

Policy Statement on Localisation for Jobs and Industrial Growth

18 May 2021

Localisation for jobs and industrial growth

In a society with extraordinary levels of unemployment and poverty, all efforts will need to be made to find commercially sustainable ways to create new jobs in the private sector, to complement what can be done through public employment opportunities.

New job growth will be stimulated by demand for the products and services so produced – these can come from a combination of expanded domestic demand and increased levels of exports. To create jobs on scale, both these drivers of new private sector job growth must be pursued.

The Covid-19 pandemic imposed high costs on the economy but it also showed large pockets of resilience that assisted industries to operate under difficult conditions and expand their operations in a number of cases.

There is a new national mood of energy and renewal which must be nurtured to strengthen industrial development and job creation.

This strategy – called localisation - is about building local industrial capacity for the domestic market and for export markets. It is not a turn away from engaging in global markets, but it is about changing the terms of the engagement to one where we are no longer mainly an exporter of raw materials.

Implementation of the strategy will not be without challenges – and finding the policy blend and careful execution required to promote deeper levels of localisation, will require drawing on the skills and expertise in the private and public sectors. SA can build on a number of successes with localisation, draw the lessons and scale these up.

Localisation has been a key component of Government's economic policy since 2014, during which period, 27 key products procured by Government have been successfully prioritised for purchasing by the state from local manufacturers. The strategic localisation objective outlined in the Economic Reconstruction and Recovery thus brings together learnings from this experience with a new galvanised purpose to drive industrialisation in the wake of pandemic.

The South African manufacturing sector has underperformed the overall economy since the start of the democratic era in 1994. This can be seen through the decline in the share of manufacturing in the overall economy. In 1994, manufacturing represented 19.2% of the South African economy, declining to 11.8% in 2020.

The decline in the South African manufacturing sector has had a detrimental impact on the overall South African economy and jobs. The manufacturing sector has one of the strongest stimulatory effects and economic multipliers of any of the broad sectors of the economy. This is largely because the manufacture of goods stimulates growth in ancillary industries like packaging, logistics and transport, component manufacture, and other service sectors needed to bring the goods to market.

The phenomenon in which manufacturing share of GDP declines over time, known as de-industrialisation, is not unique to South Africa. However, the extent to which it has impacted South Africa has been far more severe than many other countries. Countries like Japan, Turkey, Indonesia and China have levels of manufacturing relative to the rest of the economy in excess of that recorded in South Africa. South Africa also ranks below other peers amongst middle income countries (See **TABLE 1** above.)

In addition to its significant GDP multiplier effect, the South African manufacturing industry also stimulates the creation of jobs in support industries. According to the Industrial Development Corporation, for every job created or sustained in the manufacturing industry, nearly 4 jobs are created or sustained in direct and indirect supplier industries across the economy.

South Africa has an over-propensity to import goods which could otherwise be produced in South Africa. Every year, the South African economy spends approximately 25% of the national wealth created, on goods imported from other countries. (See **TABLE 2** alongside.)

This propensity is far greater than in other similar countries and is out of line with our developmental needs, and impedes the opportunity for South Africa to develop its manufacturing capacity across carefully-identified selected strategic industries to take advantage of the enormous export potential, particularly in the context of the African Continental Free Trade Area.

TABLE 1
Manufacturing output as a % of GDP

China	26,8
Thailand	25,3
Japan *	20,7
Indonesia	19,7
Middle income countries	18,3
Turkey	18,3
Mexico	17,3
Egypt	15,9
Global Average *	15,4
European Union	14,4
India	13,6
Russia	13,1
South Africa	11,8

Source: World Bank (2019; * 2018)

TABLE 2
Merchandise imports as a % of GDP

Brazil	9,6
United States	12,0
Colombia	13,4
European Union	14,0
Japan	14,2
Russia	14,3
China	14,4
Indonesia	15,3
India	16,7
Turkey	18,3
Global Average	21,8
South Africa	25,1
Egypt	26,0

Source: dtic calc from World Bank; Trade Map data (2019)

Localisation – some success stories

Aside from the state-procurement measures to boost local industries, a number of partnerships with the private sector has contributed positively to increased South African production and output.

