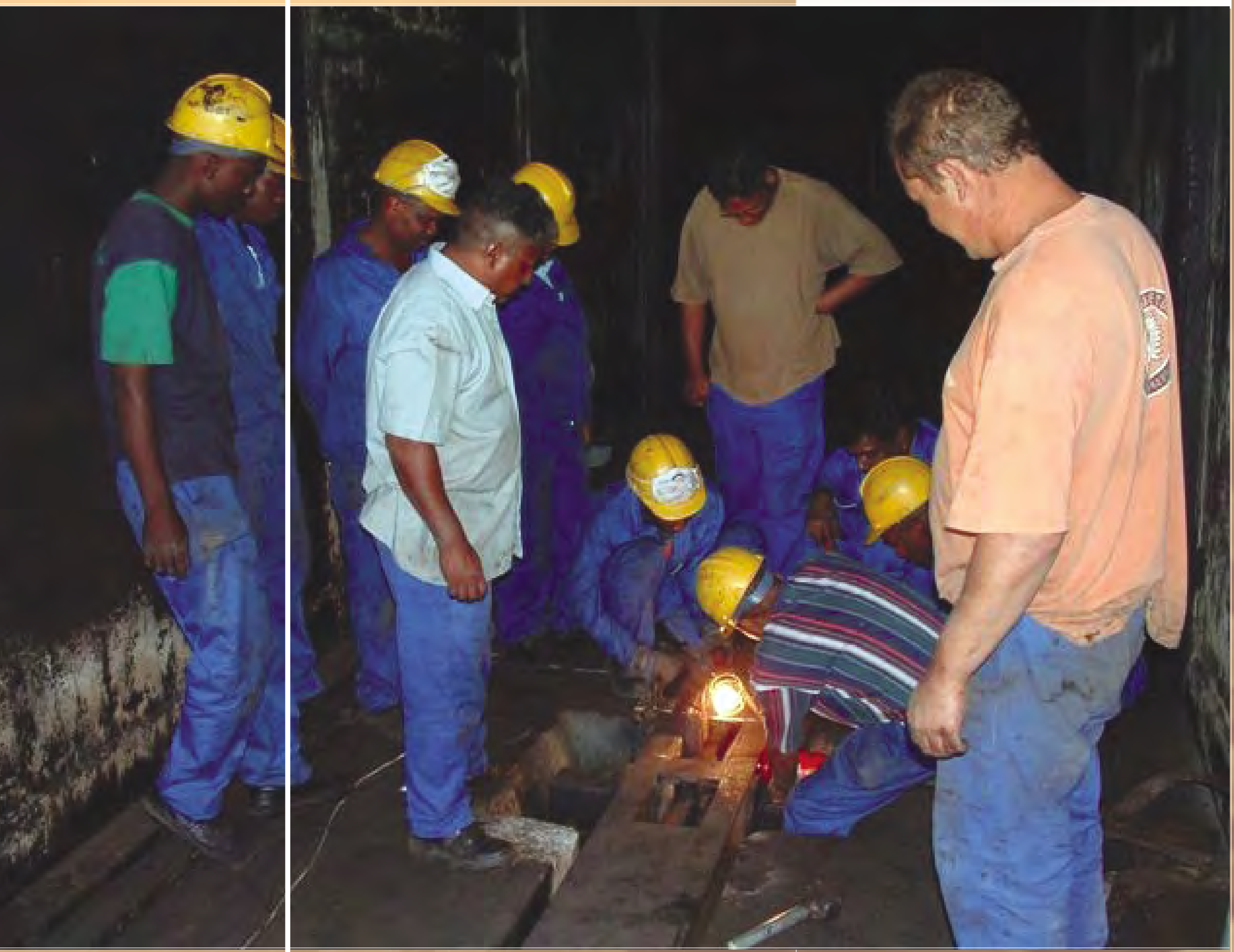
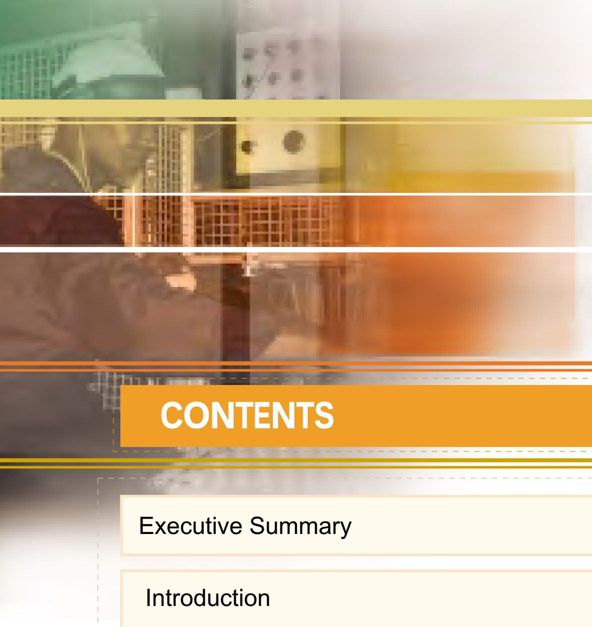


