**2. Interim Report of the Portfolio Committee on Trade and Industry on its continued oversight over factors impacting on localisation and local public procurement, dated 13 March 2019**

The Portfolio Committee on Trade and Industry, having conducted stakeholder engagements on the status of implementation of its recommendations in its four previous colloquium reports, reports as follows:

1. **Introduction**

The Department of Trade and Industry (DTI) developed the Industrial Policy Action Plan (IPAP) to curtail the growing trend of deindustrialization and to reverse this decline in the manufacturing sector. Furthermore, the IPAP seeks to diversify South Africa’s trading basket from mainly exporting raw materials and importing finished goods to exporting more value-added products. The Minister of Trade and Industry, Dr R Davies, had indicated that the new IPAP would be revised annually to move from gaining quick wins to addressing more complex, structural challenges within the economy. The new IPAP identified broad transversal areas which were integral to facilitating or encouraging the industrialisation drive and sectoral interventions. The IPAP has subsequently had 10 iterations since the 2009/10 financial year.

The IPAP identifies local public procurement as a critical lever to facilitate the development and expansion of the local industrial base. In addition, government has committed to an infrastructure build programme including upgrading and refurbishing of transport sector infrastructure. These infrastructure projects were intended to be leveraged to stimulate the local manufacturing sector. The intention is that manufacturers would locate within the borders of the Republic and produce goods using locally sourced inputs to maximise job creation in the country through a more established value chain. Therefore, international bidders can only participate in tenders designated for local production if they have a manufacturing base in South Africa.

The amended 2017 Preferential Procurement Regulations empower the DTI to designate industries, sectors and sub-sectors for local production at a specified level of local content. The National Treasury, being the custodian of supply chain management (SCM) policy in government, circulates the instruction notes/circulars which regulate the environment within which government departments and public entities may procure designated products.

* 1. **Process followed**

Since 2010, the Portfolio Committee on Trade and Industry has overseen the implementation of the IPAP. Over the 10-year period, the Committee had held several intensive colloquiums related to selected transversal areas and sectoral interventions. These were on:

* Administrative prices, namely electricity prices, port and rail charges,
* Beneficiation of minerals, agricultural produce, timber and polymers,
* The impact of transfer pricing, and
* Local public procurement, with a focus on clothing and textile and rail rolling stock.

Consequent to the last colloquium on local public procurement in 2016, the Committee had announced that it would conduct its *Oversight Inquiry into Compliance with the Localisation and Local Public Procurement Policy* with a focus on the transport sector. The process had begun with hearings on bus body procurement in February 2018. However, the process was overtaken by the Committee’s legislative responsibility to consider the Copyright [B13-2017], Performers’ Protection [B27-2018] and National Gambling Amendment Bills [B27-2018], as well as the development of the Committee Bill to amend the National Credit Act (the National Credit Amendment Bill [B30-2018]). These pieces of legislation were all finalised by November 2018.

Given the short time available before the end of the Fifth Parliament, the Committee was of the view that it should determine whether progress had been made in the areas covered by the four colloquiums, as well as whether challenges still remained. As a result, the Committee held four meetings on 4 December 2018, 5 and 12 February and 5 March 2019 to engage the relevant stakeholders, namely:

* Prof B Turok, Institute for African Alternatives (IFAA),
* Ms B Radebe, South African Mining Development Association (SAMDA),
* Transnet,
* The Office of the Auditor-General,
* National Treasury,
* The Passenger Rail Agency of South Africa (PRASA),
* The Department of Transport, and
* The DTI.
	1. **Purpose of the report**

The purpose of this report is to document the reported progress made in relation to the four colloquium reports. In addition, it is to capture the Committee’s key findings and recommendations on these matters for the Sixth Parliament’s consideration.

* 1. **Outline of the report**

Section 1 of the report provides an introduction and an outlines the purpose of the meetings on localisation and this report. Section 2 discusses the Committee’s past work on high administered prices and the progress made to date. Section 3 highlights the Committee’s past work on beneficiation and the impact of transfer ‘mispricing’ on beneficiation and on black economic empowerment, as well as progress thus far. Section 4 focuses on Committee’s past work on local public procurement and progress made in terms of the legislation underpinning local content and production, verification and auditing of local content and production and on the rail rolling stock procurement programmes. In addition, it discusses the findings from the public hearings on bus body procurement. Section 5, 6 and 7 provides the Committee’s conclusions, note of appreciation and recommendations.

1. **Administered prices**

On 24 May 2013, the Committee tabled its report on the implementation of the IPAP with specific reference to the state of the manufacturing sector. The report highlighted the impact of high administered prices, such as that of electricity and port tariffs on the relative competitiveness of the manufacturing sector.[[1]](#footnote-1) The Committee concluded that it appeared that a disjuncture in policy alignment and coordination among departments and state owned entities associated with administered prices remained, which contributed to the uncertainty and challenges faced by the manufacturing sector. It was essential that government found a solution to high administered prices to ensure that government priorities of job creation and economic growth could be met.