These include

- agreements with a number of companies based on a strong investment case in domestic and continental markets (for example, the decision of a number of food businesses to expand their output);
- provision of industrial finance (through the portfolio of the IDC);
- competition settlements with large companies (in retail, food and beverages, financial services and petroleum, among others);
- supplier development funds and measures (including those fostered through the equity-equivalent arrangements in the BB-BEE Codes);
- sector Master Plans (auto components, poultry and sugar)
- Covid-19 special measures to boost local production of medical necessities (masks, surgical gowns, ventilators, hand sanitisers and vaccines);
- investment allowances (edible oil; electronic products); and
- tariff and trade measures support (steel mini-mills, foundries, textiles).

In a number of cases, supplier-development funds supported businesses to upgrade machinery, skills or marketing. The use of industrial engineers has helped a number of firms to bring down their production costs and address production inefficiencies. Building a commercially-viable business case is the important starting point. While a number of localisation initiatives were not initially able to compete only on price, as scale and know-how improved, the price-premium declined and products became more competitive. Some of the products that benefited from these partnerships have been successfully exported and included in the global supply-chains. Many local firms were also able to compete on flexibility of supply-chains and quick turnaround times by local producers, reducing the need for large inventory and enabling a faster-response to changes in consumer tastes. These are strengths to build on.

Localisation for resilience and innovation

The reliance on imports is a challenge to the South African economy in that it makes our business and consumers vulnerable to supply shocks in other parts of the world, amply demonstrated in the Covid-19 pandemic. The reliance on imports also means longer lead times to get the necessary goods; and it results in South African businesses being price-takers in international markets. It undermines our strategic autonomy, and it means that we create fewer jobs at home.

A focus on localisation is therefore at the heart of Government's strategy to create sustainable jobs for South Africa and build the economic base for long-lasting prosperity. In the last year, South African manufacturers have increased capacity for Covid-19 essentials, showing what can be done locally.

Manufacturing is a driver of innovation, of research and development; and in times like the Covid-19 crisis, countries with industrial capacity have relied on their industries to produce food, personal protective equipment and medical supplies.

Localisation for increased competitiveness

Following the 2019 general elections, Government outlined a re-imagined industrial strategy with a focus on developing competitive industries. Key to the re-imagined industrial strategy is the development of competitiveness plans across key industries - known as Sector Master Plans - to create resilient and dynamic businesses able to compete in international markets.

Six Master Plans have been developed and are being implemented in industries such as automotives; clothing, textile, footwear and leather; poultry; sugar; steel and metal fabrication; and furniture – with the focus being to drive improved performance, job-creation, economic inclusion, competitiveness and efficiency. These sectors cover 700 000 workers in the South African economy and 6% of our GDP.

Localisation must focus on strategic industries, defined by their capacity to be labour-absorbing or providers of critical goods or significant export earners. Localisation can provide such strategic industries, as well as other infant industries, with the space and opportunity to develop and to become globally competitive. This strategy has been followed in a number of countries, including in East Asia, where advanced manufacturing sectors have flourished under a focused strategy to direct and focus demand for goods and services towards those produced locally. The drive to create competitiveness is thus key to ensuring that investment in localisation provides the long-term dividend the South African economy recovers.

Localisation can galvanise economic reforms and must strive for price-competitiveness

A successful and sustainable localisation effort requires more than only policy intent and national will. There are real constraints that have held back localisation in the past; and unless these are addressed, the full success of localisation efforts will not be realised. These include cost structures (including energy and logistics), availability of critical infrastructure (spectrum and energy-availability) and skills constraints. As part of the Economic Reconstruction and Recovery Plan, a well-focused localisation programme can help to galvanise the necessary economic reforms, including those directed at energy, spectrum, transport and logistics, environmental as well as skills challenges.

Already we are seeing investment in logistics and energy infrastructure to support the expansion of manufacturing in parts of the country. Stepped-up efforts to expand domestic industrial capacity must provide the impetus for these reforms.