Ten Years Of Democracy And Freedom

A SOUTH AFRICAN SUCCESS STORY

THE NATIONAL INDUSTRIAL PARTICIPATION PROGRAMME



CONTENTS

APPENDIX A: SELECTED NIP PROJECTS:

Executive Summary

When government makes purchases abroad worth more than US$10 million, the suppliers incur an obligation to reinvest a portion of the costs in South Africa. This is how the National Industrial Participation (NIP) programme works. It allows the transfer of skills, technology and equipment, builds exports, diversifies markets and creates new local industries.

The NIP also provides government with additional leverage in promoting investment into strategically selected high opportunity sectors (e.g. Information and Communications Technology). It furthermore assists in promoting the geographic spread of investments into poorer regions (e.g. the Northern Cape).

South Africa's NIP only began in 1996, so it is still in its relatively early stages. Nonetheless, it has already created and sustained over 7 000 direct jobs, accrued US$677 million in investments and promoted over US$1 billion in export sales. Some 125 NIP projects are under way, for a total of US$14 billion in obligations. Local sales derived from the NIP, important in the support they have given to black-owned and small business enterprises, have generated US$457 million in sales.

The performance of the obligors in meeting their targets is monitored by the Industrial Participation Secretariat, located within the Enterprises and Industry Development Division of **the dti**. Specific milestones are set for meeting the obligations, and performance is measured against these.

In this report on the NIP's project, marking South Africa's first decade of democracy and freedom, the story is one of good news. With a few exceptions, obligors are meeting their obligation milestones on schedule. Sectors invested in range from ICT to Transport and Aerospace, the Automotive industry, Metals and Minerals Beneficiation, Pharmaceuticals and Environmental Industry products, amongst others. These in turn promote new exports to a greater diversity of markets, to the benefit of South Africa's economy. In addition, they help address our skills shortage by transforming knowledge and training staff. In short, with obligors such as Volvo, General Electric and BAE/SAAB, the NIP is working, and the benefits will be fully realised in South Africa's second decade of democracy and freedom.

Introduction

The NIP is a tool government can use, informed by economic analysis and research into the latest global economic trends, to support or even create industrial sectors on the cutting edge of growth, while also creating and sustaining jobs and alleviating poverty. At the same time it can diversify markets for exports and generate foreign exchange. Throughout, however, the principles of sustainability and viability apply.

When the South African government makes a sizeable investment in foreign purchase, the suppliers participate in economic activities in the country designed to increase fixed investment and/or promote international market access for SA value-added goods and services. In terms of these obligations they are described as "obligors" and the Industrial Participation Secretariat ensures that they meet these obligations, in terms of both quantity and time scales, and trying as far as possible to encourage labour intensity.

This document celebrates the achievements of the National Industrial Participation (NIP) Programme in South Africa, and its contribution to our first decade of democracy and freedom.

Industrial participation programmes are not unique to South Africa. Many other countries have used them in the past and are still using them today.