At the time, the Committee called for all factors associated with the determination of administered prices to be investigated to ensure that the determination of these prices was evidence based. Furthermore, that the legislative and regulatory environment should be reviewed to curtail the power of state monopolies in the determination of administered prices, ensure a developmental pricing regime aligned to the strategic objectives of government, and that the funding of local governments be reviewed to curtail the charging of excessive electricity surcharges.

In 2014, the matter of high electricity tariffs and the security of electricity supply was raised by stakeholders in relation to its impact on the potential for beneficiation. However, the Committee had noted positive developments in the structure of port charges after its Colloquium on Administered Prices; but had acknowledged that further price reductions were required.[[2]](#footnote-2)

The 2018/19 IPAP continued to identify high administered prices, specifically electricity and port tariffs, as constraints to growth in the manufacturing sector. It also highlighted that rail and port inefficiencies and logistical bottlenecks have placed undue pressure on manufacturing.[[3]](#footnote-3)

In terms of electricity, the IPAP highlighted that the price disparity between municipal and Eskom-fed industrial customers had grown and rendered the former less competitive and impacts on the decision on where to locate, which inadvertently may have a negative spatial impact on employment levels. The lack of understanding between the link between electricity prices and industrial competitiveness versus revenue generation by municipalities appears to have remained.[[4]](#footnote-4)

Furthermore, the IPAP explained that high port charges and inefficiencies created a significant barrier and constraint on the export of value-added goods. Port charges have been disproportionately higher for value-added tradable goods compared to exported primary commodities and imported tradable goods. This maintains the entrenched trading patterns and reduces South Africa’s competitiveness in terms of exporting high value-added goods. In addition, it illustrated that South African port costs were still well above the global average. However, the IPAP also noted that improvements had recently been realised due to the work of the National Ports Regulator.[[5]](#footnote-5)

Prof Turok also noted the mining industries heavy dependency on state supplied electricity, transport and ports. These costs have all escalated sharply. He emphasised that there was a need for a national policy on administered prices to allow companies to plan effectively.

The DTI had also addressed this matter during engagements on its third quarter financial and non-financial performance report. The DTI remained concerned that port and rail prices were excessively high. The DTI had informed the Committee that President Cyril Ramaphosa had announced the Economic Stimulus and Recovery Plan, which included a review of various administered prices including electricity, port and rail tariffs in September 2018. It also indicated that the supply side challenges, such as high electricity, port and rail charges, would be addressed in the next iteration of the IPAP. This was to ensure that government supported strategic industries by providing appropriately priced electricity, port and rail charges to assist in improving competitiveness.[[6]](#footnote-6)

1. **Beneficiation and transfer pricing**

In 2014, the Committee scheduled a colloquium on beneficiation to engage specialists, practitioners and other relevant stakeholders to discuss the concept of higher value-addition/beneficiation of South Africa’s mineral and natural resources and how import parity pricing and other factors limit opportunities for beneficiation in this sector. One of the issues arising from the Colloquium on beneficiation was the potential impact of transfer ‘mispricing’[[7]](#footnote-7) on beneficiation. As a result of this, the Committee invited a number of experts and institutions to engage on the impact of transfer pricing practices on the South African economy, particularly in relation to industrialisation and black economic transformation or empowerment in 2015.

In its 2014 report, the Committee made a number of conclusions in relation to beneficiation. These included:[[8]](#footnote-8)

* The need for harmonisation and co-ordination of government strategies, policies, legislation and programmes to facilitate and support beneficiation. These cover areas such as mining, competition policy, industrial financing, infrastructure development, industrial policy, public procurement and skills development.
* The need to designate strategic minerals, namely ferrous metals, coal, titanium and platinum group metals (PGMs), that will be economically viable for beneficiation purposes.
* The fundamental impediments to reindustrialisation are 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.
* The need for government to develop key strategic partnerships with developing and developed countries, as well as countries on the African continent, to promote and facilitate the beneficiation drive.
* 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.
* The promotion of beneficiation will create opportunities for the emergence of black industrialists.
* The existing measures to ensure affordable access to scrap metal for the domestic market should be strengthened.
* 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.

It then recommended that the Minister of Trade and Industry should consider:[[9]](#footnote-9)

* Reviewing, in consultation with other Ministries, the legislative and regulatory environment that reinforces the IPAP’s objectives in pursuit of a developmental price within the ferrous metals, coal (polymer), titanium, and PGM sectors in support of downstream industries.
* 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.
* 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.
* Commissioning a socio-economic study on the benefits of identified upstream and downstream value chains and the impact on the economy.

