

# Manufacturing Bulletin

Quarterly review . Fourth Quarter 2015



**MANUFACTURING** CIRCLE  
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## EXECUTIVE SUMMARY

The fourth quarter of the 2015 (Q4 2015) Manufacturing Circle Survey reveals that South African manufacturers are experiencing difficult times, in keeping with global trends.

Large and leading economies indicated downward trends in Industrial Production indices towards the end of 2015. Similarly, emerging markets are facing challenging times driven by the impact of a decline in export growth and commodity prices.

Domestically, South Africa is showing a negative trend in domestic demand as well as exports, which is negatively impacting on the performance of the manufacturers surveyed. In addition, rising costs is a key area of consideration in the sector. Together with an increase in imported input costs due to a weakening exchange rate, the manufacturing industry anticipates hikes in electricity prices and rising costs of borrowing. Despite the fact that the labour environment has been relatively stable in the last quarter, this is still an area that has the potential to negatively impact on the sector.

In spite of these challenges, it is encouraging to see that a significant number of local manufacturers are implementing measures to become more competitive and foster resilient growth. A reduction in debt levels and increasing investment in skills was also a focus for some manufacturers.

# Fourth Quarter 2015

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# INTRODUCTION

## Background to the Manufacturing Circle Survey

The Manufacturing Circle Survey is compiled by Nascence Advisory & Research on behalf of the Manufacturing Circle. The purpose of the survey is to capture current and expected economic and business conditions in the domestic manufacturing sector.

This quarterly review covers the latest available trends in the manufacturing sector, as gathered from key informants during the fourth quarter of 2015 (Q4 2015).

## Profile of the Survey Participants

The survey contained quantitative and qualitative questions, completed by a total of 74 firms, varying from small to large South African manufacturing companies. The respondents represent different sectors of the manufacturing industry.

Using the Standard Industrial Classification (SIC) of economic activities codes, the respondents of the Q4 2015 edition operate in the following industries:

- Basic metals, fabricated metal products, machinery and equipment and office, accounting and computing machinery;
- Coke, refined petroleum products and nuclear fuel, chemicals and chemical products; rubber and plastic products;
- Electrical machinery and apparatus not elsewhere classified;
- Food products, beverages and tobacco products;
- Furniture, manufacturing not elsewhere classified;
- Recycling;
- Other non-metallic mineral products;
- Textiles, clothing and leather goods;
- Transport equipment; and
- Wood and wood products of wood and cork, except furniture; articles of straw and plaiting materials; paper and paper products publishing, printing and reproduction of recorded media.

The majority of respondents to the survey fall into the category small to medium enterprises, although there are large manufacturing firms too. The companies surveyed employ some 93 000 people, with 60% of the respondents with a turnover of less than R300m as shown in Figure 1.

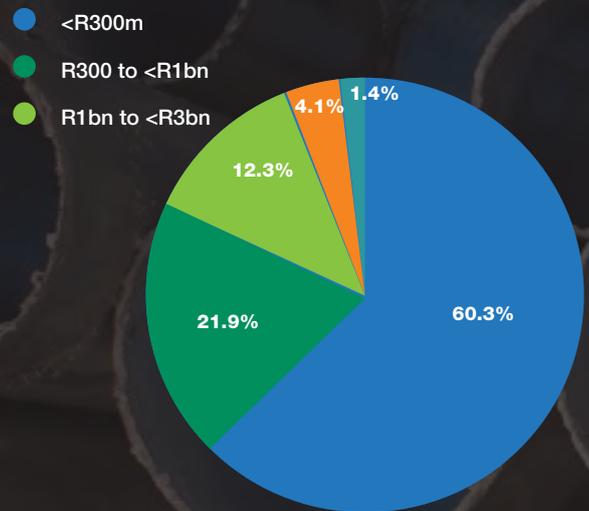


Figure 1: Turnover of respondents

## Structure of the Analysis

The survey aims to understand local trends within the context of the global economy. A review of the global and South African economies is provided, followed by an analysis of the Manufacturing Circle survey according to:

- Sentiment and operating conditions;
- Labour conditions;
- Performance and profitability; and
- Capacity utilisation and competitiveness.

# GLOBAL ECONOMIC REVIEW

## Large and leading economies face a slowdown

Despite the initial positive momentum in developed markets in the first three quarters of 2015, economic indicators for the last quarter of the year show that global economic conditions have turned – now showing a trend of deterioration.