They work, in essence, by requiring those corporations from whom large purchases have been made by government to provide a platform through which local forums and established business can foster new relationships with multinationals, via new investments or joint ventures, the development of exports, and the transfer of skills, technology and equipment. In a developing nation such as South Africa, such industrial participation programmes have a further important dimension. This is that they allow government another lever to implement its long-term economic strategy to develop the country in a strategic manner, supporting the development of neglected regions (e.g. rural areas) wherever possible, encouraging the maturation of sectors which offer long-term high potential (e.g. areas of information and communications technology), but which in their incipient phases might be seen as too high risk for conventional private sector investors to pioneer. They also ensure that vital skills and cutting-edge technologies are transferred as an investment in the future, and, finally, they open new export markets for this country, whilst diversifying the products exported into new areas. In other words, the NIP complements government economic policy and strategies. Since the Department of Trade and Industry (**the dti**) in South Africa, and the group of institutions associated with it (COTII), comprise government's main practical economic actors, the NIP is located within **the dti**, in the Enterprise and Industry Development Division (EIDD).

During the period between April 2003 and March 2004, the ICC approved 125 projects encompassing all economic sectors outlined in **the dti** s Integrated Manufacturing Strategy (IMS).

A number of these projects arose from strategic partnership agreements (SPAs), i.e. pro-active arrangements that serve to encourage international companies to identify opportunities prior to obligations being incurred and bank credits for any future obligation that may arise.

The value of obligations being monitored at present is approximately US$14 billion. Since the programme was launched in April 1997, the programme has facilitated investments and sales credits worth US$2billion, consisting of investments of US$677 million, export sales of US$1 billion and local sales (including technology transfer, Black Economic Empowerment [BEE] and Small, Medium and Micro Enterprises [SMME] promotion) of US$457 million.

The obligations need to be discharged over a period of seven years with the exception of the BAE/SAAB obligation, which must be discharged over 11 years due to its size (US$7.2 billion worth of IP credits to be fulfilled in investment and export promotion). Other significant obligations arise from purchases made by Telkom and SAA, with the rest based on purchases by other government departments and state-owned enterprises (SOEs), such as Eskom, Transnet, and PetroSA.

1.1 Increasing Investments and Promoting Exports

Obligors can fulfil their obligations either through investment in approved projects or through promoting exports of South African value-added products by either buying for their own requirements or causing foreign companies to buy from South African companies. In the case of investment, Strategic Defence Packages (SDP) obligors are entitled to sales (exports and local sales) credits arising out of those investments in addition to credits for that investment and any technology transfers that may arise. SDP obligors should fulfil approximately a third of the obligation from investment and technology transfer credits and two thirds from sales. Other obligors, in addition to investment, technology transfer and sales credits, are also entitled to credits arising out of (1) job creation, (2) training and skills development, (3) research and development expenses and subcontracting to small and medium sized enterprises. In the case of non-SDP obligations, credit multipliers are used to encourage black economic empowerment, investment and exports. In addition to companies with obligations, the IPS manages and monitors projects from companies that have signed strategic partnership agreements (SPAs) with **the dti.** At least 60% of sales credits from SPAs must be through exports.

1.2 Monitoring the Obligations

Most of the obligors have signed binding agreements for the placement of work and the purchase of locally produced, value-added goods with their international partners on the one hand and domestic firms on the other. These products encompass electronics components, heavy-duty trucks, communications products, beneficiated minerals, etc.

The performance of the obligors is monitored through six-monthly reports and review meetings, as well as regular project site visits by IPS personnel and **dti** industry experts. Where necessary, use is made of other experts from institutions such as the Council for Scientific and Industrial Research (CSIR) and Mintek.

In addition to the above measures, all the contracts signed with the SDP obligors and new contracts signed since November 2002 include specific milestones that must be achieved. These milestones are set at between two and four-year intervals to enable a tight monitoring of the performance of each obligor towards fulfilling its obligation. The SDP contracts have specific milestones, which must be met by 2003/2004, 2005, 2007 and 2011. The use of milestones in monitoring projects and taking pro-active corrective action, where appropriate, has proven very effective in making projects deliver on their plans.