Then, in its 2015 report, the Committee made a number of conclusions in relation to the impact of transfer pricing on black economic transformation and on beneficiation. These included:[[10]](#footnote-10)

* Although transfer pricing is not illegal, the practice of manipulating prices by a company in order to shift profits from a subsidiary to another part of the company in a different country to avoid taxes is unacceptable and has an adverse impact on the country’s industrialisation drive and the broadening participation efforts of the Government. This practice of transfer pricing should be discouraged.
* The Committee was of the view that it is also fraudulent to reduce profits, underreport income and to conduct exchange rate misreporting, as these practices reduce the country’s tax income.
* Greater commitment is required in terms of co-ordination among departments to ensure that legislative imperatives are not compromised and that the relevant legislation is implemented in a manner that ensures their objectives are met.
* The formulation of a developmental price for strategic minerals may discourage the practice of mispricing that emanates from the exporting of minerals at a lower price, and encourage higher beneficiation of our mineral and natural resources locally, and therefore expand the mineral beneficiation value-chain. However, in considering the implementation of developmental pricing, consideration should be given to the negative effects of such a policy position, and how such consequences will be mitigated.
* The successful implementation of relevant policies, legislation and regulations in support of the industrialisation drive in the upstream mining and beneficiation of strategic minerals should be pursued including the IPAP, and the Mineral and Petroleum Resources Development Act (MPRDA) (No. 49 of 2008) in terms of section 26(3)[[11]](#footnote-11).

The Committee recommended that the Minister of Trade and Industry should:[[12]](#footnote-12)

* Consult with the Minister of Mineral Resources to ensure that the MPRDA and any subsequent mining charter is aligned with the Broad-Based Black Economic Empowerment Amendment Act and its associated Codes of Good Practice.
* Consult with the Minister of Finance to consider measures including tax instruments to mitigate against the impact of transfer pricing on the broader economy in line with international best practice.

Prof Turok reemphasised the fact that “mineral wealth is a national asset, provided by nature, and it ought to be of maximum benefit to the people as a whole”[[13]](#footnote-13). Therefore, adding value to this resource is essential, whether this be through manufacturing and/or services that create employment and generate income locally. In this regard, he explained the concept of calculating or measuring gross domestic product (GDP) in terms of value addition throughout the economy. This can be used as a tool for understanding the effectiveness of certain policies, such as industrial policy. So value can be added by adding or improving infrastructure (e.g. building a mine and roads or constructing a hotel at a beautiful beachfront), offering services that support economic development (e.g. security services at a mine or the hospitality service at a beachfront) and/or by manufacturing a product from a natural resource (e.g. catalytic converters from platinum). Each of these adds value and can generate income for a country.

He continued to explain that initially economies grow through human effort applied to the resources provided by nature. This can then develop into human effort being applied in numerous complex ways directed at adding value.

In South Africa, gold and diamond mining has brought substantial wealth and development with other minerals joining the stream. The mining industry has been deeply embedded in the South African economy, as it requires water, power, labour, food, engineering and other services, transport, ports and many other services and products. So while the minerals were exported, the industry still made a large contribution to the domestic economy.

Beneficiation is the processing of a natural ore to prepare it for subsequent sale. There are various stages beginning with exploration, mining, processing, smelting and refining, and fabrication. Prof Turok purported that the Chamber of Mines has resisted deepening beneficiation as it was of the view that South African mining companies are highly specialized and limit their operations to preparing the minerals for export. Therefore, they are not willing to engage in manufacturing and are not interested in the domestic market. They remain of the view that a mineral resource endowment does not necessarily translate into manufacturing beneficiation, and mining should not be required to subsidise manufacturing beneficiation or to provide minerals below internationally determined prices even though there is a saving in export transport costs.

Ms Radebe acknowledged that government has adopted a Strategic Minerals Investment Policy for coal, gold, iron ore, manganese, diamonds, PGMs, chrome, vanadium, titanium, nickel and uranium. The SAMDA proposed that phosphate, limestone, shale gas and oil (petroleum) also be designated. The DTI clarified that the designation of strategic minerals is contained in the latest version of the Mineral and Petroleum Resources Development Amendment Bill [B15-2013], which was being considered by Parliament. The Department of Mineral Resources intended to designate strategic minerals once the Bill was enacted. However, the Department of Mineral Resources had independently committed to present the Coal Policy to the Portfolio Committee on Mineral Resources.

Furthermore, Ms Radebe emphasised that Section 26(3) of the MPRDA can be used to assist government in determining the true value of the commodities being transferred to the end user/consumer/manufacturers to address transfer pricing and non-compliance with the Mining Charter. It will also enable the Department of Mineral Resources to encourage foreign companies to beneficiate locally, when those companies seek written approval from the ministry to beneficiate offshore. She recommended that a South African first approach should be adopted and companies that are in breach of Section 26(3) should be penalised for sabotaging beneficiation and industrialisation of the South African economy.

The DTI reported that it was working closely with Proudly South African to deepen the Buy Local Campaign.

