

## **Report of the Portfolio Committee on Trade and Industry on the colloquium on beneficiation/value-addition, dated 4 November 2014**

The Portfolio Committee on Trade and Industry having considered the colloquium report on beneficiation/value-addition, reports as follows:

### **1. Introduction**

South Africa's need to eliminate poverty and unemployment, reduce inequality and create sustainable livelihoods calls for a radical transformation of the economy. To achieve this, the Department of Trade and Industry (DTI) is implementing the Industrial Policy Action Plan (IPAP). IPAP is seen as a vehicle to accelerate economic transformation through the re-industrialisation of the South African economy. It includes a deliberate set of policy interventions, such as government procurement and beneficiation of mineral and natural resources, which have been identified as key drivers to unlock the economic potential of the manufacturing sector. IPAP is therefore framed and driven by a particular focus on value-adding sectors that have high employment and high-growth multipliers.

In IPAP, the DTI highlighted that economic growth had been underpinned by consumption-driven sectors (namely finance and insurance, real estate, transport and storage, communication, wholesale and retail, catering and accommodation) rather than production-driven sectors (namely agriculture, mining, manufacturing, electricity and water, and construction). Furthermore, South Africa's exports are dominated by raw mineral resources, while it imports predominantly processed or finished goods manufactured from these very resources at substantially higher prices. These two practices have led to unsustainable economic growth and an increasing current account deficit. IPAP, in conjunction with the Mineral Beneficiation Strategy, is intended to shift the current trading pattern and thus alleviate the pressure on the current account balance. The largest portion of the current account is made up of trade balance (exports minus imports). The contribution of industrialisation to the trade balance is seen as twofold, firstly, the diversification of manufacturing output in the country will ensure availability locally (possibly at competitive price) of the goods that the country currently imports, the availability of those goods should lead to a shift from the consumption of imports to locally produced goods. Secondly, the diversification of local products will mean that the country has more to offer world in terms of exports, this is expected to increase the value of the country's exports. A decline in imports as a result of the shift in consumption patterns from imports to locally produced goods combined with the expected increase in exports of manufactured goods will lead to a minimised current account deficit or even a current account surplus.

The latest iteration of IPAP 2014/15-2016/17 identifies manufacturing as an essential component to move towards a value-adding, job creating economy. "Minerals downstream beneficiation and mineral upstream (inputs) have been identified as a key "pillar" of SA's reindustrialisation push<sup>1</sup>". Government's proposed legislative amendment to the Minerals and Petroleum Resources Development Act (No. 28 of 2002) (MPRDA) that a percentage of extracted strategic raw minerals should be locally beneficiated is expected to support this beneficiation drive and promote economic growth<sup>2</sup>.

The DTI has argued that a shift towards increasingly supporting the development of the production-driven sectors is fundamental to ensuring sustainable economic growth and job creation. This is

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<sup>1</sup> DTI (2014)

<sup>2</sup>Section 26 of the Minerals and Petroleum Resources Development Amendment Bill.

underpinned by the fact that investment in the manufacturing sector creates upstream and downstream opportunities by increasing the demand for inputs into the sector and services to support it. It also provides opportunities for other businesses to sell these manufactured goods, to use these as inputs in their manufacturing processes and/or to offer after-sales services for these goods. This potential to stimulate growth by the manufacturing sector should lead to a lowered current account deficit, especially if South Africa is also able to export these value-added goods and offset imports.

In this regard, the ability to “move up the value chain” or beneficiate the country’s mineral and natural resources becomes critical and has been identified as one of the key drivers for industrialisation. Mineral resources include polymers, ferrous metals, platinum group metals and titanium; while natural resources include primary agricultural, forest and fishery products. However, other areas of value-addition are also possible through technological developments and the advancement of the knowledge economy<sup>3</sup> in advanced manufacturing sectors, such as the software and aerospace industries.

In terms of mineral resources, South Africa has developed a Mineral Beneficiation Strategy and will be developing a Minerals Beneficiation Action Plan that will form part of IPAP. The four key value chains that have been analysed are ferrous metals, polymers, titanium and platinum group metals. In the 2014/15 financial year, the DTI intends to focus on strategies to support the development of the iron ore/steel, polymers and titanium value chains.

IPAP also highlights the development of the agro-processing; biofuels; aquaculture; and forestry, timber, pulp and paper, and furniture industries as areas for the beneficiation of the country’s natural resources.

However, the committee believes the challenges facing the manufacturing sector, including relatively high input costs, reliable supply of energy and high administrative prices, particularly in the transport sector, may disincentivise value-addition activities from being promoted within the economy.

Through the Colloquium on Beneficiation, the committee sought to understand all the facets involved in leveraging the comparative advantage<sup>4</sup> from South Africa’s resource endowment-based economy to develop a dynamic industrial economy which secures sustainable development, contributes to the radical transformation of the economy and job creation. Although there is general agreement among participants that beneficiation can contribute to the radical transformation of the economy they have identified the constraints to value-addition such as the absence of policy certainty and a coordinated government approach with respect to value-adding, high administered prices, the impact of import parity pricing and general input costs associated with the manufacturing of a product, the absence of investment by both the public and private sector, infrastructure development, appropriate skills development, and a secure supply of affordable energy, among others.

### **1.1. Economic context**

The DTI is the custodian of the IPAP, however, the implementation thereof lies in various Departments. IPAP informed by the vision set out by the National Development Plan (NDP) and the National Growth Path (NGP) is aimed at reviving the industrial sector with the goal of driving

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<sup>3</sup> The knowledge economy refers to the intangible assets of a country such as its worker’s knowledge or intellectual property.

<sup>4</sup> The potential gains an individual, firm, or country can realize that arises from differences in its factor endowments (e.g. mineral and natural resources or labour force) or technological progress when it trades with another individual, firm, or country.

economic growth through domestic, regional and international trade and investment, to create sustainable jobs.

South Africa's industrial development goals as outlined in IPAP with the focus of industrialising the economy, and the purpose of diversifying the country's manufactured goods from various industries that have been on the decline in the past few years including the clothing and textiles sector and through exploring opportunities for beneficiation in other sectors including the mining sector. The manufacturing sector is one of the largest employment creators in the country and has multiplier effects into other sectors.

The global recession of 2008 had a negative impact on the manufacturing sector which led to massive job losses in the sector. The recent Purchasing Managers' Index registered a three year low indicating declining business confidence and a contraction in the manufacturing sector. Furthermore, recent data indicates a sharp rise in imports at the expense of jobs with exports moving on a flat trajectory.

High administered prices, such as electricity tariffs and port charges, have further contributed to South Africa's relative lack of competitiveness and have led to the loss of many small entrepreneurial businesses, especially in the manufacturing sector, which resulted in the retrenchment of thousands of workers. While some of South Africa's trading partners have reportedly reduced their industrial electricity rates, South Africa has been increasing its electricity tariffs.

Currently, South Africa's growth remains driven by credit-fuelled non-tradable sectors while the tradable export sectors are languishing. This combination of events, as well as other domestic inefficiencies, represent a real threat to the manufacturing sector and have exacerbated the expansion of the import market which has created an entrenched external imbalance reflected in the large current account deficit. Recent economic data underlines the view that the current import intensive growth trajectory is not sustainable.

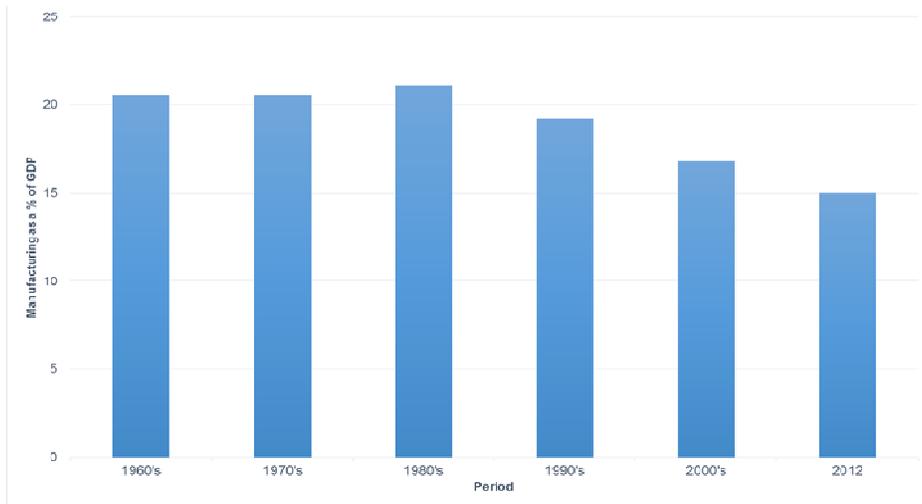
The primary sector can play a lead role in leveraging South Africa's comparative advantage. In this regard, the conversion of South Africa's mineral endowment through beneficiation has been asserted to facilitate socio-economic development. The development of local beneficiation capabilities should be supported through incentives. This use of South Africa's natural resources and the supporting incentives offered should assist in the domestic industry's global competitiveness and can lead to increased job creation and retention.