Despite indicating a positive trend since the end of the global crisis in 2008, the US index for Industrial Production turned downward towards the end of 2015 as shown in Figure 2.

Germany, the largest hope for troubled Europe, has disappointed. Industrial Production fell over two percent in December 2015 as shown in Figure 3. This contraction marks a critical turn in the global economic outlook dashing hopes of a more widespread recovery. Germany had previously led growth in the European Union, and was one of the first major econ-

omies in the world to show growth and mark the end of the economic crisis.

In China, the world's second largest economy, industrial production is a critical marker for growth. Industrial production remained frail during 2015, and in December growth in this indicator fell to below 6% as indicated in Figure 4. This is a long way from the near double digits previously seen, sending concerns to many in the world about China's fortunes in the medium to long term.

As a result, China's GDP growth fell below the 7% mark, considered by many as a critical psychological level. This has seen continued market volatility in China, which has infected global economic activity, especially emerging market peers like South Africa.



Figure 2: US Industrial Production

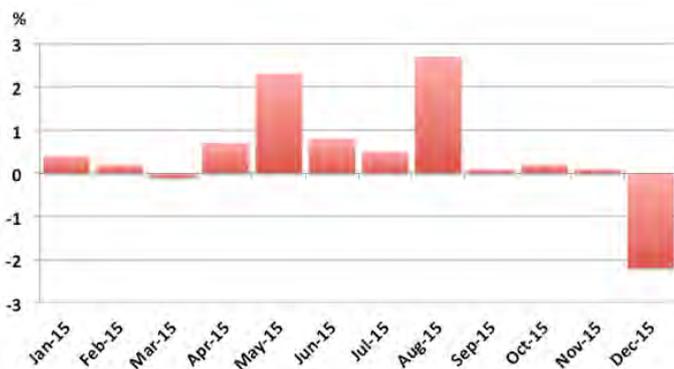


Figure 3: German Industrial Production

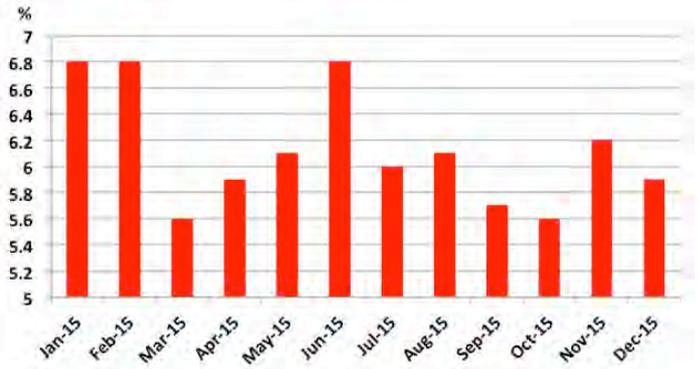


Figure 4: Growth in China Industrial Production

## Emerging markets take strain as growth in developed markets weaken

Emerging markets, previously having been thought of as “decoupled” from the developed world, seem to be facing especially challenging times.

Exports, which have been a major driver of growth in emerging markets (EM), have been falling as a result of weak global growth. The much-celebrated BRICS bloc has experienced consistent declines in exports growth, with this negative trend being sustained for consecutive months for the last part of 2015. With particular reference to Brazil, China and South Africa, this negative trend is reflected in Figure 5,

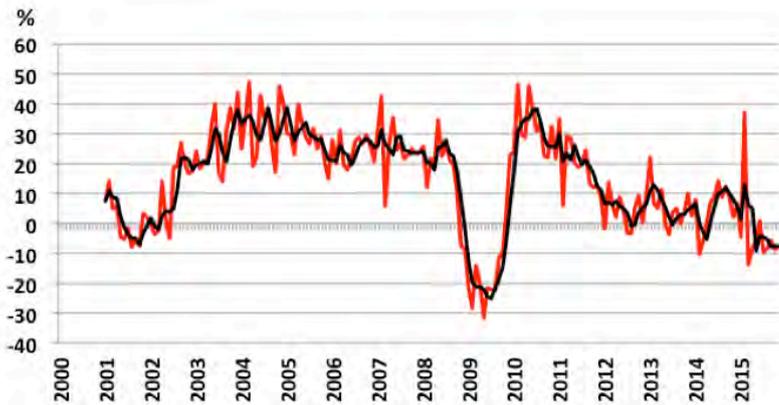


Figure 5: Growth in EM Exports for Brazil, China and South Africa (weighted average)

On an individual basis, the latter part of 2015 has been especially challenging for Brazil. South Africa has also seen weakness given its inclination towards exports of commodities as shown in Figure 6.