1. **Local public procurement**

Strategic public expenditure by organs of state, and generally all spheres of government and State-Owned Companies can:

* “Develop and enhance local manufacturing capacity and capabilities;
* Support industrial innovation and technological developments;
* Create employment and sustain jobs;
* Boost exports and ensure suppliers are integrated into Original Equipment Manufacturers’ (OEMs) global value chains; and
* Support broader economic empowerment through the creation of black industrialists.”[[14]](#footnote-14)

Hence, it is critical that the inclusion of local content and production is effectively incorporated through the public procurement process. As a result, in 2016, the Committee held the *Colloquium on Local Public Procurement* with a focus on the rail, and the clothing and textile sectors. The colloquium focused on:

* the level of compliance with existing designations in the transport sector and the clothing and textiles sector;
* mechanisms to assist companies to meet local content requirements, and
* how to ensure that local content requirements are met.

The main reason for focusing on the rail sector was because it comprises the biggest of the designated sectors in terms of procurement. Both Transnet and PRASA are recapitalising their rolling stock, inclusive of locomotives, wagons and coaches. The clothing and textile sector was identified due to it being a labour-intensive sector.

It was also intended to identify constraints and solicit solutions and recommendations from stakeholders, such as the realignment of policies or the implementation of these to facilitate local procurement, to address the constraints. Furthermore, it was intended to ensure that government departments provided clarity on the procurement policy and how it should be implemented.

The Committee concluded that:[[15]](#footnote-15)

* The National Treasury in amending the Preferential Public Procurement Framework Act (PPPFA) (No. 5 of 2000) and regulations should consider the following:
	+ Strengthening the designation process and implementation of the legislation.
	+ Ensuring that the role of the DTI is enhanced and explicit with respect to localisation and the Black Economic Empowerment (BEE) Codes.
	+ Strengthening the legislation to ensure that localisation is strengthened with respect to the Renewable Energy Independent Power Producers programme and the Competitive Supplier Development Programme.
* The National Industrial Participation Programme (NIPP) should be strengthened in the legislation to ensure that localisation becomes a condition of tender specification, not just a post-adjudication requirement which renders it a much weaker tool.
* Self-verification by private companies is acknowledged in their declaration of their local content; however, for post-award verification, the South African Bureau of Standards (SABS) should be the preferred verification body for the government.
* The procurement process should be transparent to eliminate fraud and corruption within this process and the accountability measures should be strengthened.
* The tender adjudication committees should have appropriate understanding of the legislation that underpins the tender process to ensure a fair and equitable tender process and awarding of a tender.
* Local public procurement policy requires collaboration across the respective government departments, public entities as well as provincial and local government for successful implementation.
* The challenges associated with the verification of local content of designated products are acknowledged. In this regard the relevant entities should ensure the verification requirements are explicit in all the contracts and are complied with.

Furthermore, the Committee recommended that:[[16]](#footnote-16)

* The Auditor-General should submit a report on measures taken to enhance the auditing process with respect to SCM and audit outcomes by the end of May 2017.
* The Minister of Trade and Industry should engage with the Minister of Finance on the status of the review and consequent amendments to the PPPFA and regulations so to ensure the participation of DTI in this process and to explicitly reflect who bears the cost of verification. Serious consequences should be imposed for non-compliance.
* The Minister of Trade and Industry should consult the relevant Ministries on the verification process so as to ensure that all departments that procure designated products adhere to local procurement and verification requirements.
	1. **Amendment of the Preferential Procurement Regulations and its Implementation**

The Committee’s had recommended that the Minister of Trade and Industry should engage with the Minister of Finance on the status of the review and consequent amendments to the PPPFA and regulations so to ensure the participation of DTI in this process. The National Treasury reported that the Preferential Procurement Regulations were revised in 2017. This was within the public procurement principles set in Section 217 of the Constitution of the Republic of South Africa, 1996, which guides all processes relating to public procurement. Furthermore, these amendments should enable public procurement to play a strategic role in facilitating economic development and transformation.

The National Treasury informed the Committee that Regulation 8 of the Regulations provides for the DTI to, in consultation with the National Treasury, designate a sector, sub-sector or industry or product in accordance with national development and industrial policies for local production and content. Furthermore, in terms of Regulation 8(3), the role of the National Treasury is to inform organs of state through a circular of any designation made in terms of regulation 8(1). Working together with the DTI, the National Treasury had issued a number of instructions (prior to 2017) and circulars (subsequent to March 2017) to designate sectors for local content and production, to stimulate local industrial development, skills development and employment creation.

Current instructions/circulars on designated sectors require Accounting Officers (AOs)/Accounting Authorities (AAs) to provide information to the DTI on procurement involving designated sectors. Such information includes: (i) copies of the contract; and (ii) standard bidding documents /municipal bidding documents 6.2 certificates together with Annex C, which are submitted by the successful bidder. This requirement is to enable the DTI to, amongst others, conduct compliance audits with a view to monitor the implementation of the industrial development strategies.