2 IN SUPPORT OF THE MICROECONOMIC REFORM STRATEGY

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In February 2001 President Mbeki announced an integrated action plan that focused on addressing the microeconomic bottlenecks impeding growth in the South African economy. This followed in the wake of the successful readjustment of the macroeconomic management of the South African economy since 1994, with strict monetary and fiscal disciplines rewarded by 2000 with budget deficits below 3%, lower and predictable interest rates and firm controls on state debt.

With macroeconomic fundamentals firmly in place, microeconomic constraints could now be the focus of attention. The emphasis is on strengthening the efficiency of the economy, driven by the private sector but directed by decisive coordinated state interventions. In this latter regard, the NIP plays a strategically critical role.

South Africa's NIP programme does not operate in isolation from its overall national economic strategies. In two respects in particular, the NIP goes well beyond leveraging economic growth and employment, important though that is. The NIP objectives are tailored to contribute towards meeting the objectives of the Microeconomic Reform Strategy and **the dti.** In particular, the programme supports the industry sectors as outlined in **the dti** s Integrated Manufacturing Strategy (IMS).

The vision of the future at which microeconomic reform is directed is:

- A geographic spread of social and productive investment;
- An integrated manufacturing economy capable of high degrees of value added;
- An extensive ICT and logistics system capable of speed and flexibility;
- A high degree of knowledge and technology capacity;
- Greater diversity of enterprise type and size;
- Skilled, informed and adaptable citizens;
- An efficient, strong and responsive state structure.

In addition to this, South Africa's strong growth in manufactured exports enables attention to be given to export sectors that both meet the above criteria and bring with them added spin-offs boosting the development of a South African economy well suited to the demands of the 21st century.

2.1 Target Sectors

The following sectors have thus been selected for their employment potential in wider value chains, for their integration into global production systems, for their potential for beneficiation and for the strengthening of existing competitive advantages:

- Clothing and textiles;
- Auto, auto components and transport;
- Agro-processing;
- Mining, metals and minerals beneficiation;
- Chemicals and biotechnology;
- Crafts;
- Information and communication technology.

As will be seen from this review of the NIP activities, the NIP presents South Africa with a strategically vital opportunity to target precisely those sectors in areas where normal business considerations might present risk profiles that initially deter private sector investment.

Much of this thinking is encapsulated in **the dti**'s Integrated Manufacturing Strategy (IMS). The IMS specifically identifies a key role for the NIP to leverage investment in targeted sectors. It builds on and expands the Microeconomic Reform Strategy. It is in this light that the review of NIP activities should be regarded.

Although South Africa's purchase of military goods receives maximum public attention, in fact many obligations occur through non-defence related purchases by government. Good examples of this are purchases by Telkom and by South African Airways. The offset investments include export promotion and Strategic Partnership Agreements (SPAs) entered into by potential suppliers. These projects are anticipated to generate credits to the value of US$1.5 billion, mostly in the high growth potential areas of South Africa's aerospace, telecommunications, information technology and engineering sectors.

Defence-related purchases took place later (2000) and so still have some time to run. However, the requirements are that the obligations have to be discharged over a seven- to eleven-year period (2011). So far, 76 projects have been approved by the NIP Secretariat under the SDP contracts.

The most recent review of "milestones" set, held in 2004, indicates that the obligors are proceeding satisfactorily.

3.1 BAE/SAAB

BAE/SAAB s first contractual NIP milestone in April 2004 comprised the following commitments:

Total:	US$2.3 billion, made up of
Investment:	US$300 million and
Sales:	US$ 2 billion.

BAE/SAAB have established a local company, South African National Industrial Participation (SANIP), to manage their offset programme.

The dti can report that BAE/SAAB has progressed satisfactorily in achieving their first milestone. Their projects are in various sectors and cover green field and brown field projects resulting in new and increased sales, new technologies being applied in the production process and new jobs and transfer of skills. BAE/SAAB have in aggregate exceeded their first NIP contractual milestone by achieving more than 100% of the investment milestone and approximately 95% of the sales milestone targets.