#### **1.1.1. Manufacturing sector**

Manufacturing is one of the backbones of the South African economy. However, the manufacturing sector has experienced minimal growth in recent years. South Africa's manufacturing sector is the second largest sector in the country after the finance, real estate and business services sector and a key contributor to the economy both in terms of contribution to Gross Domestic Product (GDP) and to employment. Manufacturing as a percentage of GDP has continued to decline over the past three decades. It had been 22 per cent in the 1980s and 19 per cent in the 1990s. Manufacturing as a percentage of GDP at 15 per cent is now just above the comparative number for the United States and compares unfavourably to a number of countries including China 34 per cent, South Korea 28 per cent, and Malaysia 27 per cent.<sup>5</sup>

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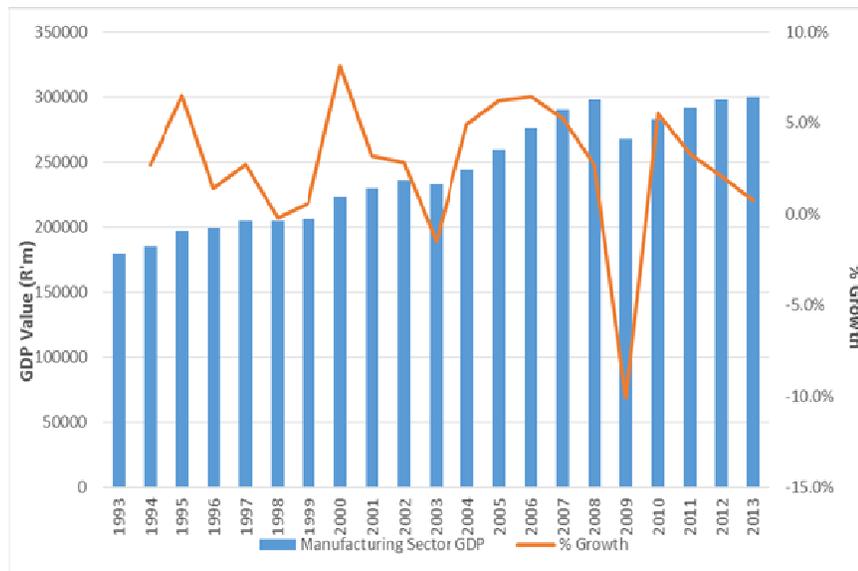
<sup>5</sup> Chamber of Mines (2014)



**Figure 1: Manufacturing as a percentage of GDP**

Source: Chamber of Mines (2014)

Low growth rates in manufacturing value-added (MVA) in South Africa (only 2.9 per cent in 2010-2012) versus high MVA growth in competitors (such as China 8.8 per cent, Turkey 5.5 per cent, and India 5.8 per cent) means that the competitiveness gap between South Africa and its competitors will continue widening as returns to investment in the manufacturing sector remains relatively low.<sup>6</sup>



**Figure 2: South Africa's economic growth**

Source: Statistics South Africa (2014)

As can be seen in the figure above, the manufacturing sector has experienced minimal growth in recent years. South Africa has a well-developed and diverse manufacturing sector with some subsectors more developed than others. The sector contributes greatly to international trade in terms of exports of both finished and semi-finished products. The country's manufacturing output that of food, beverages and tobacco; clothing and textiles; petroleum, chemicals, rubber and plastic

<sup>6</sup> Chamber of Mines (2014)

products; metals, metal products, machinery and equipment; automotives, and transport equipment among others.

Manufacturing output growth fluctuated between 1993 and 2003 with growth rates between 6.5 percent and -1.5 percent. Between 2004 and 2007, significantly with growth rates of ranging from 6.9 percent to 6.4 percent. In 2009, the sector's output declined by as much as 10.6 percent. This was mainly a result of the global recession of 2008 which adversely affected the manufacturing sector among other sectors. In 2013, manufacturing output grew by 0.8 percent. An entrenched external imbalance reflected in the large current account deficit.

## **1.2. Purpose of the colloquium**

The main objective of the colloquium was to engage with specialists, practitioners and other relevant stakeholders to discuss the concept of value-addition through mining and manufacturing beneficiation of South Africa's mineral and natural resources and how import parity pricing and other factors limit opportunities for beneficiation. This discussion was intended to lead to possible solutions, such as the application of licensing conditions, to address the identified constraints.

## **1.3. Process followed**

In 2014, the committee agreed to schedule a colloquium on beneficiation to engage with specialists, practitioners and other relevant stakeholders to discuss the concept of value-addition through mining and manufacturing beneficiation of South Africa's mineral and natural resources and how import parity pricing and other factors limit opportunities for beneficiation. This discussion was intended to lead to possible solutions, such as the application of licensing conditions, to address the identified constraints.

The Committee invited the following economists to engage it on matters related to the beneficiation during its public hearings:

- Dr Simon Roberts to deliver a paper on the current justification and the impact of import parity pricing and transfer pricing, and possible mechanisms to address this form of discriminatory pricing.
- Dr P Jourdan to unpack value-addition through mineral beneficiation using the iron ore/steel and polymer value chain as case studies.
- Professor Ben Turok on beneficiation.
- Dr W du Preez to unpack value-addition through mineral beneficiation using the titanium value chain as a case study.
- Dr M Horak to unpack value-addition through the beneficiation of natural resources using the essential oils value chain as a case study.

The following public institutions were also invited to attend and contribute to the broader discussion on the beneficiation of mineral and timber resources.

- The Department of Trade and Industry (DTI)
- The Department of Mineral Resources
- The Department of Agriculture, Fisheries and Forestry
- Industrial Development Corporation
- Competition Commission

Furthermore, other stakeholders and companies invited to discuss the concept of value addition through mining and manufacturing beneficiation of South Africa's mineral and natural resources and

what impediments exist to optimally utilise our mineral and natural resources to address the triple challenges of unemployment, poverty and inequality:

- The Manufacturing Circle
- Sasol
- Chamber of Mines
- ArcelorMittal South Africa
- South African Mining Development Association
- Plastics South Africa
- Steel and Engineering Industries Federation of South Africa(SEIFSA)
- Akasia Healthcare (as part of the Plastics SA delegation)
- Gold Sun Industries (as part of the Plastics SA delegation)
- National Employer's Association of South Africa (NEASA)
- Zimco Group (as part of the SEIFSA delegation)
- Competition Commission
- Forestry South Africa
- Sawmilling South Africa
- Paper Manufacturers Association of South Africa (PAMSA)
- Mainstream Renewable Power
- Federation of Unions of South Africa

#### **1.4. Layout of the report**

The report is structured in the following manner:

- Section 2 provides an overview of the general issues influencing the success of the beneficiation drive, as well as the sector specific concerns for the various value chains.
- Section 3 lists the committee's key findings emanating from this colloquium.
- Section 4 covers the committee's conclusions.
- Section 5 acknowledges the various stakeholders contributing to the committee's deliberations and report.
- Section 6 contains the committee's recommendations to the National Assembly.

## **2. Issues raised by stakeholders**

The following issues were raised by stakeholders:

### **2.1. Rationale for beneficiation of South Africa's natural endowments**

South Africa's existing mineral endowment provides a potential comparative advantage for upstream and downstream manufacturing that could support and sustain transformation and industrial development. Dr P Jourdan asserted that South Africa has sufficient mineral and natural resources to ensure the cost-effective provision of critical mineral and natural feed-stocks for downstream beneficiation to create job creation and could use government intervention to achieve this and develop a competitive advantage<sup>7</sup> for South Africa. The Minister of Trade and Industry, Dr R Davies, supports this view and further argued that this endowment also has the potential to attract and develop technological excellence in upstream and downstream minerals-related industries. Furthermore, the Minister stressed that the real value of the raw material increases as it is processed

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<sup>7</sup> A competitive advantage refers to something that gives a firm or a person or a country an edge over its rivals (The Economist).

and one moves along the value chain. However, this transformation process requires appropriate skills and technology to transform the raw product.