These reforms can further mitigate against any potential price rising effects of localisation efforts, which may exist in the short term, by bringing down the overall production and logistics costs for key industries. They should be coupled with efforts to foster greater competition among domestic firms. The lesson from production of Covid-19 medical supplies is that whilst prices were initially higher than equivalent imported products, with the benefit of clear offtake commitments, over time local firms have been able to match and beat imported prices.

Localisation for transformation, economic inclusion and jobs for women and youth

Successful localisation efforts will expand the South African economy, providing opportunities and jobs for a greater number of South Africans. To ensure that historically disadvantaged South Africans can take advantage of the opportunities, government introduced the black industrialist programme, providing funding to black entrepreneurs who own and operate their businesses. Over a five-year period, more than R32 billion has been invested by **dtic** entities in some 800 such businesses.

Increased localisation fostered through promotion of SME's can reduce harmful economic concentration, which keeps new businesses from entering the market, by building the industrial base of the company. It must be recognised however that this is not an automatic outcome of such a focus and would need strong coordination and partnerships to achieve. A larger and more transformed industrial base is what is required to provide the opportunities for more women, youth and people with disabilities to play their role in build our economy and driving growth.

Localisation for greater beneficiation of mineral resources

South Africa's mineral reserves are valued at US\$2.5 trillion, with the Bushveld Complex holding the world's most valuable minerals. Gold's share of mining output has declined from 67% in 1980 to 14% by 2018. In addition to diamonds and gold, the country also contains sizeable reserves of iron ore, platinum, manganese, chromium, copper, uranium, silver, beryllium, zinc, vanadium and titanium. The mining sector has become more diversified over time.

While SA has significant reserves, historically the country has exported raw minerals, and imported consumer and capital goods. Beneficiation creates opportunities for development of new value chains, leveraging the mineral wealth of the country for the creation of jobs and investment. Particular success has been seen in the development of fuel cell and catalytic converter production capacity which uses platinum group metals, as well as the development of energy storage solutions using vanadium and nickel sulphate; and steel.

To deepen levels of beneficiation, a number of constraints will need to be addressed, including the price and availability of electricity. Successes are being registered with new investments in businesses that use local raw materials and add significant value to these.

Localisation to develop jobs in new industries and the green economy

The development of new industries, particular in the energy sector provides a significant opportunity for South Africa. A just transition to a low-carbon, climate-resilient, green economy forms an integral part of SA's global commitments, its Integrated Resource Plan 2019 and the Economic Reconstruction and Recovery Plan.

South Africa has to some extent used its renewable energy investment programme to development local capacity to create the components which go into wind and solar

projects. Currently there are significant domestic and foreign investment in solar and wind plants with 21 000 MW of additional energy expected to come on stream in the next 10 years. This provides the opportunity for the development or expansion of component manufacturing.

South Africa is also well positioned to be a global player in the burgeoning green hydrogen economy, given our endowment of platinum group metals and increasing renewable energy capacity.

Discussions have also started with the automotive sector to position South Africa for the shift in the industry from the internal combustion engine to battery electric-powered vehicles, and to develop the components which can support growth in the industry for products destined for both local and international markets.

The new global pressures around climate change will mean a greater focus on localising the sites of production, to avoid the enormous cost of carbon emissions which come from transporting goods across the world. An estimated 7% of all carbon emissions comes from global freight trade. Localised value chains can further help to reduce the carbon footprint of global trade.

Localisation to enhance government support for industrial sectors

Government can play a role to support efforts to localise, within the rules of the WTO, by focusing on improved competitiveness.

The **dtic** approach to investment incentives is to ensure that recipients commit to investments which boost localisation and industrialisation. Such approaches have already yielded recent successes in the expansion of South Africa's edible oil and dairy production capacity.

Tariff protection can also be used to stimulate localisation and industrial expansion through reciprocal commitments from the beneficiaries of such protection. The **dtic** has focuses on ensuring that tariff protection does not yield lazy industries, by including commitments for investment, and ensuring that beneficiaries do not simply increase prices to the detriment of consumers.