3.2 Agusta

Agusta s perfomance with regard to the first milestone was assessed in April 2003. and its contractual milestone commitment was made up of the following amounts

Investment:	US$32 700 000
Sales:	US$ 9 940 000
Total:	**US$42 640 000**

The company has so far achieved its first milestone in full and the second milestone will be assessed in April 2005.

3.3 Thussen Krupp

Thyssen on the other hand, faced their first sales milestone in 2003/2004. Their commitment can be summarised as follows:

Investment:	US$147 630 850 million to be met in 2005/06 and
Sales:	US$ 56 594 000 which was met in 2003/04

Thyssen s sale milestone has been successfully achieved and their first investment milestone will be assessed next year

3.4 German Submarine Consortium: Ferrostaal

Ferrostaal s performance with regards to their first penalty milestone will be assessed at the end of the year 2004. **The dti** is concerned that Ferrostaal is running out of time to meet this commitment. Their commitment can be summarised as follows

Sales:	110 million,
Investment:	610 million,
Total:	720 million.

3.5 Thales

Thales's first milestone commitment was assessed in April 2003 and their contractual milestone can be summarised as follows :-

Investment:	US$ 86 776 767
Sales:	US$191 622 028
Total:	**US$278 408 795**

Thales has so far achieved 85% of its overall target of US$278 408 795. The second milestone will be assessed in 2005.

Detailed information on the sectors outlined below follows in Appendix A.

4.1 Information and Communications Technology

NIP projects in the important ICT sector range from the export of telecom systems as part of Marpless UK's obligations incurred through the supply to the Department of Home Affairs of a National identification System, worth R32 million in exports, to Mobile Data Solutions' creation of a Software Development Centre and Systems Integration Plants to support local software development. The latter represents a total investment of US$2.6 million, with projected sales of US$6.1 million over five years.

Following many years of operation, Siemens has finally sold its facility to manufacture Main Distribution Frame (MDF) connectors to a consortium consisting of management and a BEE company that will be able to manufacture and sell similar products to other clients, with Siemens being the primary customer.

An IT fund has also been established, with the aim of assisting IT companies looking to expand. This is partly funded by a BAE Systems and SAAB joint venture.

4.2 Transport and Aerospace

Highlights here include the local manufacture of interior components for Boeing aircraft (Aerosud) and of components for the full range of Boeing 737 to 777 aircraft (Denel).

Airbus purchases initiated by SAA have led to Airbus's investment in a new Africa Non-Destructive Testing Centre and in outsourcing the design and manufacture of aircraft components. This enabled Denel Aviation to participate in the structural design of the A400M Programme.

4.3 Auto

Much activity around the investments by obligors into South Africa's burgeoning automobile and components manufacturing industry has taken placed under the NIP. These investments can be divided into several categories:

i. Export Promotion:

- Alltube, producing aluminium tubes for radiators, an investment by GFC Thyssen worth US$2 million, with projected sales of US$28 million;
- Brits Textiles, producing rear parcel trays for Mercedes Benz C Class vehicles, an investment by Daimler Chrysler of R20.34 Foundries, with actual sales to date of R34.2 million;
- vehicle cylinder head-blocks and crankshafts, a R250 million investment by Daimler Chrysler, with local sales of R845million, and export sales of R612 million over seven years;
- similar projects for camshaft forgings, producing for local and export markets, by Daimler Chrysler;
- split leather production for motor vehicle seats, an investment by Agusta (helicopters), with exports of US$6 million, rising to a projected US$30 million by 2007 (DCSA);
- the manufacture of carbon fibre wheels by Blackstone Tec for motor cycles, a Thales project with big potential for expansion into other high-performance (e.g. Formula 1) vehicle components, with projected sales by end-2004 of R20 million, mostly for export;
- Johnson Control, a Volvo investment, is also producing leather car seats for Volvo Sweden;
- Columbus Stainless Steel produces steel for Volvo Bus bodies, and aluminium wheels; and