Furthermore, the National Treasury reported that service providers that experience challenges in meeting the stipulated minimum threshold for local content are required to inform the DTI. This is so that the DTI may verify that their challenge is legitimate and, in consultation with the AO/AA, provide further directives. The DTI clarified that the Instruction Notes dealt with the consideration of exemption requests where a particular designated material/component cannot be manufactured in South Africa. Bidders and potential suppliers must apply for this exemption prior to the closure of the tender in a case where a designated material/component is not available in the country. A condonation on local content cannot be granted when and where there is local capability and capacity, as this will be transgressing the PPPFA, the 2017 Preferential Procurement Regulations and the Instruction Notes regulating the implementation of local content in government.

In terms of the requirements of national legislation, the National Treasury is of the view that it has addressed its obligation of providing the policy platform for designations. It is also in the process of developing a reporting framework for purposes of gleaning information from organs of state relating to the implementation of the requirements of the regulations.

The DTI noted that Section 14 of the Preferential Procurement Regulations, which provides for remedies for non-compliance did not provide an adequately robust remedy to deal with non-compliance. It required that an organ of state must disqualify a tenderer that had submitted false information regarding Broad-based Black Economic Empowerment (B-BBEE) and Local Content requirements or for any other matter or must terminate the contract in whole or part, and, if applicable claim damages from the tenderer. The National Treasury must be informed of any actions taken and may restrict the tenderer from doing business with government for 10 years. However, it does not allow for a tenderer to remedy the situation and meet the obligations it had made in terms of local content.

* 1. **Verification and auditing of local content**
		1. **Verification of local content**

The SABS is responsible for verifying that local content declared by winning bidders meet the minimum local content requirements set. The DTI raised the challenge that due to the lack of certainty in the funding model, for example fiscal transfers or the successful bidder should pay for the costs of verification; there had been delays in the verification of local content. This impacted on the SABS’ ability to ramp up its capacity to deliver on this function in terms of investing in the relevant technical skills and technologies.

However, the DTI informed the Committee that the SABS had subsequently been provided with the necessary support through fiscal transfers to start with the verification of local content and would be prioritising rail localisation programmes. Thus far, the SABS was conducting verifications on 64 companies representing 88 tenders to the value of R56.4 billion[[17]](#footnote-17). In this regard, the Technical Specification on the Measurement and Verification of Local Content (SATS 1286: 2011) is now a National Standard (SANS 1286: 2017), which will be used by SABS for this purpose.

Verification is conducted in three stages, namely:

* Preliminary stage: Confirmation of information and holding initial meetings.
* Field work: Actual verification up to the third level of suppliers.
* File review: SABS Approvals Board processes and issues certificates.

The DTI highlighted that there is still a need to clarify when is the ideal time to verify local content, so that there is still time to implement remedial action to ensure that government can still retain some value from its strategic procurement efforts.

* + 1. **Auditing of compliance with local content requirements**

The Office of the Auditor-General had begun to incorporate the auditing of local content as part of its compliance audit under the Procurement and Contract Management Focus Area for the 2016/17 financial year. This audit requires compliance with the regulations of the PPPFA in terms of the prescribed minimum local content requirements for designated products/sectors. It had audited a total of 131 national or provincial auditees in terms of local content based on an evaluation of their procurement profiles. The Office of the Auditor-General identified the key impacts of local content on the SCM processes, namely for[[18]](#footnote-18):

* *Demand management*: In determining the requirement/procurement need, organs must consider whether the product falls within the designated sectors.
* *Bid specifications*: Bid specifications must specify the local content requirements which comply with the prescribed local content thresholds
* *Submission of bids*: Bidders must submit bids that comply with the specified requirements.
* *Evaluation of bids*: (i) Evaluation committee must evaluate compliance with local content thresholds based on information submitted by the bidders. (ii) Bids that do not comply with the requirements are considered non-responsive and are disqualified.
* *Contract management*: Institutions must implement effective measures to ensure that the suppliers deliver goods that comply with the local content requirements as per the contract.

Thus far, it has tested whether:

* Bid specifications specified the minimum threshold for local production and content which is not less than the threshold prescribed in the relevant National Treasury Instructions.
* As part of the tender, the winning bidder has furnished the procuring institution with the declaration on local production and content.
* The winning bidder met the minimum threshold for local production and content.

It will expand its audit to determine whether the following was met during the next audit of the 2018/19 financial year:

* The procuring institution has defined and implemented measures to monitor that the supplier is delivering goods that complies with the specified minimum threshold for local content.
* The defined monitoring measures are sufficient to ensure effective contract monitoring of compliance by the supplier.

