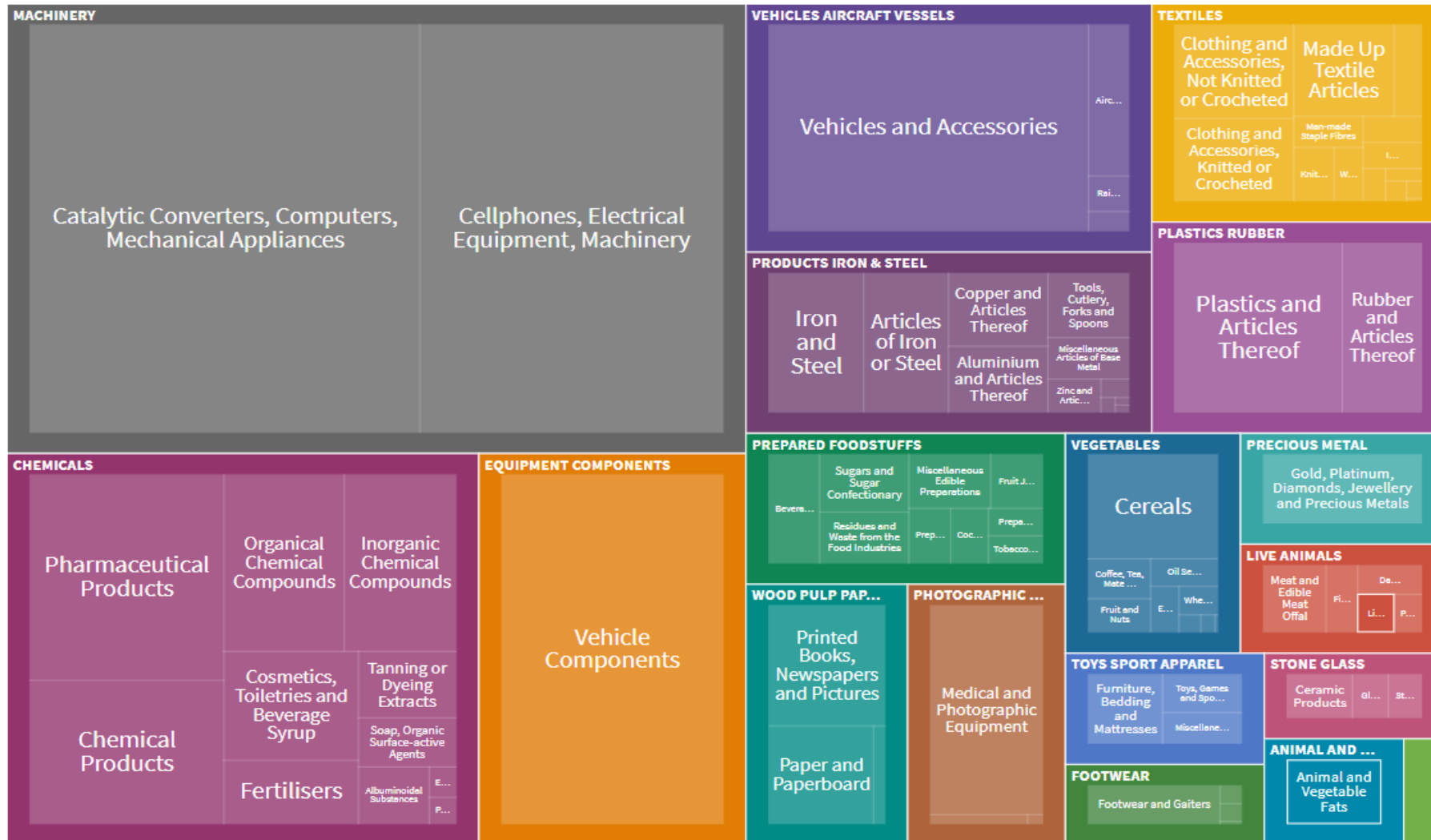
Modelling review

- Looking back at the data and trends over the past 15 years, what might be possible?
- Take average five-year pre-pandemic domestic manufacturing growth rates and apply them to current levels to see if 20% of imports can be substituted through sector expansion within the next five years.
- High probability of meeting target: paper, wood, motor vehicles, ceramic products, glass, basic iron and steel, and food and beverages sectors
- Mixed probability of meeting target: metal products and chemicals
- Low probability of meeting target: printing and publishing, textiles, clothing, footwear, rubber and machinery and electronic equipment sectors
- (Lot of nuance within categories requires sectoral organisation work)
- Interesting to overlay these sets of products with right foundational conditions
- Also to consider export pressures on these sectors that can drive competitiveness