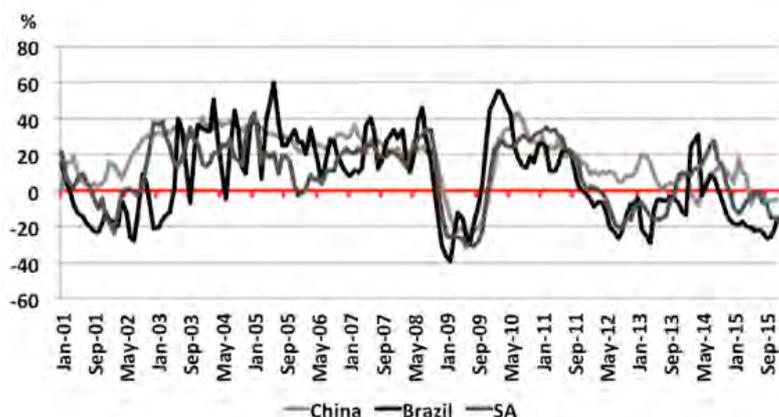


Figure 6: Growth in EM Exports for Brazil, China and South Africa (disaggregated)

In addition to weak exports, China’s manufacturing has contracted. The China official PMI remained in contractionary mode for a sixth straight month in January 2016, falling to its lowest level in nearly four years in January 2016 as shown in Figure 7. This means that looking ahead, we should expect continued weakness in production and in exports.

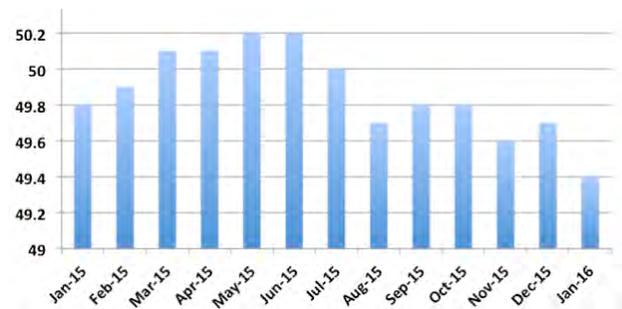


Figure 7: China Official Purchasing Managers Index (PMI)

In South Africa, the picture is predictably similar, with the Barclays Manufacturing PMI falling two index points to 43.5 in January from 42.5 in December, confirming that manufacturing conditions in South Africa are looking gloomy.

Purchasing manufacturers surveyed in South Africa indicated that they did not see any improvements in the near future, and expected business conditions to deteriorate to seven-year lows. The main contributor to this decline was seen in rising inventories, suggesting that going forward, production would fall in order to accommodate the depletion of rising stockpiles.



Figure 8: Barclays SA Purchasing Manufacturers Index (PMI)

Confirming the weakness in export and manufacturing activity is the BDI global shipping index (Baltic Exchange Dry Index) as represented in Figure 9. The BDI index measures the price of moving major raw materials through major sea routes. Falling prices suggests a decline in demand for raw materials and therefore export.

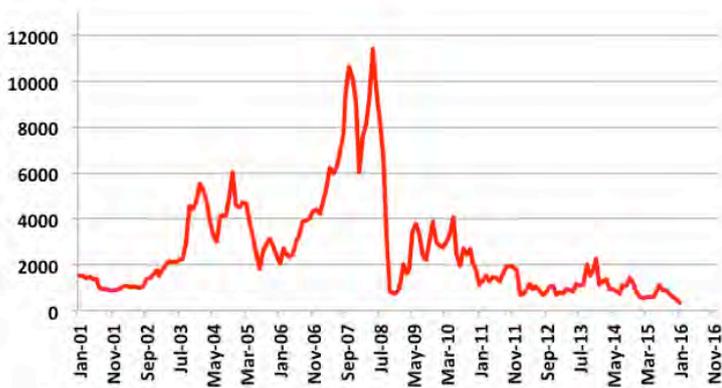


Figure 9: Baltic Shipping Index

We have also seen a decline in prices of raw materials and commodities, as shown by the World Bank's commodities indices. Indeed, these have been in sharp and consistent decline since the start of 2015 across a variety of metals and raw materials, nearing levels not seen since the 2008 crisis.