Compliance with local content appears to have declined from the 2016/17 financial year to the 2018/18 financial year. In the 2017/18 financial year, 67 out of the 131 auditees failed to comply with requirements on promotion of local production and content on awards amounting to R450 million. Fifty-three auditees’ (2016/17: 35 auditees) bid documentation had not stipulated the minimum threshold for local production and content; 31 auditees (2016/17: 18 auditees) awarded bidders that had not submitted a declaration of local production and content and 18 auditees (2016/17: 17 auditees) awarded bidders that had not met the minimum threshold for local production and content. The Office of the Auditor-General attributed the non-compliance to either (i) a lack of awareness or understanding of the requirements or (ii) a disregard of the requirements. The former required improved awareness campaigns; while the latter would form part of irregular expenditure, which could lead to action being taken against any liable officials.

* 1. **Procurement of Bus Bodies**

In February 2018, the Committee engaged local municipalities and the National Home Builders Registration Council that had procured buses since bus bodies had been designated on the 16 July 2012, as well as the OEMs that supplied these buses to them. The municipalities included the City of Johannesburg (Rea Vaya, and the Metrobus), the eThekwini Municipality, the City of Cape Town, and the City of Tshwane. The bus manufacturing companies that attended were Marcopolo SA, BUSMARK 2000, Volvo Group Southern Africa (Pty) Ltd, Iveco South Africa (Pty) Ltd and MAN Automotive South Africa (Pty) Ltd.

Procuring entities were requested to brief the Committee on:

* The volume and value of bus bodies procured since bus bodies were designated in July 2012.
* The timeframes associated with the procurement of bus bodies.
* Any other bus body procurements subject to procurement obligations including the NIPP.
* Any challenges in finding suppliers that met the local content requirements.
* The local content requirements set in the tender documents and the final agreed contractual obligations reached.
* The process implemented to verify that local content requirements are being met.
* Progress with meeting the localisation targets set in the 2012 bus body designation.

Bus manufacturers were requested to brief the Committee on:

* Whether they were able to meet local content requirements and how they were achieving this.
* The measures they had implemented to ensure that their suppliers were meeting local content requirements.
* What supplier development initiatives they had, if any.
* If there were any challenges with respect to compliance with local content requirements.
	+ 1. **Municipalities on bus procurement**

The engagement by the Committee with the City of Johannesburg (Rea Vaya, and the Metrobus), the eThekwini Municipality, the City of Cape Town, and the City of Tshwane revealed that there is compliance with local content requirements in the procurement of buses. According to the presentations made, local content ranged between 80 percent and 85 percent, with most of the cities achieving procurement that is above the 80 percent minimum local content requirement. This was achieved in bus procurement of approximately R2.2 billion over the period from 2012 to 2018.

The requirement was specified in the tenders for bus procurement. In terms of agreed minimum procurement, agreed contractual obligations and actual delivery, it was reported that there was more local content in the delivered output than the required minimum.

Challenges highlighted in the local procurement of the buses include:

* Legislation – particularly provisions that are inadequate for the enforcement of local procurement requirements;
* Limited suppliers in South Africa for bus bodies and other equipment suppliers such as glass suppliers for bus windows;
* Lack of skilled and qualified artisans in the bus body manufacturing;
* Quality of locally manufactured components; and
* Sustainability of local suppliers where there is long term procurement or for the sourcing of replacement parts in the future.

Notwithstanding the challenges that have been highlighted above, it is important to note that these challenges differ because of the different types of buses procured.

* + 1. **Bus manufacturing companies**

The manufacturing companies reported that there were local content requirements in all tenders for bus procurement and that calculation of local content is in line with the SABS approved technical specification, SATS 1286:2011. In this regard, local content was above the 80 per cent threshold. In addition, the companies mainly have production plants in Kwa-Zulu Natal, Tshwane, and Johannesburg and employ local labour force.

To ensure that component suppliers also comply with local content, a number of initiatives were mentioned including financial assistance to small black suppliers, bringing experts to perform training for local small and medium enterprises. In addition, they are empowering local companies in terms of access to raw materials, provision of training, and provision of quality supervision and management assistance.

However, the manufacturers raised the following challenges with respect to local bus procurement:

* Government contracts are short term; therefore, it is difficult to build and sustain capacity when the demand is unpredictable;
* Procuring locally is more expensive than importing; therefore, imports are more attractive. For example, because a market such as Brazil is more competitive than South Africa, a bus body produced in Brazil would be 10-20 percent cheaper;
* Calculation of the local content is complex and administratively burdensome;
* There is not a holistic way of adjudicating in bus procurement, as local content and price of delivering the required buses is taken into account while B-BBEE requirements are often ignored; and
* There is no government incentive for manufacturing bus parts locally as is the case in other sectors like the automotive sector.

* 1. **Procurement of Rail Rolling Stock**
		1. **Transnet**

Transnet awarded a total of R50 billion worth of contracts to China South Rail (CSR) Zhuzhou Electric Locomotive, China North Rail (CNR) Rolling Stock SA, Bombardier Transportation SA and General Electric SA Technologies for the building of 1 064 electric and diesel locomotives at Transnet’s Engineering plants in Pretoria and Durban. This excluded 70 locomotives to be assembled outside South Africa. It must be noted that CSR and CNR have since merged to form CRRC E-Loco Supply (Pty) Ltd.