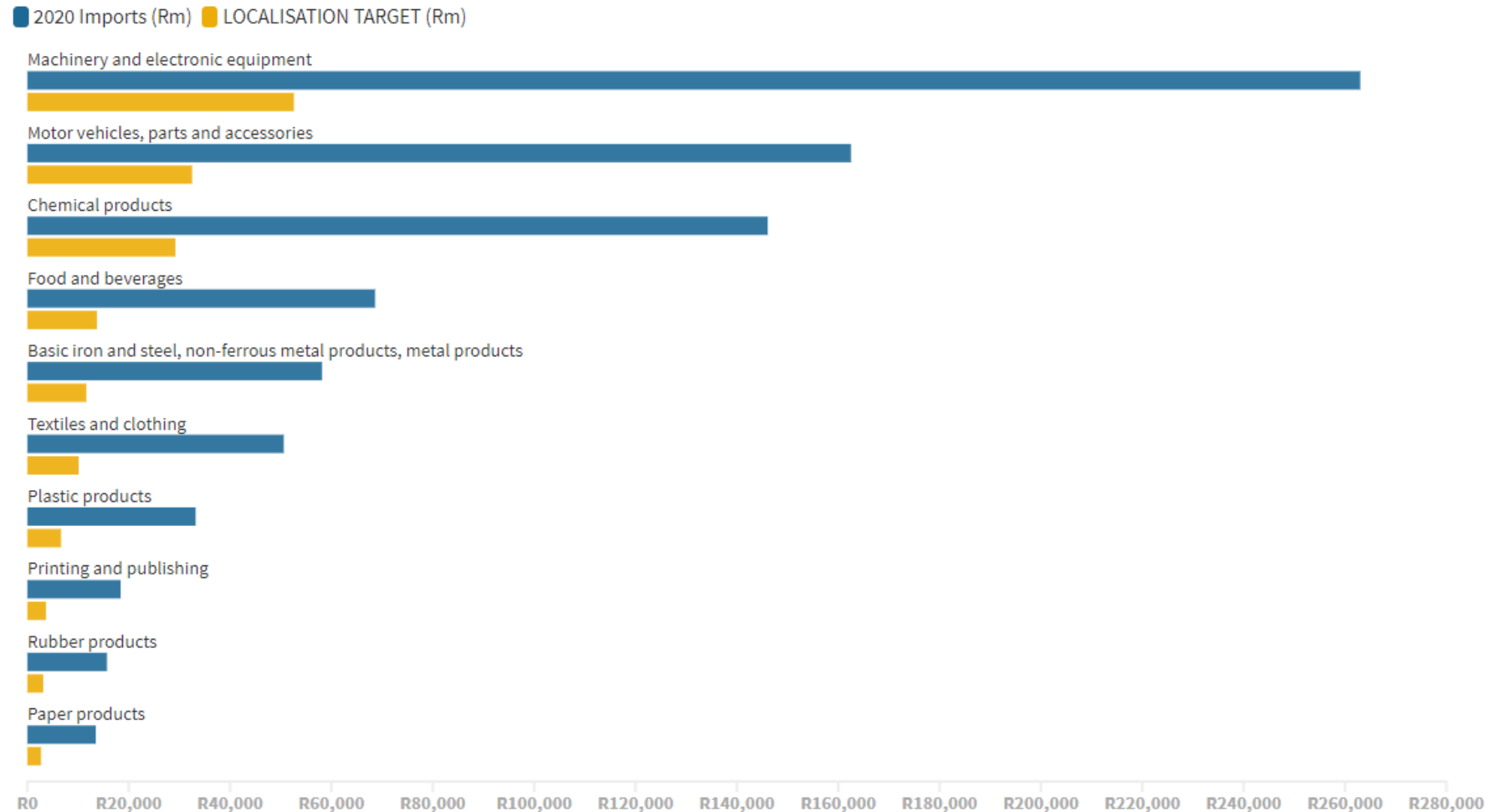
Modelling review

*Imports
(nominal)
Ex
petroleum*





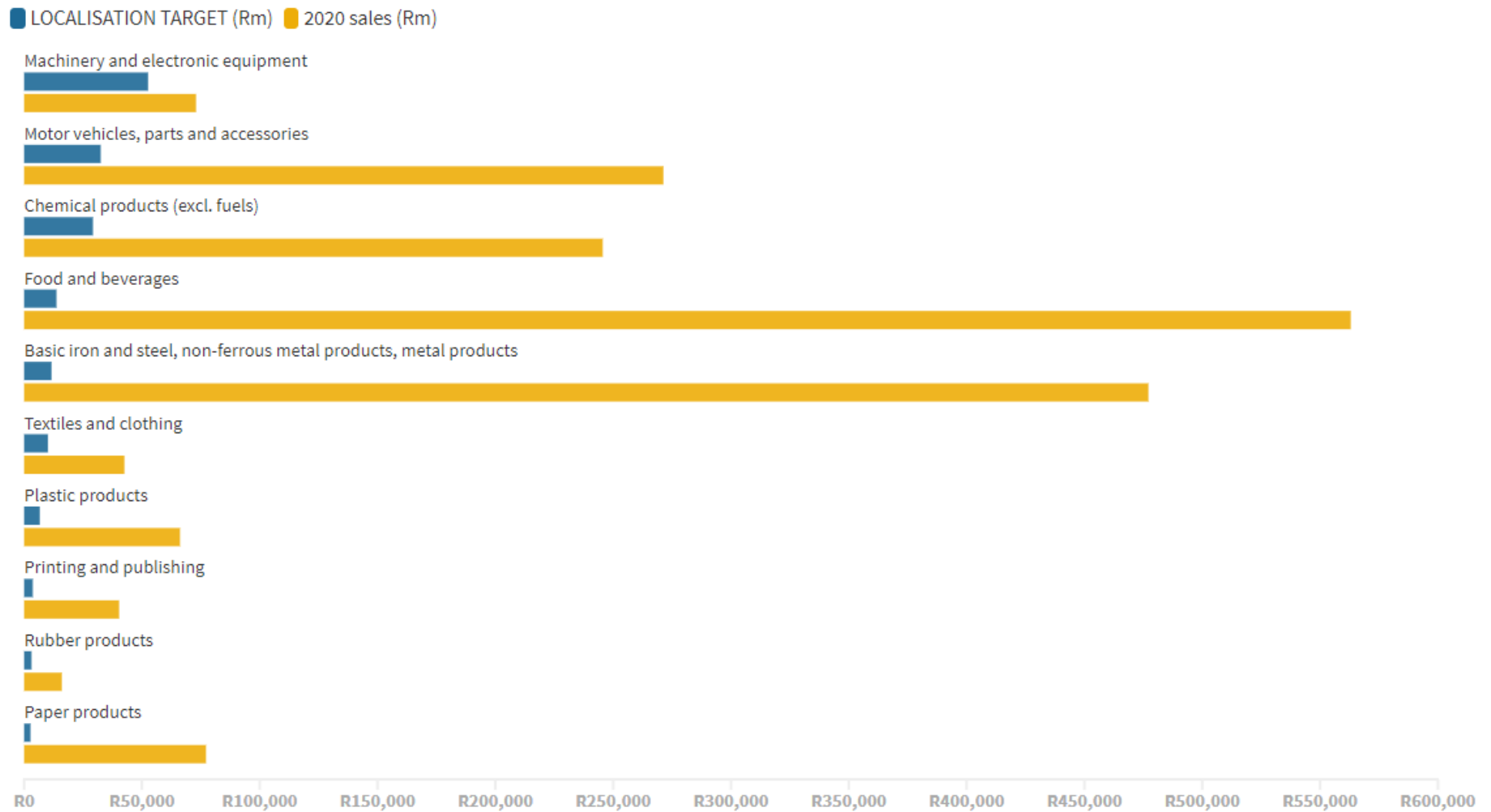
Modelling review



Imports substitution (ZARmn)