A second school of thought exists that argues that the natural and mineral endowment of a country should not be considered as its comparative advantage. Rather it should be focused on supporting and embracing technological competences in the manufacturing sector rather than beneficiation which would be the driver of economic growth. The Chamber of Mines (CM) are of the view that the comparative advantage of mineral resources should not be considered as a key driver of manufacturing beneficiation investment but that other competitive advantages such as cost-competitive production, skills and craftsmanship, should drive this investment decision. Furthermore, the Chamber is of the view that manufacturing is currently driven by competitiveness issues rather than the availability of natural resources.

In addition, not beneficiating the non-renewable natural resources, would result in South Africa not achieving its developmental goals of poverty reduction, reducing inequality and job creation. It was reported that the failure to beneficiate had resulted in several developmental linkages and broader manufacturing capabilities, such as research and training, being undermined. Further, the latter approach of not using the country's comparative advantage would leave the country vulnerable to commodity price fluctuations.

However, the committee is of the view that the two arguments may not be mutually exclusive. The ability to leverage the comparative advantage of South Africa's mineral and natural resources as well as core technological competencies are necessary to move up the value chain. Furthermore, the development of upstream and downstream beneficiation linkages is critical. Therefore, securing the knowledge linkages is a prerequisite for developing the crucial upstream and downstream beneficiation linkages. However, monopolistic behaviour of dominant firms that provide key inputs undermine the competitiveness of the manufacturing sector.

Beneficiation should advance development through the optimisation of upstream and downstream linkages, in the mineral value chain, thereby promoting economic diversification and job creation through industrialisation. Beneficiation also aims to expedite progress towards a knowledge-based economy and contribute to an incremental domestic product growth in mineral value-addition per capita, in line with the vision outlined in the New Growth Path, the National Industrial Policy Framework and the Advanced Manufacturing Technology Strategy. Although the mining sector is important for the domestic economy, the manufacturing sector has the highest multipliers<sup>8</sup> with significant spill-over effects. Therefore, the need to move up the value chain is critical to address South Africa's socio-economic challenges.

## **2.2. South Africa's Beneficiation Strategy**

The Minerals Beneficiation Strategy provides a framework that seeks to translate the country's sheer comparative advantage inherited from mineral resources endowment to a national competitive advantage. The strategy is aligned to a national industrialisation programme, which seeks to promote the creation of decent employment, diversify the economy, including the promotion of the green

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<sup>8</sup> A multiplier, in economic terms, refers to the multiplication effect that an investment and/or injection into the economy may have on jobs or economic growth in a broad manner. So if an industry has an employment multiplier of 2, then for every R1 invested into that industry, 2 jobs is expected to be created in the economy. While an economic multiplier of 2 would imply that for every R1 invested into that industry, R2 is expected to be generated in the economy.

economy, and enhance the quantity and quality of exports. Further, the strategy is contributory towards strengthening the knowledge economy in support of the overall competitiveness of the economy.

Although South Africa has achieved the first three stages of (upstream) beneficiation<sup>9</sup> it failed to move to stage four, downstream beneficiation as a result of how the economy is structured, the anti-competitive behaviour of monopoly firms, high cost structures, and the failure to attract sufficient public and private investment in manufacturing industries. The IDC is of the view that a beneficiation strategy should identify which valuechains should be developed and link these to the domestic resources, infrastructure capacity and skills base. The strategy should leverage market access to subsidies and incentives to acquire and develop technology, and expertise through transfer arrangements and licence agreements. The high cost structure, such as input cost (including transport and energy cost), and wages and salary, weakens competitiveness.

The Department of Mineral Resources (DMR) is of the view that beneficiation is part of a broader policy and legislative framework that leverages more value from the mining sector beyond taxes and royalties. The Mining Sector Value-addition Framework covers strategic state participation in mining, broad ownership of mines, the development of mining communities, leveraging procurement and enterprise development by mines, developing mine workers and ensuring sustainable development and growth around mines, as well as mineral beneficiation. The DMR informed the committee that strengthening the MPRDA to ensure security of supply is important to provide clarity on how the Minister would promote beneficiation. Amendments with respect to section 26(3) of the MPRDA attempts to address the need to strengthen beneficiation requirements and security of supply and would empower the Minister to designate certain minerals for beneficiation purposes and require mining operations to set aside a certain percentage for local production.

The Manufacturing Circle supports the beneficiation initiative of our mineral and natural resources and the increased role of the manufacturing sector. A major concern for the Manufacturing Circle was labour market instability, especially within the mining sector, which it alleged negatively impacts on the manufacturing sector due to the economic linkages. Decisive government response with respect to labour market instability is required to ensure that its impact on the economy is minimal. It also noted that manufacturing is broader than beneficiation encompassing the inputs into mining and downstream beneficiation, as well as the use of recycled material that can substitute certain raw mineral resources in an energy efficient manner.

### **2.3. Constraints to beneficiation**

A number of broader constraints were identified by stakeholders. These included:

- Incoherent and/or inconsistent policies which create policy uncertainty.

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<sup>9</sup>The four stages of beneficiation after the production of the saleable raw material or basic saleable product are as follows:

- Saleable smelted or refined products,
- fabrication alloys,
- semi-manufactured articles, and
- fabricated articles. (Robinson and van Below 1990)

- The impact of the regulatory environment, which either places a high compliance burden on industry or is not being implemented effectively to provide adequate support for beneficiation.
- The use of import parity pricing in the steel and polymer industries.
- The high domestic cost of transport and energy.
- Low local demand and inconsistent use of public procurement to support value-addition.
- Insufficient and sometimes inappropriate skills development coupled with low levels of investment in research and development.
- Continuous labour unrest.

These are discussed in further detail below.

### **2.3.1. Regulatory environment**

A number of stakeholders highlighted the need for greater policy coordination among government departments to ensure policy certainty and to reduce the compliance burden. Furthermore, there was a perception that the current policy and regulatory environment was not necessarily working together to support beneficiation by collectively promoting the development of the requisite upstream and downstream linkages. This encompassed areas covering economic development, infrastructure development, provision and pricing of economic services, such as electricity and transport, and environmental protection.

In addition, there were complaints that certain enabling provisions were not being implemented, in particular, section 26 of the MPRDA. This section provides for the promotion of mineral beneficiation through the provision of incentives, the determination of particular minerals for beneficiation and for the Minister of Mineral Resources to be notified and consulted about the foreign beneficiation of South African mined mineral. The DMR informed the committee that parts of this section cannot be operationalised; hence, the need to amend the MPRDA.

Furthermore, Forestry SA raised concerns regarding the implementation of policy to support small growers. This included the transfer of state plantations to rural communities for reforestation; the provision of a grant to support small grower development; and the implementation of the Forest Protection Strategy.

In terms of the environmental regulatory framework, the National Environmental Management Act (No. 107 of 1998) (NEMA) requires that environmental authorisation be obtained before engaging on listed activities such as afforestation. The DTI reported that this regulated process may take as long as 18 months to complete. In addition to the time it takes to complete, several specialist inputs are required as part of the application. Funding therefore becomes a problem for communities interested in forestry. This constrains growth in the whole forestry value chain including timber and non-timber products such as essential oils. Dr M Horak also emphasised that the existing regulatory framework was stifling the growth of the essential oils sector. He argued that the environmental requirements are not appropriate for this level of economic activity. In addition, the application processes do not consider the capabilities and resources available to rural communities and small enterprises.

The Manufacturing Circle inferred that currently environmental measures were working against sustainable beneficiation due to the onerous cost of compliance related to environmental impact assessments and water licence applications. It also highlighted disparities in water licence applications between public, public-private and private sector projects. Forestry SA concurred with the challenges related to water licence applications. Furthermore, it complained that the enforcement of

water licences was skewed with forestry being strictly regulated while other stream reduction activities such as agriculture and mining are not equally monitored.

Other concerns raised by the Manufacturing Circle and Plastics SA was that competitors located in other countries were not necessarily required to meet the same onerous environmental requirements. Compliance with these domestic environmental requirements raise the cost for local producers and may lower their competitiveness, as there is no buffer from similar imported goods in the domestic market that do not have to meet similar requirements elsewhere. The committee is of the view that there is a need to simplify and expedite processes to encourage and assist rural communities to participate and comply with the legislative requirements.