The DTI highlighted that the Request for Proposals (RFPs) had included local content requirements at a component level as required by the Instruction Note for the rail rolling stock. The RFP had further stated that the SABS Technical Specification SATS 1286:2011 must be used for the calculation of local content. It also listed that local content declaration documents are returnable under Section 4 of the RFPs.

In 2015, Transnet provided the DTI with copies of the local content declarations excluding the contracts and signed bidding documents as required by the Instruction Note. These contracts and documents are required by the DTI and the SABS to conduct compliance audits and verification as part of their monitoring functions. Furthermore, the OEMs had only declared their overall local content and not the local content at a sub-component level as required. Based on these declarations, each OEM would meet the overall stipulated minimum threshold levels of 60 per cent for diesel locomotives (Bombadier: 60.1 per cent and CSR: 60.52 per cent) and 55 per cent for electric locomotives (General Electric: 55.74 per cent and CNR: 55 per cent). Subsequently, Transnet informed the Committee that Post-Tender Negotiations, Bombardier (52.5 per cent), CSR (49.6 per cent) and CNR (37.6 per cent) no longer complied with the minimum thresholds on local content production. Therefore, their appointments were contrary to the PPPFA and the Instruction Note and a court could be approached to declare these contracts void or to get a just and equitable remedy.

In April 2018, Transnet submitted another set of declaration documents, including contracts, to the DTI,theDepartment of Public Enterprises and the SABS after the intervention by both the Ministers of Trade and Industry and of Public Enterprises.Upon reviewingthe contracts for local content requirements, it became apparent that these did not include obligations pertaining to local content, except for the CNR. Thus, Transnet had failed to comply with the 2011 and 2017 Preferential Procurement Regulations, the Instruction Note for the Rail Rolling Stock even though its RFPs for the procurement of locomotives had local content requirements. However, the DTI was of the view that an opportunity still existed to review the Bombadier Transport and CNR projects, as these were still being delivered on and were undergoing their local content verification process. In addition, that Section 14 of the PPPFA Regulations should be applied for non-complying OEMs.[[19]](#footnote-19)

Transnet subsequently confirmed that these Acquisition Contracts did not make provision for Local Content remedies, as required, and that they were fraught with irregularities based on the outcome of forensic investigations conducted at the request of Transnet.

However, these contracts would be re-negotiated to rectify the irregulaties, to the extent possible, those clauses in the contracts that gave rise to the irregularity to include local content and supplier development commitments, amongst others. The Board was also advised to initiate disciplinary actions against all employees concerned. To date, the following actions have been taken: (i) the employees concerned have been suspended or dismissed; (ii) criminal cases have been instituted against the said employees; (iii) summons have been issued against these employees to recoup any monies that were lost by Transnet in the 1064 Locomotives Acquisitions and related transactions; and (iv) summons have also been issued against Regiments Capital and Trillian, who were transaction advisors in the 1064 Acquisition Process, to recover monies unlawfully paid to them by/or at the instance of the employees concerned. Furthermore, the Zondo Commission, the Special Investigating Unit, the Asset Forfeiture Unit and the Hawks are investigating the 1064 Locomotive transactions.

* + 1. **Passenger Rail Agency of South Africa (PRASA)**

PRASA awarded a tender to Alstom through the Gibela Consortium for the manufacturing of 7 224 coaches to be built between 2015 and 2025. This procurement is projected to result in the estimated creation of 8 088 direct jobs.

Gibela’s Dunotter Park in Ekurhuleni was launched in October 2018 and the first local produced train was delivered in December 2018. These initial trains are expected to have 67 per cent local sourced value, which will be scaled up to 74 per cent from the 34th train onwards.[[20]](#footnote-20)

The DTI had analysed PRASA’s rolling stock contracts. It found that the tender had not been issued in terms of the 2012 Instruction Note, as it pre-dated the Instruction Note’s official sign off. The tender had been awarded with the overall minimum local content requirement of 65 per cent but with differences on the sub-component local content levels and ramp-up approach compared to the Instruction Note. However, the DTI did not have access to the PRASA-Gibela contract and was unable to assess the collective industrial impact of the programme.[[21]](#footnote-21)

1. **Conclusions**

Based on its deliberations, the Committee drew the following conclusions:

5.1 The Committee remained concerned that little progress had been made in addressing high administered prices given the impact of these on economic growth and employment sustainability. The Committee welcomed the Department of Trade and Industry’s indication that administered prices would be incorporated into the next Industrial Policy Action Plan; however, the implementation of measures to address this would need to be monitored by the next Parliamentary Committee.