Modelling review



Imports substitution vs capacity (ZARmn)

Modelling review

Sector	2020 sector size (Rm)	Total growth required	2015-2020 annual growth
Paper products	R77 202	3.50%	2.9%
Rubber products	R16 008	19.62%	1.0%
Printing and publishing	R40 310	9.13%	-3.6%
Plastic products	R66 176	10.03%	1.8%
Textiles and clothing	R42 565	23.77%	-3.9%
Basic iron and steel, non-ferrous metal products, metal products	R477 144	2.44%	5.1%
Food and beverages (incl. agriculture)	R563 021	2.44%	12.9%
Chemical products	R245 574	11.90%	1.8%
Motor vehicles, parts and accessories	R271 287	11.98%	4.5%
Machinery and electronic equipment	R72 965	72.09%	-3.5%



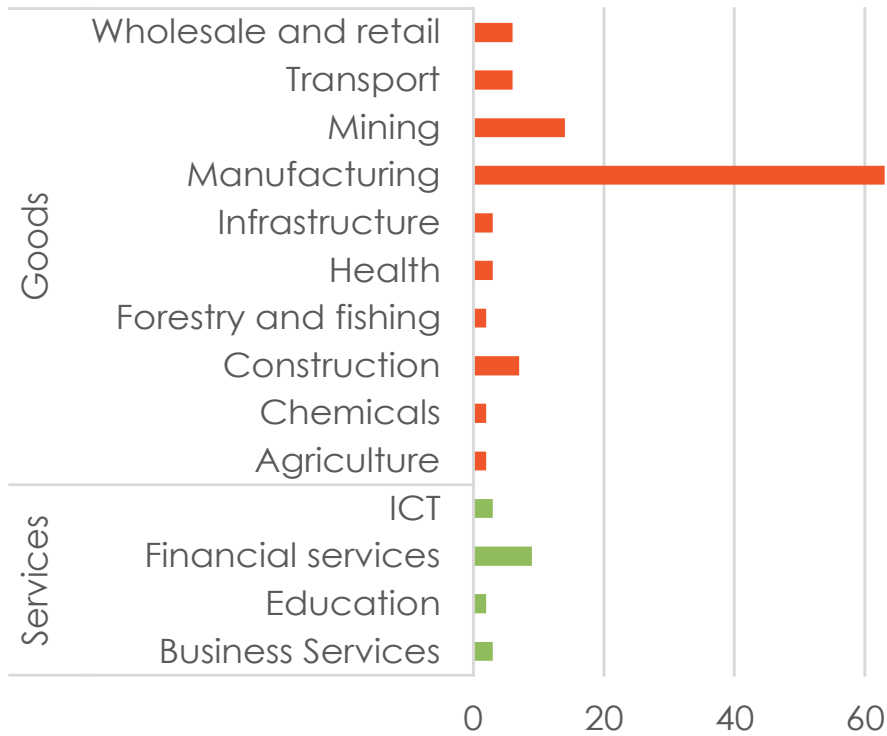
Survey results

- 125 members provided full, clean responses to February online consultation
- Both goods and services producing companies asked about goods imports
- Nuanced results (weighted by GDP)
- Businesses:
 - Are against previous localisation policies
 - Are for future attempts to improve localisation **under the right conditions**
 - Worry how much DTIC knows and understands about the ability/capacity to localise
 - Believe capacity onshore and price are the top-ranked blockages for companies buying more onshore. Technology availability and government policies also a concern.
 - Express frustration at trying to expand capacity
 - Goods-producing companies can undertake substitution of 12.6% of imports “right away” under the right conditions. Rose to 32.3% of imports substituted after five years. Service-producing companies saw possible substitution of 5.5% of imported inputs right away under the right conditions, rising slowly to 11.6% after five years.

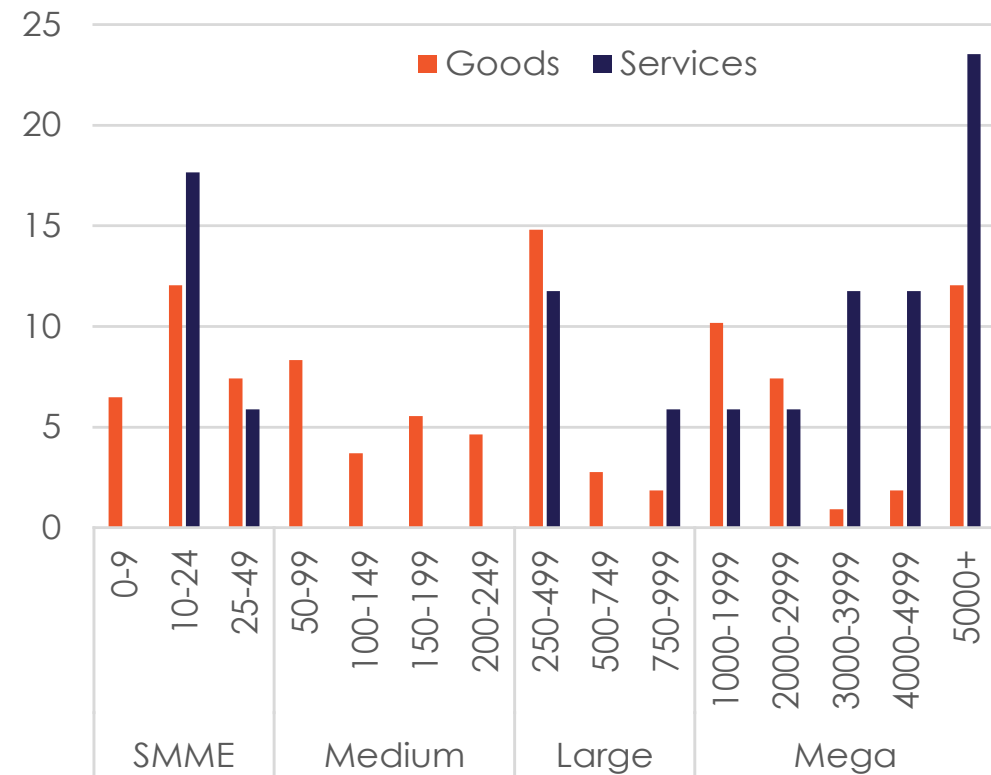


Survey results

Sector of respondents (number)