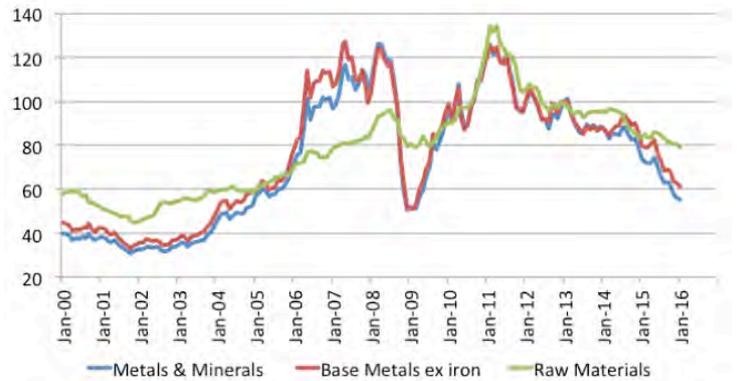


Figure 10: World Bank Commodities Indices

## The South Africa case: a mixed bag of bad news and hope

The manufacturing sector in South Africa has faced various pressures, from global economic activity slowing down, to local challenges, including shortages in power supply, labour volatility and low consumer and business confidence.

This has led to extremely volatile manufacturing production, which has been contracting on a trend basis for several consecutive months in 2015 towards the last quarter as shown in Figure 11.



Figure 11: Manufacturing Production

Manufacturing production fell by 1% for the month of November 2015, compared to the same time in 2014. The decrease was driven by lower production in basic iron and steel, and thus consistent with the weakness in demand for raw materials and basic metals.

Despite this long-term negative trend in manufacturing production, the data released towards the end of 2015 showed marginal improvements. This was also seen in manufacturing capacity utilization (measuring the percentage of available capacity used by manufactur-

ers) which indicated a two percentage points increase for the same period. This increase in capacity utilisation was mainly attributed to manufacturing of motor vehicles, parts and accessories and other transport equipment. An increase in food and beverages was also evidenced. This positive development could be attributed to the weaker Rand, which is making local manufactured goods comparatively cheaper, especially for markets such as the US.



Figure 12: Capacity utilization

# THE MANUFACTURING CIRCLE SURVEY

## A show of optimism in spite of challenges

Responses to our survey of the manufacturing sector for the last quarter of 2015 paint a consistent picture to observations from external data. Across the sections of inquiry from operations, to capacity utilization and profitability, we observed that the sector is demonstrably under pressure.

However, while surveyed manufacturers expressed pessimism about the future, local manufacturers are still taking steps to improve competitiveness and boost economic resilience.

### Sentiment And Operating Conditions

Manufacturer's outlook seems to be relatively negative, confirming what has emerged from various Purchasing Manufacturing Indices.

Asked about how they viewed operating conditions going forward, over 60% of manufacturers surveyed said they expected conditions to deteriorate over the next year. This is even worse than the 54% who said conditions had deteriorated over the past quarter, indicating that we are seeing a negative and worsening trend.

Only an average of 11% of manufacturers surveyed had a positive experience over the last quarter, and this number falls to 8% when we asked about the outlook for the next four quarters.

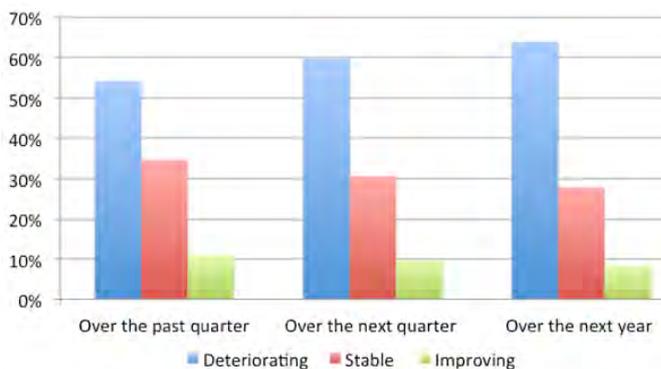


Figure 13: Opinion on operating conditions

The main reasons advanced for the negative outlook included the weakening exchange rate, as well as policy.