Localisation to build capacity for the African market and the rest of the world

Localisation refers to the development of local industrial capacity to serve both the domestic and export markets. The African market represents a R7 trillion market opportunity for goods manufactured on the continent to replace those currently being imported from outside of the continent. The introduction of the African Continental Free Trade Area (AfCFTA) provides South Africa with an opportunity to access market opportunities across the continent. The manufacturing sector is key to unlocking opportunities, and building industrial capacity through localisation will ensure that South African firms are able to take advantage of the opportunities. The development of regional value chains across the continent further offers the opportunity to create market linkages between regions and integrate supply-chains.

Expanding access to other markets also serves to grow investment and jobs in the South African economy. Preferential access to key export markets has been secured through various agreements and by participating in regional economic communities. This has ensured preferential access for South African goods to countries representing 62% of global GDP. High value manufactured and agricultural goods are in greatest demand and provide an opportunity for South African businesses.

Localisation in infrastructure development

South Africa is rolling out a large infrastructure programme, with large investments in transport, logistics and energy infrastructure. R791 billion allocated for public sector spending on infrastructure over the next fiscal 3 years (up from R630 billion during previous 3 years).

Infrastructure investment pipeline valued at R340 billion in network industries such as energy, telecoms, transport, water & sanitation, digital, etc has been identified, and published in the Government Gazette.

Infrastructure development needs to re-energise SA manufacturing through the prioritisation of locally produced steel, building materials and other components needed.

A social compact for localisation

On 15 October 2020, President Ramaphosa tabled before a joint-sitting of parliament, an Economic Reconstruction and Recovery Plan (the “Plan”), aimed at stimulating equitable and inclusive growth in South Africa in the wake of Covid-19 pandemic.

The Plan was the culmination of work between social partners at the National Economic Development and Labour Council (“Nedlac”) over a number of months. The Plan reflects a consensus amongst the social partners that there should be substantial structural change in the economy that would unlock growth and allow for development.

The Plan has identified 9 key policy interventions, including **employment-orientated strategic localisation, reindustrialisation and export promotion**. Overall, the programme to drive industrialisation through localisation will seek to achieve the following strategic objectives:

- Reduce the proportion of imported intermediate and finished-goods;
- Improve the efficiency of local producers; and
- Develop export competitive sectors that can expand the sales of South African made products on the continent and beyond.

Priority has been placed on key value chains such as in construction; agro-processing; healthcare; basic consumer goods; capital goods including equipment and industrial inputs used in infrastructure projects; and transport rolling stock focusing on automobile and rail assembly component production, with 42 product areas already identified as a focus for strategic localisation over the next five years. Further product areas may be included. The priority value chains represent opportunities where South Africa is either well-placed already to further localise production, and/or where localisation can unlock economic growth and jobs.

Nedlac parties have agreed to work together to reduce South Africa's non-oil import bill by 20% over the next five years (the "Localisation Initiative"). The extended timeframe was agreed in recognition of the need to phase in the prerequisites for a commercially-sound localisation programme. The parties agreed to review the targets and timeframes in the light of experience; recognising further that progress may start slower and can scale up over time to take account of the impact of reforms on the investment and business climate. If executed successfully, it is expected to return more than R200 billion in domestic demand for South African produced goods. The IDC has estimated that successful implementation of the Localisation Initiative over the next five years can increase GDP over the baseline by 5 percentage points by 2025.

To support the Localisation Initiative, Chief Executive Officers and other senior leaders have agreed to serve as product champions across the 42 product areas ("Localisation Champions"). Funding has been mobilised from the private sector - R240 million by May 2021 – to support the recruitment of technical experts able to identify, unlock and implement localisation initiatives. Such experts include industrial engineers, project managers, supply chain specialists, and experts in trade.

Ordinary South African have an important role to play in supporting the localisation initiative, through actively looking for South African-made goods and services and looking for the **Made in South Africa** label on the products in-store, in the home and in the work-place.