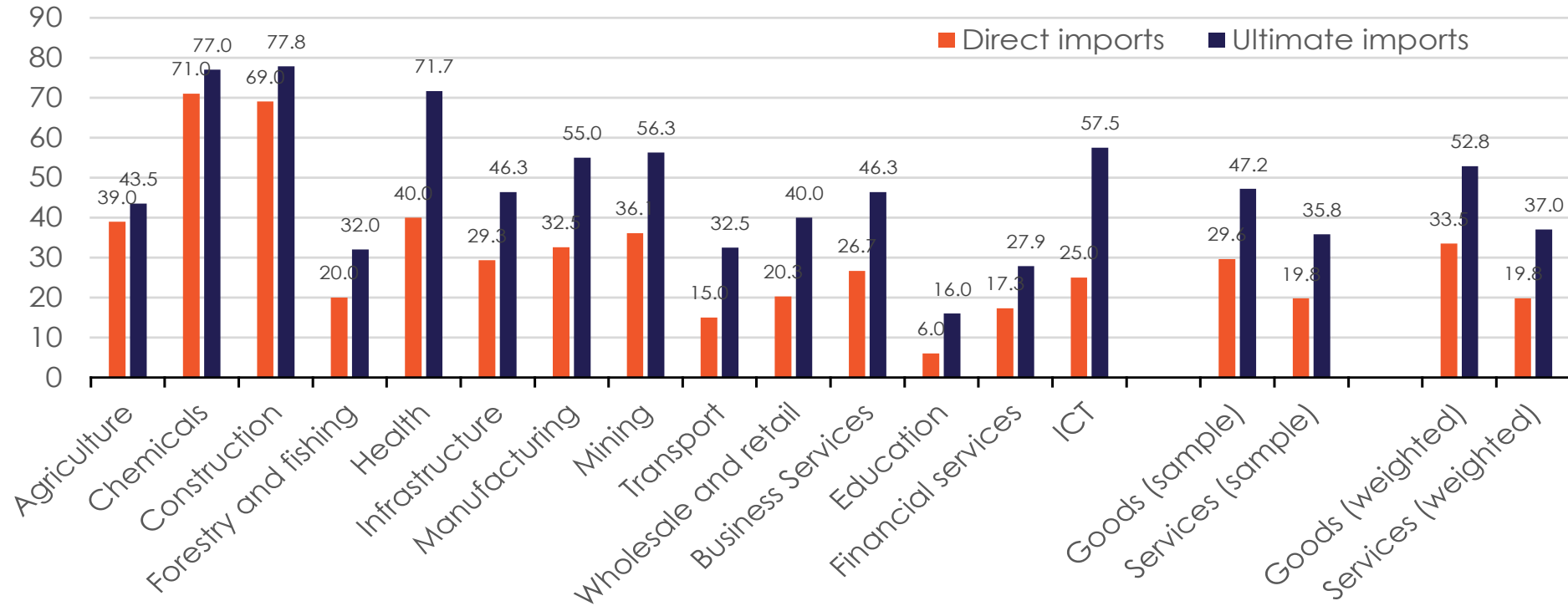
Number of employees (% of group)





Survey results

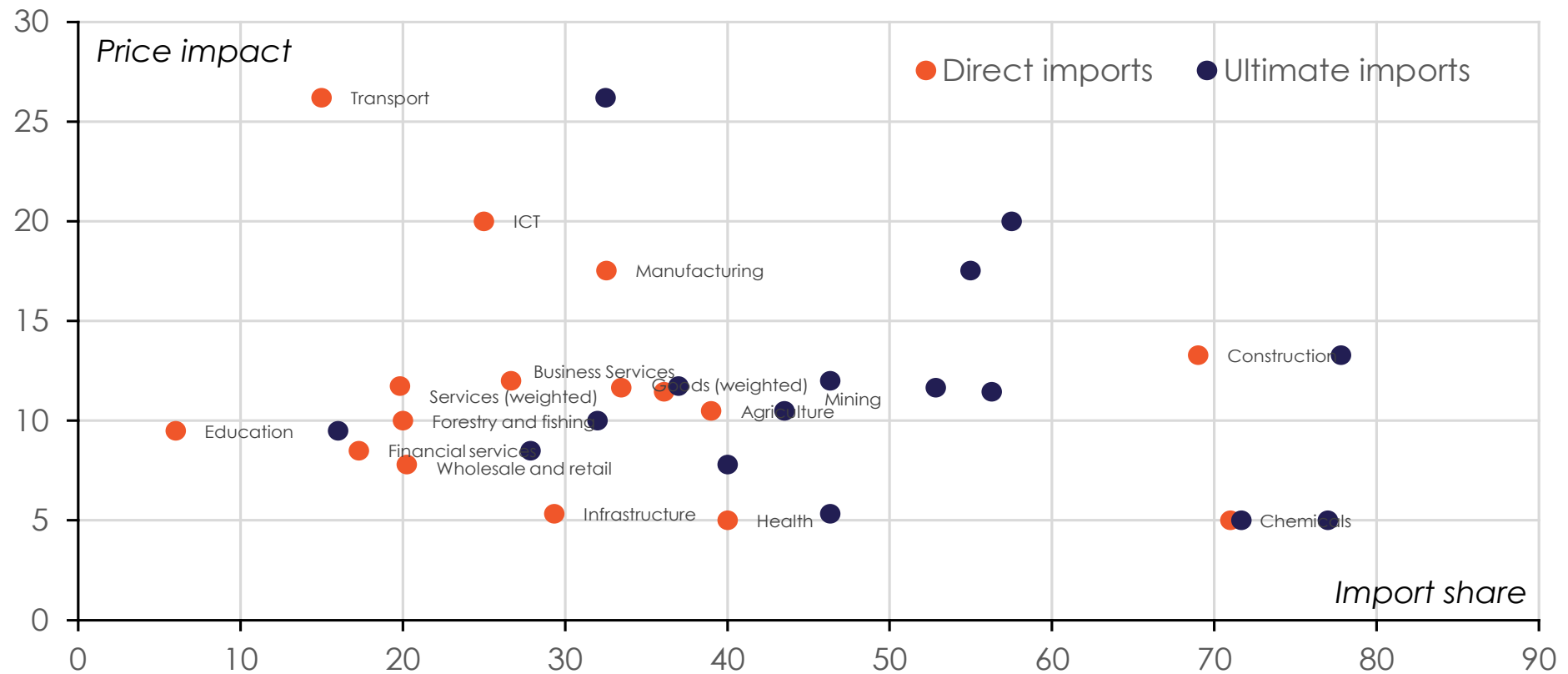
Direct and ultimate (via supply chain) imports as a % share of input cost