It is important to note that while negative sentiment exists, forty percent of respondents indicate the perceptions are either stable or improving over the next quarter.

Respondents with a positive outlook cited an improvement in economic conditions in Sub Saharan Africa and revisions in strategy to capture market share. This suggests that regional diversification is an important strategy for manufacturers.

Financial conditions also deteriorated somewhat, perhaps responding to policy action as the central bank increased interest rates to contend with rising inflation in South Africa.

Asked whether debt levels increased or decreased over the last quarter of 2015, the majority of respondents signaled a decrease.

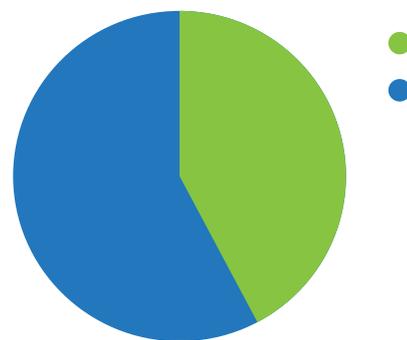


Figure 14: Debt profile

Credit and debt levels fell in more than half of surveyed manufacturers, signaling deleveraging in the face of a rising interest rates environment. Further, looking at data from the financial sector, credit to the private sector decreased by about 1% in December following long growth in previous months.

Confirming this trend, respondents seemed to be borrowing or long term loans at higher interest rates. Fifty six percent of responding manufacturers said they were accessing long term finance at "prime plus" rates, whereas short term lending occurred at more favourable rates.

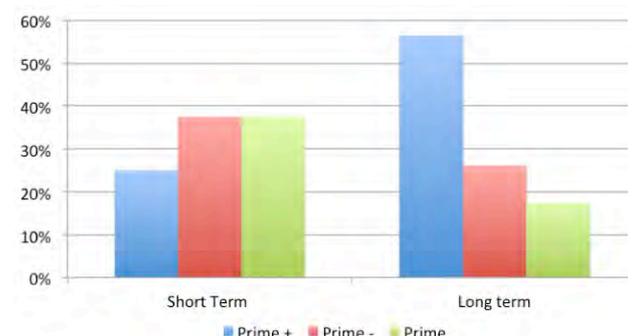


Figure 15: Lending rates spread

Stats SA data supports these findings, where the number of liquidations has fallen across the board in the last quarter of 2015, including manufacturers. Higher interest rates and perhaps tougher criteria within banks are being countered with a drive to deleverage.

In addition, a handful of respondents noted that borrowings came from internal sources, including parent companies.

## Labour Conditions

Labour conditions is a critical area of analysis in the sector given various recent developments in South Africa to include labour industrial action and the minimum wage debate. It is noteworthy that surveyed manufacturers employed nearly one hundred thousand people, 12% of whom were on a part time basis.

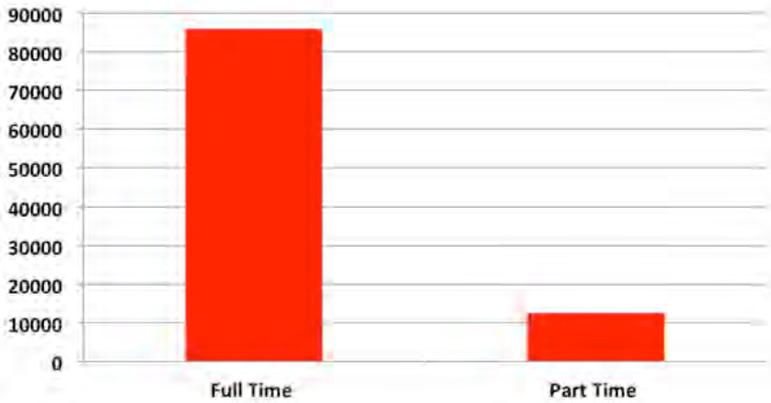


Figure 16: Split in employment regime

Within this context, 27% of respondents thought labour productivity had deteriorated, while two thirds said it had remained the same or improved.