5.2 The Committee welcomed progress made in terms of the verification and auditing of local content requirements. It was, however, concerned with the findings of the Office of the Auditor-General, which highlighted an increase in non-compliance. Notwithstanding, the legal constraints to remedy non-compliance with local content requirements, it urged the Department and the National Treasury to address non-compliance and to review the legislation to strengthen measures of promotion and enforcement.

5.3 The Committee welcomed the initial funding of the South African Bureau of Standards to enable it to create capacity to verify local content requirements. However, there is a need to establish a norm regarding the ongoing funding of local content verification and to determine the most appropriate time to test whether the supplied goods meet the local content declared by a supplier and the minimum local content threshold set.

5.4 Individual government departments and entities should ensure that their supply chain management policies reflect the relevant elements set out in the Preferential Public Procurement Framework Act, such as local content, and Broad-Based Black Economic Empowerment requirements. Subsequent to this, these factors are incorporated from the procurement planning phase through the tender process to the delivery of the required goods and services.

5.5 While local content requirements are critical, there is a need to also factor in black economic empowerment imperatives when adjudicating tenders, to ensure transformation.

5.6 The Committee was of the view that where there were irregular contracts entered into by the State, apart from implementing Section 14 of the Preferential Procurement Regulations to terminate contracts, there should also be an effort to recover funds from concerned parties. Where it is impossible to cancel a contract, just and equitable measures should be considered to ensure compliance.

5.7 The Committee would refer the allegations of irregularities within the Transnet 1064 locomotive contracts to the Zondo Commission.

1. **Appreciation**

The Committee would like to thank the Department of Trade and Industry, the National Treasury, the Department of Public Enterprises, Transnet, the Department of Transport, the Passenger Rail Association of the South Africa, the Office of the Auditor-General, participating municipalities, the bus companies, Prof Ben Turok (IFAA) and Mrs B Radebe (SAMDA) for their cooperation and transparency during the process of engagement on localisation and local public procurement. The Committee also wishes to thank its support staff, in particular the Committee Secretaries, Mr T Madima and Mr A Hermans, the Content Advisor, Ms M Sheldon, the Researcher, Ms Z Madalane, the Committee Assistant, Ms Y Manakaza and the Executive Secretary, Ms T Macanda, for their professional support and conscientious commitment and dedication to their work.

The Chairperson wished to thank all Members of the Committee for their active participation during the process of engagement and deliberations and their constructive recommendations reflected in this report.

1. **Recommendations**

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

7.1 Engaging the Minister of Finance and all relevant Ministers to determine the funding model for the South African Bureau of Standards’ verification of local content and production, as well as the timing thereof.

7.2 In consultation with the relevant Ministers, stipulating that every contract entered into by the State should include penalties for non-compliance with the Preferential Public Procurement Framework Act including local content and Broad-Based Black Economic Empowerment requirements.

7.3 Engaging with the Ministers responsible for State-Owned Enterprises to ensure that irregular contracts, where legally possible, should be cancelled and the funds irregularly received are recovered from the relevant parties.

7.4 In consultation with the Minister of Finance, addressing non-compliance by reviewing legislation and strengthening measures to promote and enforce local content requirements.

**Report to be considered.**

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1. Portfolio Committee on Trade and Industry (2013) [↑](#footnote-ref-1)
2. Portfolio Committee on Trade and Industry (2014) [↑](#footnote-ref-2)
3. The DTI (2018: 55) [↑](#footnote-ref-3)
4. The DTI (2018: 56) [↑](#footnote-ref-4)
5. The DTI (2018: 58) [↑](#footnote-ref-5)
6. Portfolio Committee on Trade and Industry (2019) [↑](#footnote-ref-6)
7. 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 2019) [↑](#footnote-ref-7)
8. Portfolio Committee on Trade and Industry (2014) [↑](#footnote-ref-8)
9. Portfolio Committee on Trade and Industry (2014) [↑](#footnote-ref-9)
10. Portfolio Committee on Trade and Industry (2015) [↑](#footnote-ref-10)
11. Section 26(3) requires that any person who intends to beneficiate any mineral mined in the Republic outside the Republic may only do so after written notice to and in consultation with the Minister of Mineral Resources. [↑](#footnote-ref-11)
12. Portfolio Committee on Trade and Industry (2015) [↑](#footnote-ref-12)
13. Turok (2018) [↑](#footnote-ref-13)
14. DTI (2018b) [↑](#footnote-ref-14)
15. Portfolio Committee on Trade and Industry (2016) [↑](#footnote-ref-15)
16. Portfolio Committee on Trade and Industry (2016) [↑](#footnote-ref-16)
17. SABS correspondence dated 14 March 2019. [↑](#footnote-ref-17)
18. Auditor-General South Africa (2019) [↑](#footnote-ref-18)
19. DTI (2018b) [↑](#footnote-ref-19)
20. PRASA (2019) [↑](#footnote-ref-20)
21. DTI (2018b) [↑](#footnote-ref-21)