Survey results

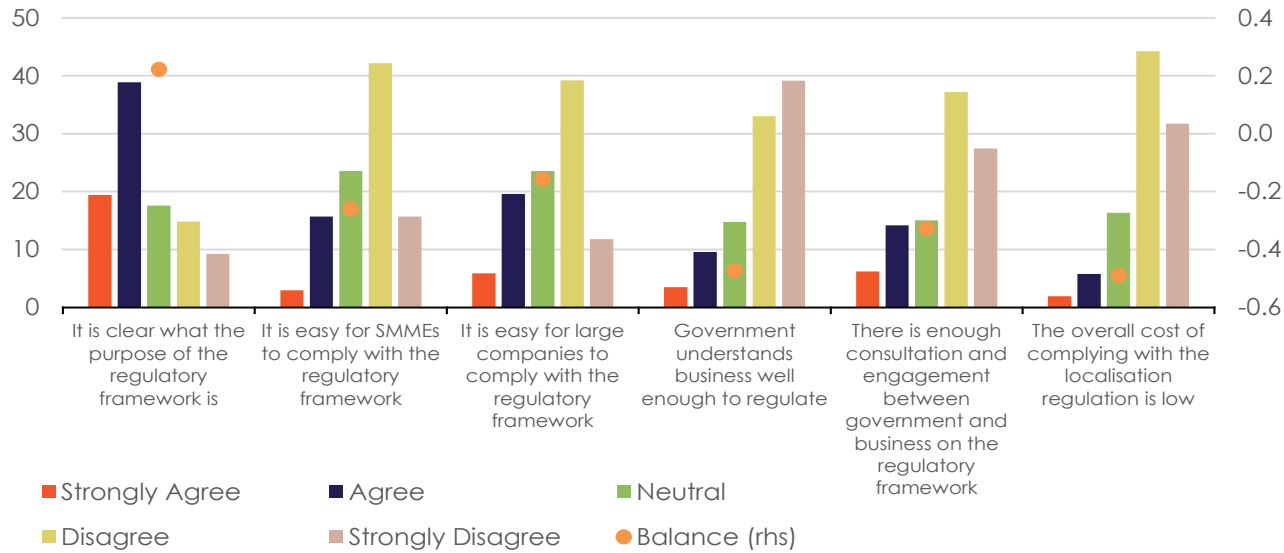
Comparison of price impact vs share of input costs imported





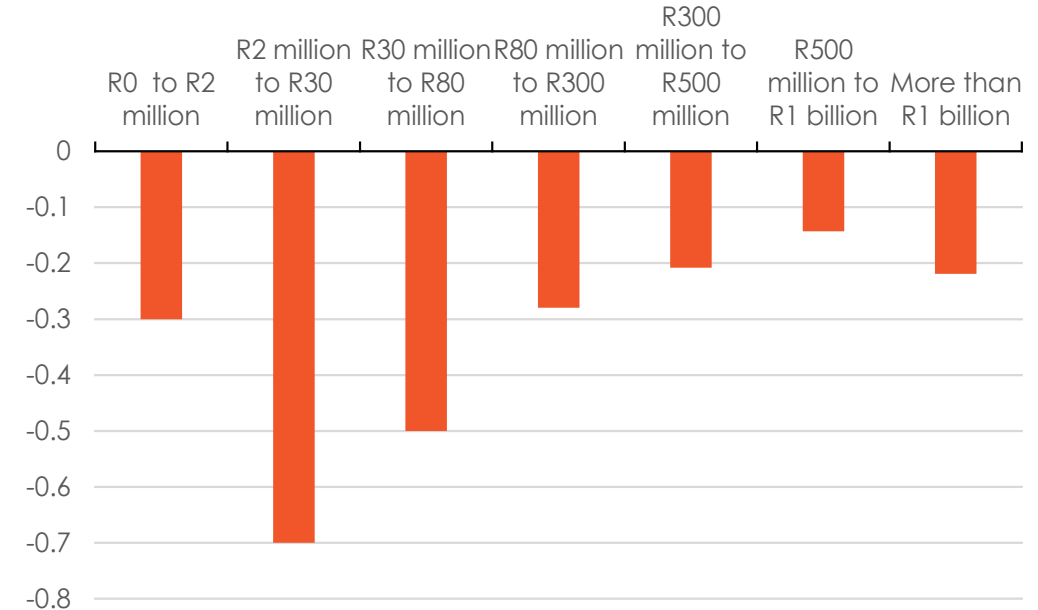
Survey results

Sample views on localisation framework - % agreeing or disagreeing and balance



Note: Balance, +1 = all respondents strongly agreed, -1 = all respondents strongly disagreed