### **2.3.2. Import Parity Pricing**

In 2011, the committee emphasised the role that steel played in the manufacturing sector as a key input. The price of steel was identified as a key impediment in the reindustrialisation drive to develop the economy and create sustainable jobs. At that stage, the committee criticised the impact of ArcelorMittal South Africa's (AMSA) import parity pricing<sup>10</sup> (IPP) policy on the competitiveness of the steel industry and subsequently on downstream beneficiation. Recently, it has been reported that Sasol has been producing propylene and polypropylene at possibly the lowest cost in the world but still marking up the domestic price by 30 per cent more than the export price. The matter is currently under review after the Competition Tribunal had ruled against Sasol.

According to the Competition Commission, pricing at IPP itself is not in contravention of the Competition Act. However, where IPP represents the exercise of market dominance by maintaining high prices by "shorting" the local market<sup>11</sup>, it is a concern. The Competition Commission is of the view that this practice curtails beneficiation as the benefits to those controlling minerals and producing primary derivative products are not flowing to downstream industries in the form of competitive prices. This also distorts local costs due to the lack of local competition. This practice often occurs in industries that are characterised by entrenched dominant firms seeking to protect their positions. Therefore, the essential inputs to industrial development are not made available at a competitive domestic price that would contribute to industrial development.

Prof Simon Roberts agrees that the existence of inherited monopolistic powers especially in upstream firms related to mineral and natural resources is a fundamental impediment to industrialisation. A number of these monopolistic firms were established and supported by the state as a consequence of the apartheid policies, this was reinforced by the absence of competition when these firms were privatised post-1994. It is within this context of monopolistic behaviour that industrial policy should seek, through the necessary regulatory and legislative inducement, to address this imbalance to radically transform the economy. The abuse of dominance provisions within the Competition Act (No. 89 of 1998) are intended to address this legacy of "existing entrenched positions, disciplining the exertion of market power"<sup>12</sup>. These positions of dominance were not earned through "risk and investment" but were achieved through significant state support which entrenched their dominance.

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<sup>10</sup> Import parity pricing ("IPP") essentially describes the situation where a domestic supplier of a particular good sets the price of that good at a level which is equivalent to the cost its potential customers would incur if they were to import the good from elsewhere (Murgatroyd and Baker 2010).

<sup>11</sup> "Shorting" the market refers to exporting/reducing supply to create an artificial situation where the import price sets the local price.

<sup>12</sup> Simon Roberts presentation

Dr Paul Jourdan concurs that a major constraint to reindustrialisation is monopolistic pricing of mineral feedstocks. He is of the view that minerals should be made available at a developmental price along the valuechain in order to facilitate industrialisation. The Minister agreed with this view that strategic inputs should be available at developmental/discounted prices to support value-addition of raw minerals. He argues that this is possible as currently mining houses are capturing mineral resource rents<sup>13</sup> over and above a reasonable profit. Alternatively, the state could capture these rents to reinvest in capital and human infrastructure development that would support beneficiation efforts if mining houses were unwilling to pass the benefits of these resource rents to downstream users of their products.

The Minister illustrated that “according to the auto catalytic converter industry if the price of a catalytic converter produced in South Africa was 10 per cent cheaper the industry would be able to grow their production five times and consume half of South Africa’s PGM’s<sup>14</sup>. The PGM metal itself accounts for 50 per cent of the cost of a catalytic converter and stainless steel 20 per cent, a 15-20 per cent discount below market prices will be required for both the PGM’s and stainless steel and would contribute to South Africa’s ability to produce catalytic converters”<sup>15</sup>. Therefore, an alternative pricing policy to the existing IPP policy could have a profound impact on domestic production and competitiveness.

#### **2.3.2.1. Iron and steel**

It became clear through the committee’s recent engagement with AMSA and other stakeholders that the matter with respect to the price of steel in support of downstream beneficiation still remains a challenge. AMSA maintains that its current pricing policy is to offer a competitive steel price to the domestic market through benchmarking international price trends in both the domestic<sup>16</sup> and export markets and that it contributes to government’s downstream beneficiation initiatives through its rebate incentive scheme for exports.

AMSA produces five per cent of the world’s primary steel products, of which approximately 82 per cent is exported. AMSA informed the committee that it is a loss-making company. In 2012, it made a loss of R477 million and a profit of R47 million in 2013. AMSA also claimed that although the price of steel has increased by eight per cent, its cost of production has increased by 12 per cent. AMSA attributes its loss to internal constraints with their production processes that has led to it producing steel below full capacity and to the low local demand for steel. Its dilemma is exacerbated by competition from cheap subsidised imports. Other reported constraints included high administered prices, labour cost and low productivity, which had a major impact on its performance. Therefore, AMSA asserts that it is not in a position to change its pricing model.

The Minister informed the committee that AMSA’s steel prices have been on average 13 per cent higher than the proposed DTI benchmark price (excluding China) and tended to range in the top quartile of world steel prices. This level of steel pricing is inhibiting downstream beneficiation and contributing to reduced industry competitiveness. The Minister, supported by the committee, is of the

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<sup>13</sup> Mineral resource rent: a tax on profits generated from the exploitation of non-renewable resources.

<sup>14</sup> PGMs refer to platinum group metals

<sup>15</sup> Presentation of the Minister of Trade and Industry, Dr R Davies on 2 September 2014

<sup>16</sup> This is based on the price of steel imports that have been delivered to South Africa.

view that without a competitive steel industry South Africa will not have a competitive manufacturing sector. In addition, the Minister does not support the views purported by AMSA that it represents a struggling industry hampered by high administered prices and the influx of cheap imports. This is in light of the fact that AMSA has been reducing its production of steel products by approximately 20 per cent when world steel production has been rising.

In AMSA's response to a request for additional information with regard to its current pricing policy and how it determines its prices, AMSA informed the committee that "steel pricing is a complicated issue ... and we cannot discuss these issues in public as they are confidential to our business model"<sup>17</sup>. The limited information received from AMSA with respect to the determination of domestic prices led the committee to conclude that their determination of the domestic price is not based on AMSA's input costs including the iron ore price of cost plus a margin of 20 per cent from the Sishen Iron Ore Company.

#### **2.3.2.2. Polymers**

The pricing of chemical feedstocks has been recognized as a challenge to the growth of the plastics sector by IPAP. Sasol's pricing of intermediate products has been subject to competition enforcement cases, the latest of which is the Competition Commission versus Sasol Chemical Industries (SCI) case on the pricing of propylene and polypropylene. According to Prof Simon Roberts the discrimination against local buyers, by charging at import parity for products that Sasol has large net exports may be in contravention of clause 8 of the standard mining licences which stipulate non-discriminatory pricing. The downstream plastics industry has performed poorly as a result of an increased import penetration and the price of polymer inputs.

According to the Minister, polymers can represent up to 60 per cent of the input cost to the plastics industry. If the price of polymers were discounted by 10 – 15 per cent downstream industries would have a competitive advantage. He was of the view that securing the price discount was critical for beneficiation.

Plastics SA was of the view that discounting the cost of the raw material in isolation will not result in the industry becoming more competitive. They proposed an integrated approach which considers the various aspects that impact on the value chain, such as the regulatory framework affecting plastic products, skills development, other input costs, research and development of new materials and products and the availability of testing facilities. A holistic solution would make the local consumption and export of plastic products more viable by reducing the associated manufacturing costs, which are also out of alignment with international competitors. As an example, Plastics SA emphasised the cost of compliance with regulations, which foreign competitors were not affected by that influenced the sector's level of competitiveness.

The committee as well as other stakeholders actively shared the view that an inclusive, expanding economy would be elusive until monopoly pricing of mineral feedstocks and high administrative input costs were effectively addressed. A coordinated approach is critical especially among the various government departments responsible for industrial policy, regulation and competition policy to ensure that these are complementary and mutually reinforcing.

#### **2.3.3. Transport and energy costs**

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<sup>17</sup> Letter dated 12 September from AMSA in response to a request by the committee for additional information.

There was general consensus that transporting goods within South Africa's borders was more expensive than transporting goods from South Africa's ports to Asian countries. There was also concerns raised about access to rail transport in terms of the challenges in securing contracts and the time taken to transport goods.