Balance of ease to comply with rules on localisation by turnover of company

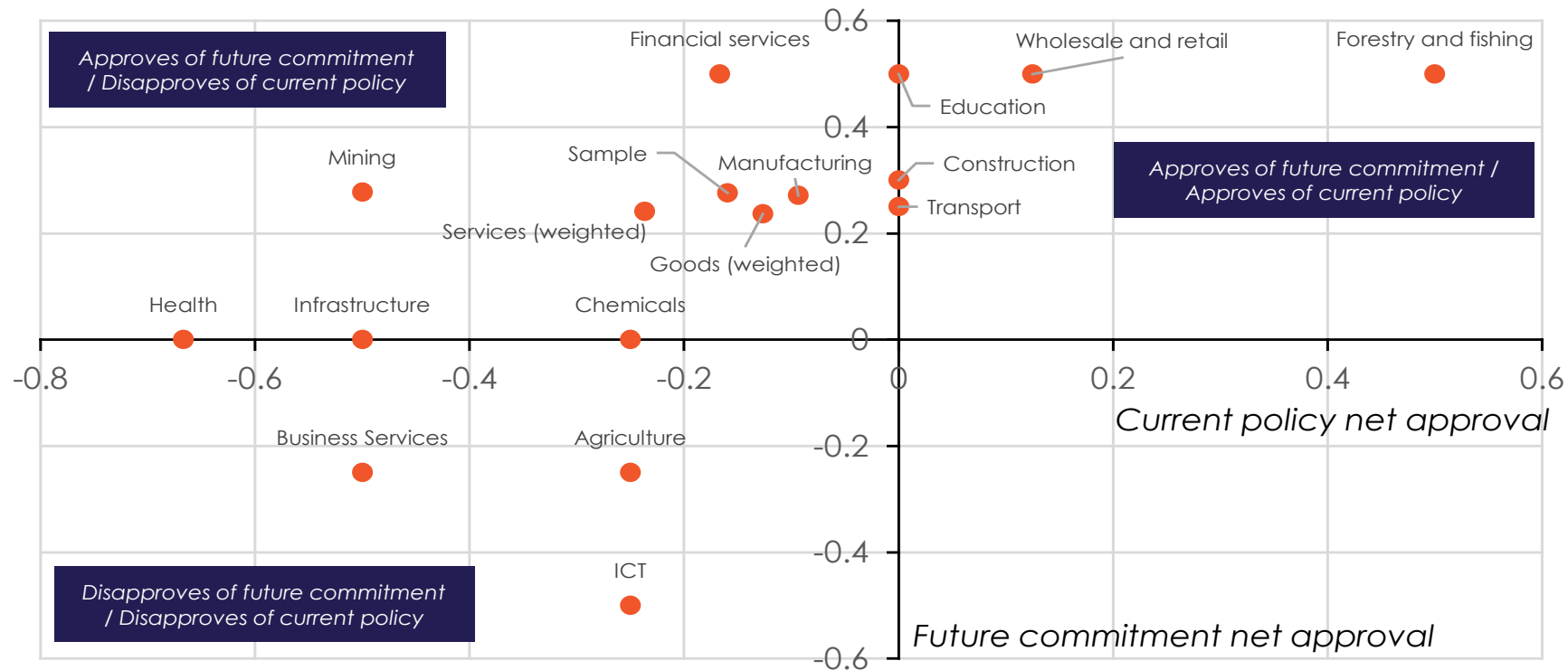


Note: Balance, +1 = all respondents thought it very easy, -1 = all respondents thought it very difficult



Survey results

Net approval rates of current policy and future commitments by government and organised business

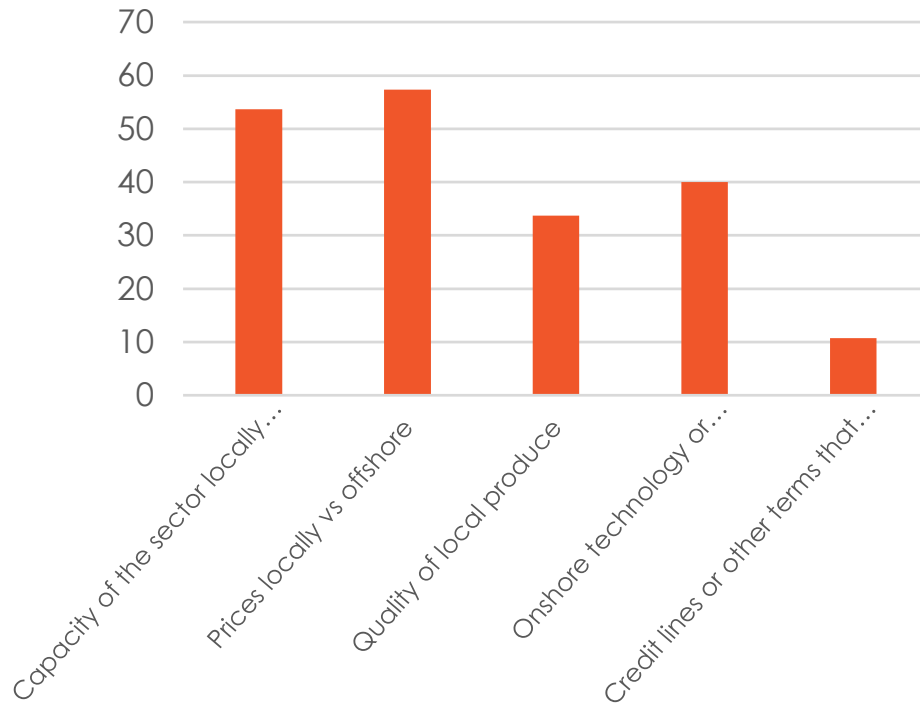


Net approval, +1 = all respondents in sector saw approved, -1 = all respondents in group disapproved

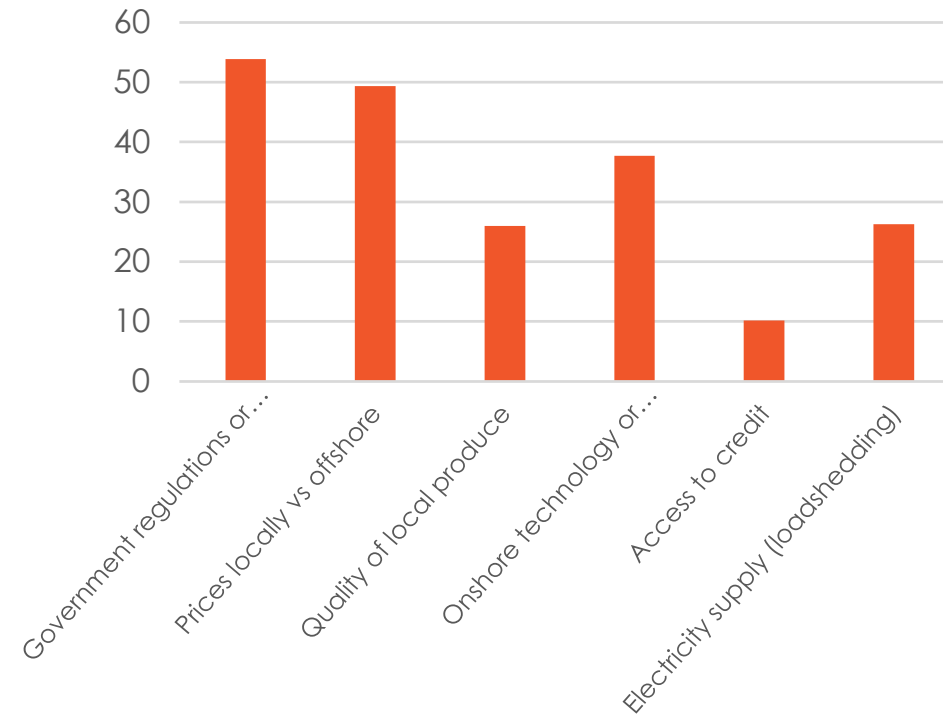


Survey results

Constraints to respondent using more local content (% ranking in top two priority)



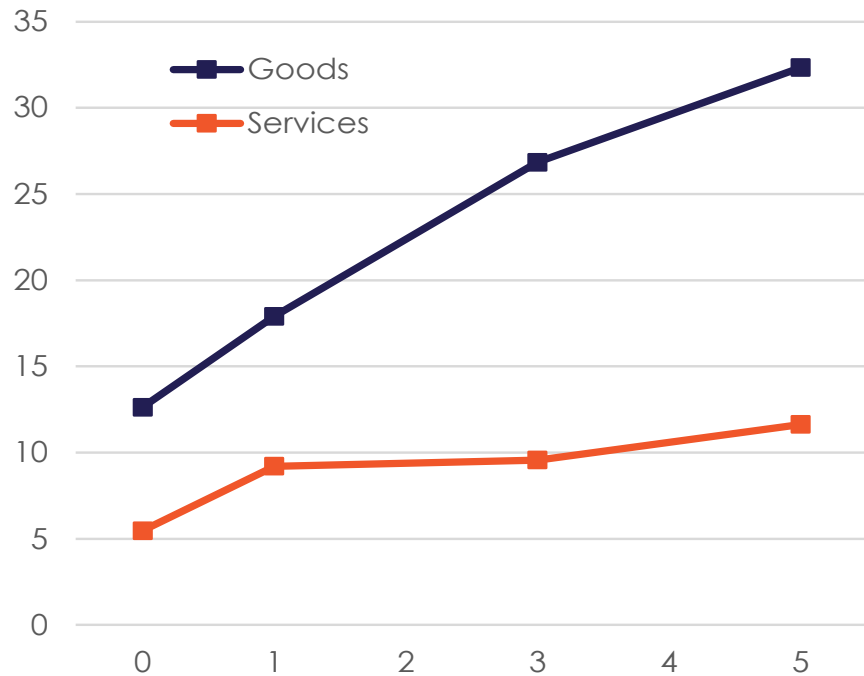
Perceived onshore supply chain constraints (% ranking in top two priority)





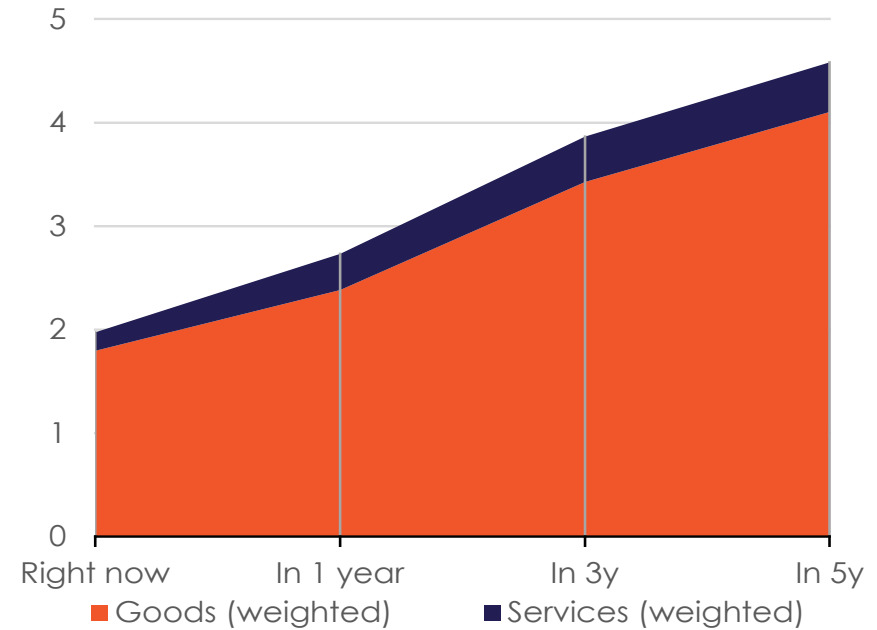
Survey results

Capacity to localise over what time-frame (under the right conditions)