In particular, the plastics industry has highlighted that the low weight-high volume ratio of plastic goods affected its transport costs. They informed the committee that local transport costs are high due to road freight<sup>18</sup> being the main choice for transport. As there is a minimum charge for a truck to travel a certain distance or a route; plastic products attract a higher unit cost relative to other products being transported on the same size truck making the cost of transport the second highest after raw materials. The industry asserts that it is more cost-effective to ship plastic products from Cape Town to Mumbai than to transport the same load from Cape Town to Johannesburg or to Durban. In addition, port tariffs affects the competitiveness of plastic products in the export markets. According to SEIFSA, venturing into the export market is complex due to the competitiveness factor.

In addition, Plastics SA informed the committee that energy cost is the third highest input cost for the industry. The supply of affordable energy is critical as it affects the profit margins, its competitiveness, and its ability to export. Furthermore, plastic conversion requires an uninterrupted supply of electricity as the cost implication of unplanned load shedding is huge. When electricity tariff increases exceed inflation, it influences the selling prices and negatively impacts on business because consumers are price sensitive. Administered price inflation, which is higher than the Consumer Price Index (CPI), the insufficient electricity supply and the certainty of supply have a major impact on business.

To mitigate against high energy cost and the need to secure energy supply, government has recognised the importance of seeking alternative energy sources to secure future supply. According to Mainstream Renewable Power, "South Africa has vast renewable energy sources which could provide South Africa with 40 gigawatts (GW) of new capacity by 2035, and up to 100 per cent of the country's electricity by 2050".

The Renewable Energy Independent Power Producers Procurement (REIPPP) Programme introduced by government seeks to secure future supply, mitigate against environmental concerns and contribute to job creation. Driven by the REIPPP South Africa has seen a significant growth in the renewable energy market which provides opportunities for the development of a local renewable energy industry and creating the necessary local supply chains. Mainstream Renewable Power illustrated the possible saving to the Nelson Mandela Bay area if it utilises wind power based on a simulation using actual data from the Jeffrey's Bay wind farm.

Mainstream Renewable Power informed the committee that manufacturing jobs would be created if there is long-term certainty with respect to volumes and clear public procurement process rules. This could potentially lead to the creation of 360 000 jobs for a 20 year programme at 2GW and create jobs in manufacturing in relation to the production of wind blades, towers, solar panels with an associated positive spin-offs for the tertiary sector.

In addition, there are signed agreements that will add to the pool of nuclear suppliers from which the country can choose for its nuclear procurement programme. This contributes to the existing nuclear energy plant in Koeberg to a more comprehensive, self-sufficient nuclear industry.

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<sup>18</sup> Factors that influence the cost of road freight include fuel and toll prices, insurance and interest.

While the use of alternative energy such as wind energy is encouraged, it should be noted that it is not a major employment creator beyond the construction phase. Short-term employment is created during the construction stages, after which fewer employees are required for day-to-day operations of the wind mills. However, once these skills are acquired, they can be used to manufacture and sell renewable technology to the African region and beyond. At this stage, the cost of renewable energy is lower than new coal-fuelled electricity.

#### **2.3.4. Public procurement**

Plastics SA raised concerns around government's implementation of public procurement of locally produced goods through the Preferential Procurement Policy Framework Act's (No. 5 of 2000) (PPPFA) regulations, particularly for designated sectors, which could be a strategic instrument to increase domestic demand for plastic products and thus increase the economies of scale for local producers. The association referred to the closure of several manufacturers due to insufficient domestic demand for certain products that these manufacturers produced such as syringes.

Factors that influenced local manufacturers' ability to meet state demand includes:

- The timeframes from the state's announcement of its decision to procure certain products and its implementation thereof,
- The length and security of such tender contracts,
- The associated low return on investment, and
- The apparent lack of recognition of the local plastic content as components of other procured or designated goods.

In terms of the long timeframes before procurement and the uncertainty of continued demand, manufacturers are hesitant to make large investments in new moulds or to change their production lines in the absence of certainty about the demand for these products. Furthermore, as plastic tends to be an input into a wide range of products, the need to recognise the local plastics component in those products becomes critical to ensure that plastics, as a targeted area, benefits from local procurement. Manufacturers remain concerned about the lack of recognition of its local content and have requested that the plastics industry be designated.

#### **2.3.5. Skills development and Research and Development**

The rapid technological changes and competitiveness within the manufacturing sector necessitates investment in rebuilding South Africa's industrial capabilities through domestic research and development with government playing a key role. Dr Paul Jourdan argues that investment in Science, Technology, Engineering and Mathematics (STEM), technology development (RDI) and geo-sciences (geo-mapping for future resources) requires a change in expenditure policies of government. Skills formation and research and development would enhance the competitiveness of the manufacturing sector and would positively impact on economic growth. Innovation based on research and development requires capital investment from the public and private sector. The mining sector should regain its mining technology capacity as it was under the guidance of the Chamber of Mines Research Organisation (COMRO). Dr du Preez informed the committee that in pursuit of the beneficiation opportunities South Africa has established a Titanium Centre of Competence with the mission of integrating and coordinate research and development as well as commercialisation of titanium across the value chain. Developing the necessary technology platforms is critical for the

industrialisation and commercialisation of technologies and would lead to the establishment and development of South African suppliers.

The Manufacturing Circle highlighted the importance of innovation in the beneficiation drive. They are of the view that the current IP regime does not support the national system of innovation due to a lack of online patent search facilities. They propose the implementation of an examining system for innovation in the interim to bring it in line with international practice.

The absence of appropriate skills to advance the objectives of industrial policy has been identified as a major constraint by stakeholders. All stakeholders identified that the cornerstone of any industrialisation drive is the availability of appropriate strategic skills and strengthening the implementation of the existing measures to facilitate skills development.

The DTI has demonstrated through the National Tooling Initiative Skills Development Programme that the skills shortage can be overcome. The committee is of the view that government, in cooperation with industry, should develop specific programmes that develop and deploy skills into critical areas of the economy; such programmes would include harnessing the wealth of knowledge and experience in retired engineering, science and project management professionals.

#### **2.4. Impact of transfer pricing on transformation of the mining sector**

Southern African Mining Development Association (SAMDA), led by the chairperson, Ms B Radebe, raised the issue of transfer pricing<sup>19</sup> within the mining sector as it compromised compliance with the Mining Charter and thus transformation within the mining sector. She informed the committee that the practice of transfer pricing, both legally and illegally, is not a new phenomenon in the mining sector and involves the sale of a company's commodities to its off-shore divisions at a lower than market related price. She illustrated this practice with the following example:

Company A is a mining transnational company (also known as a multi-national company) based in countries X and Y. If the corporate tax rate in X, where the actual mining takes place, is 28 per cent and 18 per cent in Y, Company A would automatically increase both its absolute profit and its rate of profit per share by 10 percentage points if it were taxed in country Y rather than X. It achieves this desirable objective simply by including a 50 per cent discount in its invoice to its company in Y. Thus, instead of a market price of, say, R20 million, it charges itself only R10 million. In this way, it simultaneously reduces its taxable income by R10 million in high tax country X, while increasing its taxable income in low tax Y. This results in a saving of R1 million (i.e. 10 per cent of R10 million).

This results in the exportation of profits to off-shore accounts and the declaration of low profits and the payment of low taxes in South Africa where the commodity is produced and exported from. This practice allows the foreign trading companies to make extraordinary profits at the expense of the broad-based black economic empowerment (BBBEE) partners who are effectively denied profits leading them to be unable to repay loans that were used to acquire shares. This practice also deprives the fiscus of tax revenue and the resultant saving deprives the workers of a decent wage. The committee agrees with SAMDA on the negative impact of transfer pricing on the economy and

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<sup>19</sup>The transfer price refers to the price at which divisions of a company transact with each other. Transactions may include the trade of supplies or labour between departments. Transfer prices are used when individual entities of a larger multi-entity firm are treated and measured as separately run entities. (Investopedia 2014)

supports SAMDA's call for the alignment of the Mining Charter with the DTI's new BBBEE Codes of Good Practice to address transfer pricing and the non-compliance of the Mining Charter.

However, government has failed to use the necessary regulatory and legislative tools at its disposal to address these anomalies. With respect to transfer pricing the DMR informed the committee that a legislative basis exists to address transfer pricing. Currently work is underway with all the relevant role-players to mitigate against the practise of transfer pricing.

## **2.5. Specific industry comments**

### **2.5.1. Steel**

Scrap metal is a direct input into steel making, for AMSA and the other small mills. It is also a major input into the foundry sector. Scrap metal consists of ferrous and non-ferrous metals. Ferrous metals contain iron (for instance steel) whilst non-ferrous metals do not contain iron (for instance aluminium and copper). Scrap metal is sourced from end of life products ranging from mining, chemical and processing plants to old fridges and cars; and from scrap produced during manufacturing processes. Steel, in one form or another, comprises the most significant input into a wide range of [manufactured and value-added products](#). Therefore, access to affordable steel and scrap metal is critical for the development of the local metal manufacturing industry.