Note: weighted

Localisation potential as a share GDP (%) by group

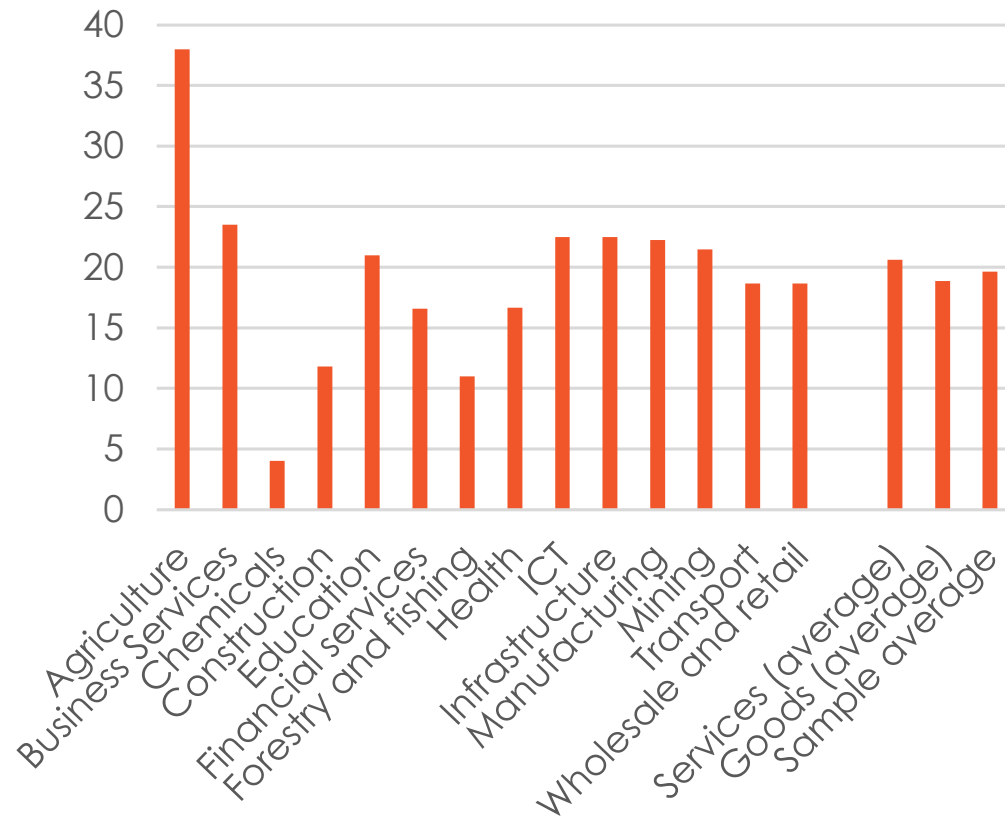


Note: Excludes financial services



Survey results

Price elasticity of attempted substitution of 20% of import prices





Key takeaways

- From literature review –

- Is SA at risk of throttling investments? (Possibly – concerns over REIPPP for instance)
- Is SA driving an export led recovery? (Partially – policy here is partial and unclear)
- Is SA driving a productivity led recovery? (Yes in principle with Operation Vulindlela but actual success at speed in doubt)

- From quantitative study –

- Policy needs understanding of differentiated sectors, ability to respond
- Blanket targets make little sense given this

- From survey of businesses –

- Willingness and interest in localisation under right conditions
- **But do those conditions exist? (for localisation at scale)**
- Policies still holding back capacity, price and quality. Energy security problems. Policy uncertainty.
- Can exist but will take time.

No contradiction between free market precepts and choosing local where there is cost, capacity, quality parity vs offshore

- Simple answer – no, this is not realistic at present as envisioned



Questions to ponder

- How does this fit into AfCFTA?
 - Free trade areas are about the exchange of comparative advantage
- What about petroleum?
 - From a macroeconomic perspective (balance of payments etc) key risk issue, more easily dealt with?
- How do you create scale?
 - Individual projects would not be enough here
 - Blanket rules and import taxes create negative sentiment and harm growth



Recommendations

- 1) Localisation should not be a fundamental policy goal – should be second-order policy aim. Jobs growth should be the fundamental policy aim from a whole economy (general equilibrium) perspective – and especially where achieved through cheap imports.
- 2) An honest conversation should be had between all parties on the price increases that are acceptable and the trade off between prices, quality and jobs that may often exist (but not always).
- 3) One-size-fits-all commitments to localisation targets should not be accepted. Instead, focus should be on widespread deepening of supply chain options for all companies of all sizes – but particularly SMMEs.
- 4) Government needs to offer up clearer roadmaps for the foundations for sustainable localisation:
 - a) Skills education
 - b) Reliable electricity
 - c) Interconnectedness of export markets
 - d) Skills immigration
 - e) Cutting of red tape
- 5) Government should take a risk-averse stance on localisation requirements where they may slow down or impede necessary rapid investment – in particular in energy.
- 6) “Policy predictability”. Trade offs should be well understood by all. Business should be clear with government on the risks of a host of policy changes to a steady, sustainable shift down a localisation path – especially after the experiences of REIPPP.



Recommendations

- 7) Transparent and public exposition by business and government on what local capacity currently is. DTIC needs to be more open about what it does and does not know on capacity issues.
- 8) Individual businesses and sectoral associations, coordinated through BUSA, should publish clear pathways to sustainable localisation showing:
 - a) Skills required
 - b) Investment needed
 - c) Blockages in place (regulatory, credit, demand, quality)
 - d) Realistic timelines
 - e) The role of SMMEs
- 9) Localisation should be viewed as a step-by-step process that works 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 this chain should be considered.
- 10) DTIC should set up a unit within InvestSA that works with the Investment Envoys and IIO to map and target onshore licensing of production of OEM components and assembly of larger goods.



Any questions?

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