The DTI is of the view that scrap metal should be regarded as a beneficiated product that is more energy efficient when used in a value-adding process. The unimpeded, unencumbered export of scrap metal poses a significant threat to the manufacturing sector. The DTI is of the view that rapid increases in scrap metal exports has undermined the local industry, with adverse consequences for economic growth and job creation. Introducing the necessary instruments to secure affordable supply of scrap metal in support of the manufacturing sector is important. These policy instruments should seek to contribute to the re-industrialisation of the economy and the creation of jobs.

Mr B Stone, the sales director of Zimco, a subsidiary of the Zimco Group, provided the committee with a breakdown of its key manufacturing input costs, of which the price of raw scrap metal because of the high export demand constituted 60 per cent of the manufacturing cost. This unrealistic input cost clearly undermines the local beneficiation drive. The availability of quality and affordable quantities of scrap metal is critical to local manufacturers given the fact that the export of scrap metal has increased significantly. He informed the committee that due to a decline in the international competitiveness of beneficiation of non-ferrous scrap metal the industry welcomed the price preference policy by which exporters of scrap metal must first offer domestic foundries, mini-mills and secondary smelters scrap metal at a price discounted by 30 per cent to international prices before qualifying for an export permit. However, he raised the concern that notwithstanding the price preference policy that no companies are paying the preferred preferential price, as scrap metal dealers had not been cooperating with local scrap metal converters. In this sector, the increase in the price of popular grades of scrap metal has led to a contraction in the industry as the cost of scrap feedstock is a major cost driver.

As indicated by ZIMCO, the mechanisms put in place by the International Trade Administration Commission (ITAC) have to a large extent been unsuccessful in addressing the pricing and access challenges to quality scrap feedstock, notwithstanding the court challenges by the Metal Recyclers Association against the measures. It should be noted that scrap metal, referred to as “mining above ground”, is now a major industrial input in manufacturing across the world leading to unrealistic pricing models depending on the objectives of the procuring country. At different periods, some countries, including South Africa’s direct competitors, have either imposed an export ban or an export tax on scrap metal. The DTI is working with ITAC and Economic Development Department to improve the current measures.

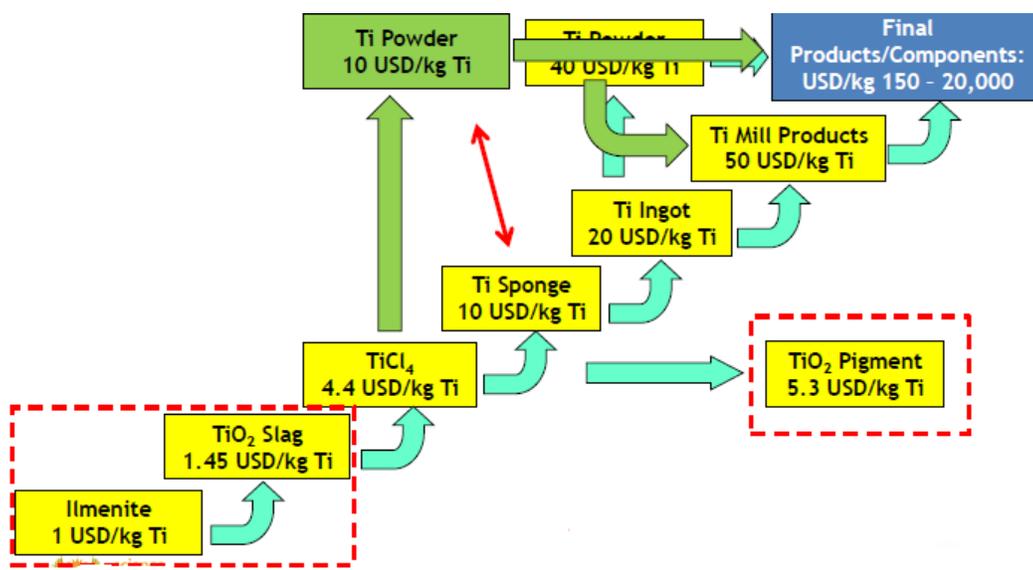
Over and above the measures to improve the pricing and access of inputs, the DTI, working with the foundry sector and academia, runs the National Foundry Technology Network (NFTN) whose objective is to enhance the competitiveness of the foundry sector. This in turn will improve the quality, delivery time and delivery cost of casting into the local manufacturing sector especially for designated sectors like valves and rolling stock.

However, to ensure the domestic availability of scrap metal at reasonable prices, measures are needed to counter-balance the impact of tariffs, anti-dumping duties and subsidies, and a favourable exchange rate for exporters.

**2.5.2. Titanium**

Beneficiation of our mineral and natural resources has become a national imperative for sustained economic growth and job creation. In 2011, the Department of Mineral Resources in its beneficiation strategy for the mineral industry in South Africa identified the development of the titanium value chain as a potential key growth area for South Africa. The goal for the titanium beneficiation programme is to have a titanium industry with potential revenue of R5 billion per annum and an increased international market share.

Dr W du Preez informed the committee that downstream markets exist, but absent is a downstream industry for these metals which have significant market opportunities within the aerospace, medical and marine sectors. Titanium presents a significant opportunity for value-addition within the primary metal and mill products, downstream components and manufactured products. Figure 2 provides an overview of the titanium value chain and the typical prices earned for each product along this chain in the blue and yellow blocks. According to Dr W du Preez, South Africa is currently producing titanium dioxide slag with a market value of \$1.45 per kilogram of titanium from ilmenite and titanium dioxide pigment with no value-adding beyond this and importing titanium metal at a high cost (see Figure 2). Given South Africa’s resources, this is considered a market failure.



## **Figure 2: Typical prices along the titanium value chain**

Source: du Preez (2014)

The potential for value-addition in down-stream manufacturing of titanium and titanium dioxide in South Africa beyond titanium dioxide or slag cannot be underestimated. South Africa is the second largest producers of titanium mineral, if developed, has massive potential for the aerospace, medical, marine, chemical, automotive, recreational industries among others. It is therefore critical for the development of the processes and technologies that would enable industries to operate across the titanium valuechain that add significant value to a natural mineral resource. The commercialisation and improvement of mineral processing technologies would contribute towards a more cost-effective and wider exploitation of mineral resources addressing environmental concerns.

Dr W du Preez informed the committee that establishing an industry would lead to the emergence of downstream manufacturing industries. Establishing a titanium metal industry will contribute to economic growth, continued job opportunities and revenue generation. He was of the further view that it can potentially create opportunities for the establishment of small and medium enterprises and complement Black Economic Empowerment initiatives, such as the emergence of black industrialists. However, this would require a significant investment to develop and commercialise new titanium technologies (namely the green block and arrows in Figure 2 to bypass the current value chain and produce titanium powder directly and then fabricate this).

IPAP has identified the “development of a titanium production capability roadmap with the focus on downstream manufacturing technologies and products...” positioning South Africa as the lead supply chain participant within the global titanium manufacturing industry, concentrating on aerospace and defence products and new technologies, with significant possibilities for downstream industries such as medical, energy, automotive, chemical processing, marine oil and gas. Dr du Preez argued that “significant value-addition could be achieved if South Africa moves higher up the value chain. The ability to produce titanium metal in a cost-effective way would have massive potential for the manufacturing industry. In this regard, South Africa has been investing in research to develop the necessary technology to produce titanium powder and fabricate this into finished products.

The DTI is of the view that South Africa could benefit by collaborating with countries, like China, which are ahead of South Africa in titanium beneficiation. At the current rate, South Africa will only be a significant titanium beneficiator in ten years' time.

### **2.5.3. Plastics**

Plastics SA informed the committee that plastics are a key economic driver for industrialisation and economic growth. However, the emphasis on the importance of raw material costing should not be ignored. The DTI reported that, in most cases, 60 per cent of the input costs are attributed to polymers. The plastics sector annually contributes 1.6 percent to GDP and 14 per cent of the manufacturing sector's contribution to GDP. IPAP recognises the growth potential for plastic products

citing a growth multiplier of approximately 2.6 and an employment multiplier of about 3.5<sup>20</sup>. However, plastics also have many applications in other downstream manufactured products, such as stationery, clothing and footwear, medical equipment and certain vehicle components.

Notwithstanding the sector's growth and value-adding potential, in certain segments, it faces huge challenges with competition from cheap imports and alleges that under-invoicing of imports has also been rife. Recently, Plastics SA, in partnership with the South African Revenue Service (SARS), introduced a reference pricing system for film (i.e. printed or unprinted sheeting used to make potato chip packets and for other packaging), which has been entering the country at prices lower than the material cost for local manufacturers. This had the potential to undermine the sector. Furthermore, the sector was of the view that existing tariffs and tariff negotiations do not take into account that plastic products are being targeted as part of the industrialisation drive.

The industry was concerned that the trade balance for its products was in a deficit and was deepening. The value of exports have been constant, while there has been a significant increase in imports over the last few years. If the industry was able to regain this local market share, particularly in the public sector, it would lead to significant job creation.

Sasol focused on its beneficiation activities in terms of converting coal and gas to liquid fuels, as well as the by-products of these processes that may have other commercial uses. It alluded to the benefits of its production of chemicals to downstream sectors, as well as the assistance it provides to these users. Sasol also highlighted the need for continuous research and development investment, an enabling regulatory framework, and access to feedstock, the role of infrastructure and utilities, skills and energy security to facilitate beneficiation efforts.

Although the Committee commended Sasol's upstream beneficiation activities, it was concerned that Sasol had not engaged on the key issues of the colloquium which related to the pricing of their chemical feedstocks to downstream, labour-absorbing, manufactured products such as plastics. Similar to AMSA, Sasol's pricing model was also based on import parity pricing.

From the presentations by SASOL, it was clear that the local fuel price determined Sasol's decision to produce polymers and the pricing thereof. There appeared to be no discretionary decision to link the price of polymers to the local downstream industry.

#### **2.5.4. Forestry**

Forestry SA (FSA) informed the committee that the plantation industry is currently only occupying one percent of arable land. The two main species used in commercial plantations are pine and eucalyptus with wattle comprising only 9.5 per cent of total production. The total value of timber produced in South Africa is R6.7 billion, while associated value-adding sectors contributed a further R20.4 billion and sales to processing plants an additional R17.4 billion. The timber industry contributes 7.7 per cent to manufacturing GDP and 25.5 per cent to the agricultural GDP.

FSA informed the committee that the primary sector does not significantly beneficiate but provides the raw material for beneficiation in subsectors such as pulp and paper, sawmilling, particle boards, mining timber and poles with 98 per cent of the timber beneficiated domestically. Sawmilling SA concurred with the view that exportation of timber is minimal. The majority of South African pine is used for structural purposes. Beneficiation of imported lumber is high and prevalent in the furniture

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<sup>20</sup> DTI (2014: 18-19)

industry, as the domestic market mainly demands furniture made from high value sub-tropical, tropical and temperate hardwoods, which cannot be grown locally at the required scale due to South Africa's climatic conditions. However, the sector does provide wood for the frames and/or carcasses of upholstered furniture. The sector contributes about R42 billion to GDP.

One of the challenges facing the industry is related to the availability of land for afforestation. There has been a decline in the land available for plantation and this was exacerbated by the failure to transfer state land to rural communities. Government's decision to disinvest in state forests in the Western Cape and Mpumalanga, although reversed now, had an adverse impact on the industry which will take some time to recover. FSA informed the committee that industry and government had agreed in the Forestry Sector Charter that 100 000 new hectares of timber would be planted in Eastern Cape and Kwazulu-Natal, which could be a catalyst for local economic development. Unfortunately, not even 2 000 hectares were planted yet.

South Africa had a competitive advantage with respect to clonal breeding and in pest and disease control which has slowly been eroded. The lack of support for small-scale growers and the risk of pests, diseases and fires, especially to small-scale growers contributes to the decline in South Africa's relative cost-competitiveness in this sector. These factors affect the stock available to downstream users, as well as the ability of the sector to transform. South African timber exports are facing tariff and non-tariff barriers from competitors that subsidise their forestry sector. The industry requested state intervention for new afforestation in the Eastern Cape and KwaZulu-Natal and for the establishment of a forestry grant to assist small growers.

Specific challenges facing small-scale growers include insufficient access to affordable development finance, soaring administered prices, high labour costs relative to the time period before the return on investment is realised, the absence of state support in the form of grants for small growers, limited access to rail and performance-based standards (PBS) vehicle alternatives, insecure tenure over crops and vexatious water regulations.

The main challenge affecting the emergence of black small growers is access to affordable funding. The available land suitable for new afforestation is largely owned by communities. Private companies partner with these communities to develop forestry projects. In the last few years, the Department of Agriculture, Forestry and Fisheries and the DTI have funded some EIA costs for some of these projects (private sector-community projects). Unfortunately, this is not enough to cover all the EIA funding required for new projects. The problem is that these are not coming from an established grant/incentive programme; therefore, funding is not always available. Through the Forestry Sector Charter, the Department of Agriculture, Forestry and Fisheries has committed to establish a forestry enterprise grant. The absence of this grant is a major constraint to both the establishment of new forests and the participation of black growers.

Paper Manufacturers South Africa (PAMSA) acknowledged that to improve domestic competitiveness the necessary investment in research and development is critical, and the partnership with the Department of Science and Technology would contribute to innovation and the development of appropriate skills for the industry.

Although there are opportunities to grow the industry, particularly through public procurement of building construction material for housing projects and paper for education and other purposes, industry players in the forestry value chain face increased competition due to imports from countries that subsidise their industries. In 2006, the ITAC took the decision to remove all the pulp and paper

industry's tariffs which has seriously disadvantaged the timber industry.

The furniture industry is experiencing an influx of imported furniture, especially from the East. The escalation of cheap imports over the past ten years has resulted in the furniture industry shifting from being a net exporter to being a net importer with industry capacity utilisation decreasing from around 70-100 per cent to around 50 per cent, from decreased demand of locally produced furniture. Influx of cheap imports and the challenge of getting retailers to buy locally produced products. With the industry already at its bound rate<sup>21</sup> (tariffs), the survival of the industry will largely depend on interventions to and increase procurement of locally manufactured products by both government and retailers.

Three categories of furniture have been designated for local procurement, namely: base and mattress, school furniture and office furniture. It has only been two years since furniture was designated and may not show much impact now. The government procurement systems, especially relating to school furniture, where schools are procured as turnkey projects might lead to some leakages. The procurement volumes are also low as organs of state procure separately. Much effort will need to be placed on ensuring compliance and identifying gaps in the classification of furniture products, standardising and lumping orders across organs of state, as has happened with Information and Communications Technology procurement through the State Information Technology Agency.

#### **2.5.5. Essential oils**

Adding value to South Africa's plant biodiversity through scientific innovation should not be underestimated. This was the view expressed by Dr M Horak who informed the committee that South Africa's indigenous knowledge and biodiversity resources have not yet been leveraged for the benefit of sustainable development or systematically investigated to develop new medicines and drugs. South Africa has a competitive advantage which should be harnessed through scientific research but has not yet bridged the gap that would lead to the development of new enterprises that cultivate and process indigenous plants with fragrant, cosmetic, medicinal and/or nutritional value. These markets have not yet been explored despite access to resources and a plethora of scientific research findings, and patents emanating from local universities but very few enterprises have emerged that cultivate and process indigenous plants. The committee is of the view that the Intellectual Property Laws Amendment Act (No. 28 of 2013), which deals with the commercial use of indigenous knowledge, will support the emergence of these types of enterprises once the Act becomes enforceable.

Essential oils and medicinal plants presents an opportunity for on-farm value-addition through the processing of harvested crops. A collaboration between traditional healers and the CSIR led to the invention of a novel insect repellent product. Currently, three community-based essential oil agro-processing units produce the insect repellent oil. According to Dr Horak, the invention provided an opportunity to demonstrate the value of beneficiation of local resources and indigenous knowledge. Essential oils and medicinal plants present a viable opportunity for sustainable development with the potential for wealth and job creation in rural areas. Potential challenges to the growth of the essential oil and medicinal plant industry is the use of communal land and the environmental and other legislative frameworks.

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<sup>21</sup> The bound tariff is the maximum tariff that a country, who is a member of the World Trade Organisation (WTO), can impose on an import from another WTO member based on its agreed Schedule as part of the General Agreement on Tariffs and Trade.

### **3. Committee findings**

During the colloquium, the committee identified several common constraints associated with up- and downstream beneficiation, which are captured below:

- 3.1 The absence of a coherent and coordinated beneficiation strategy across critical ministries such as the Departments of Agriculture, Forestry and Fisheries, of Economic Development, of Energy, of Mineral Resources, of Public Enterprises, of Science and Technology, of Trade and Industry, of Transport, and National Treasury that would provide policy certainty.
- 3.2 The constraints associated with South Africa's economic structure which inhibits the move toward stage 4 beneficiation that of expanding downstream labour intensive industries and increasing economic diversification.
- 3.3 The failure by government to leverage State Owned Enterprises and public sector's strategic procurement opportunities to develop local industries.
- 3.4 The existence of monopoly pricing (IPP) of mineral and natural feedstock, high administered prices and the current energy-constrained environment that undermines downstream beneficiation opportunities.
- 3.5 Scrap metal is a direct input into steel making and the high levels of export has threatened the availability of affordable scrap metal which is critical for the development of the manufacturing sector. Although the Economic Development Department has created measures to address this, industry has not yet benefitted from these measures.
- 3.6 The failure of the South Africa's Intellectual Property (IP) rights regime to support the national system of innovation in the promotion of innovations and to protect SA IP internationally.
- 3.7 Labour market instability associated with the mining industry and its negative impact on manufacturing output and economic growth and the ineffective response from government.
- 3.8 The failure to attach conditionalities to state-owned companies (SOCs) capital expenditure programmes to secure an increase in local content of products which would enhance beneficiation opportunities.
- 3.9 The continued absence of national mining technology development capacity, which was a comparative advantage that further undermines upstream capital goods structure. Further investment should be given to MINTEK, CSIR and universities for skills development and technology development.
- 3.10 The lack of physical and human infrastructure that do not support beneficiation initiatives either directly or indirectly.
- 3.11 The failure of government to attach industrial development conditionalities when issuing mining licences, such as increased local content in products, value-addition and contributions towards Research and Development. Thus far the Mining Charter appears to have been ineffective in addressing these shortfalls.
- 3.12 Government's inability to invest as a result of budgetary constraints, the failure or reluctance of private sector to invest in downstream beneficiation, and the absence of a resource rent tax that would facilitate beneficiation.

### **4. Conclusions**

Based on its deliberations and its findings from the current colloquium and the findings from the "Report of the Portfolio Committee on Trade and Industry on the implementation of the Industrial

Policy Action Plan with specific reference to the state of the manufacturing sector”, the committee concluded that:

- 4.1 There is a need for a coherent and coordinated beneficiation strategy across critical Ministries that would harmonise policy, legislation and regulation.
- 4.2 The need for harmonisation of all legislation and regulations in support of government’s beneficiation strategy is critical and that benefits from any government support is realised along the value-chain. In the case of the environment and the economy, harmonisation will ensure that laws aimed at protecting the environment do not unduly hinder the growth of the economy.
- 4.3 The successful implementation of relevant legislation and regulations in support of the broader upstream mining and downstream value-addition sectors is dependent upon agreement and progress in relation to a range of complex and inter-locking policy levers, which are the responsibility of several government departments. These include the following:
  - 4.3.1 The Minerals and Petroleum Resources Development Act and the Mining Charter which falls under the Department of Mineral Resources.
  - 4.3.2 A review of competition policy, with possible amendments to competition legislation which falls under the Department of Economic Development, as well as industrial financing which falls under the Industrial Development Corporation and the Department of Economic Development.
  - 4.3.3 Agreements and conditions related to infrastructure development programmes and provision, falling under SOCs reporting to the Department of Public Enterprises.
  - 4.3.4 The Special Economic Zones policy, legislation and programmes inclusive, of incentives, which are the responsibility of the DTI.
  - 4.3.5 The designation programme of government through the amended PPPFA regulations and the implementation by all government departments and entities, particularly SOCs.
  - 4.3.6 The development, transfer and retention of strategic skills by the Departments of Higher Education and Training and of Science and Technology, as well as through apprenticeships, learnerships and other on-the-job training offered by industry, to support beneficiation.
- 4.4 Government through the appropriate legislative mechanisms and informed by the country’s developmental imperatives should designate strategic minerals, namely ferrous metals, coal, titanium and PGMs, that will be economically viable for beneficiation purposes.
- 4.5 The existence of inherent monopolistic power especially in upstream firms, including the import parity pricing of mineral and natural feedstocks; high administered prices; and the current energy-constrained environment are fundamental impediments to reindustrialisation. The committee noted some positive developments in the structure of port charges after its Colloquium on Administered Prices; however, further price reductions are required.
- 4.6 The DTI and the lead departments identified in the IPAP should develop key strategic partnerships with the developing and developed countries, as well as countries on the African continent, in order to promote and facilitate the beneficiation drive.
- 4.7 It welcomes the implementation of the REIPPP programme and recent government plans to improve the energy mix in order to secure a reliable supply of energy, in support of economic growth and job creation. Importantly, the end user price of energy needs to be competitive for

manufacturers and the beneficiation drive. If the final price of electricity is too expensive, it can do more harm than good for manufacturing and industrialisation generally.

- 4.8 The DTI with other departments should spearhead the public procurement support for localisation but all stakeholders should promote a “buy South Africa” campaign to encourage South Africans to purchase locally manufactured products. Markets should be developed and expanded to absorb locally beneficiated products.
- 4.9 The promotion of beneficiation will create opportunities for the emergence of black industrialists. However, there is a need to promote an entrepreneurial culture by addressing strategic skill shortages and considering the strengthening of entrepreneurial and vocational skills development within the education system, as well as focussing on further education and training and deepening investment in STEM skills.
- 4.10 It is of the view that the creation of black industrialists should contribute to industrialisation and broad-based black economic empowerment (B-BBEE). Small enterprise development and B-BBEE policies should focus on the development of entrepreneurs who can provide productive inputs into the real economy.
- 4.11 Labour unrest arising from poor working conditions and the rising wage gap has resulted in protracted and sometimes violent labour strikes in recent years. This has become an impediment to inclusive economic growth and industrialisation. South Africa needs to remain attractive to foreign direct investment. Therefore, the committee believes that South Africa needs a stable labour environment with decent wages and working conditions to improve productivity as an integral part of the Social Compact.
- 4.12 The existing measures to ensure affordable access to scrap metal for the domestic market should be strengthened. This would also positively contribute to South Africa’s energy efficiency. There is a need for the DTI to conduct a comparable study in this regard.
- 4.13 Based on the presentations from the forestry sector, it is evident that there are significant imports of wooden furniture which could undermine the domestic furniture market. There was an identification of an additional 100 000 hectares for afforestation in the Eastern Cape and Kwazulu-Natal by the Department of Agriculture, Forestry and Fisheries as part of the Forestry Sector Charter in 2007. This commitment should be expedited within the constraints of legislation pertaining to land and water use.
- 4.14 Greater commitment is required in terms of co-ordination efforts of the Inter-Ministerial and inter-departmental teams dealing with the implementation of the IPAP. Further, the committee concluded that it should have at least biannual engagements with the relevant committees within the economic cluster to monitor the implementation of the IPAP.
- 4.15 Manufacturing value chains, from the production of raw material to the final value-added product, are extremely complex and sophisticated. In the past, discount prices at the raw material phase have not been passed on to other producers further down the value chain. This underlines the importance of all stakeholders involved in the value chain to implement this to achieve the objectives of beneficiation. It is therefore not guaranteed that any price controls of raw materials will have the desired impact on the rest of the value chain.

## **5. Acknowledgements**

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## **6. Recommendations**

Informed by its deliberations, the committee recommends that the House requests that the Minister of Trade and Industry should consider:

- 6.1 Reviewing, in consultation with other Ministries, the legislative and regulatory environment that reinforces the Industrial Policy Action Plan's objectives in pursuit of a developmental price within the ferrous metals, coal (polymer), titanium, and PGM sectors in support of downstream industries.
- 6.2 Significantly increasing incentives for manufacturing, such as tax incentives, rebates; long term export guarantees; export credit support; critical infrastructure; and import tariff policy and engaging the Minister on Finance in relation to tax incentives.
- 6.3 Engaging the relevant Ministers through the Inter-Ministerial Committee to ensure harmonisation of legislation and regulations that underpins government's beneficiation strategy in support of industrialisation.
- 6.4 Commissioning a socio-economic study on the benefits of identified upstream and downstream value chains and the impact on the economy.

The Democratic Alliance objected to the first recommendation (6.1).

Report to be considered.

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