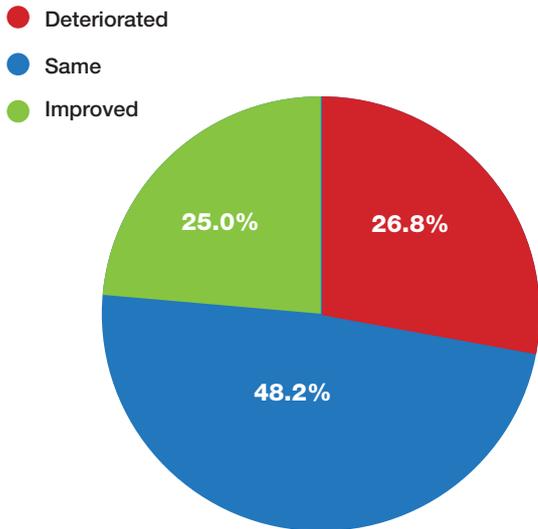


Figure 17: Labour productivity

About 20% of surveyed manufacturers indicated plans to cut jobs in the next 3 months, while 60% percent looked to keep the same level of labour.

In the longer term, 40% of manufacturers indicated plans to cut jobs within the next 12 months.

It has to be borne in mind that the fourth quarter of the year is the holiday season, and can be expected to see decreased productivity. Survey results are not currently seasonally adjusted, and thus the seasonal effect would therefore need to be kept in mind.

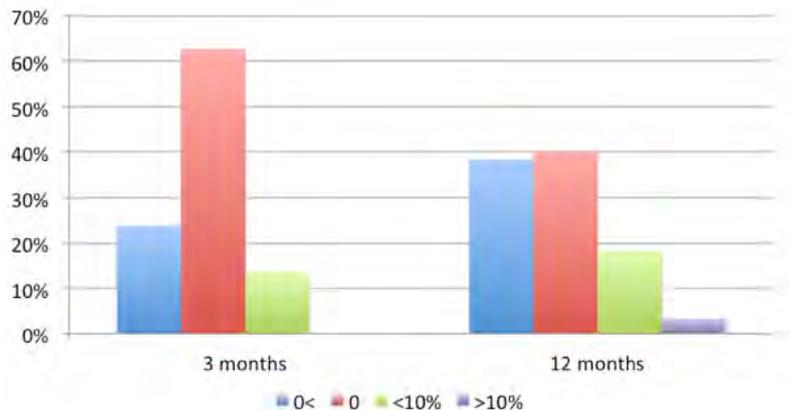


Figure 18: Split in employment regime

Performance and Profitability

From a sales perspective, 64% of respondents are exporting less than 20% of production, while 16% are exporting in excess of 60%.

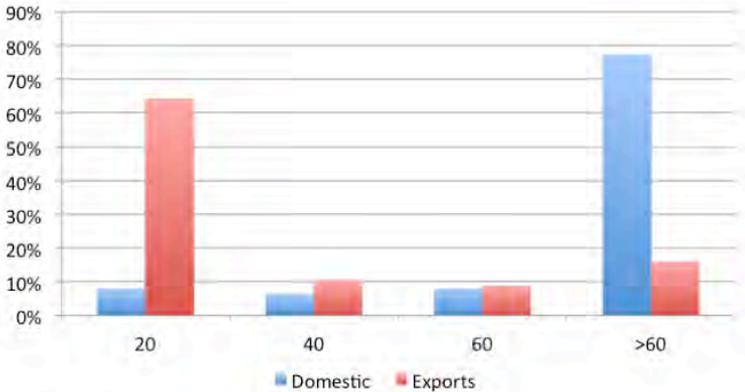


Figure 19: Imports and exports sales

From a sales performance point of view, domestic conditions were reportedly discouraging. Fifty percent of manufacturers saw a contraction in domestic sales over the past quarter. A quarter said they saw no change in sales in the last quarter, while less than 10% saw a marginal increase. For manufacturers who are exporters, they reported that they saw less than 5% increase in export sales, with 20% of manufacturers reporting a contraction sales value and volumes.

This is concerning given that this was the festive or holiday period.

While sales were under pressure, input costs also seem to have been an issue. Sixty percent of respondents said their imported input costs escalated more than 6%, whereas domestic input costs were seen to rise by a rate of below 5%.

Many blame the weaker rand as the main cause for escalating imported costs.

Respondents also said the higher input costs came from materials, while labour and utilities seemed to be less of a driver. This is not surprising given the reliance on imports for materials, especially in the agricultural sector. Further, although utilities and labour were seen as the least contributors, they are likely to be a major driver in the next quarter given a probable rise in electricity costs and increasing focus on industrial action and the minimum wage debate.

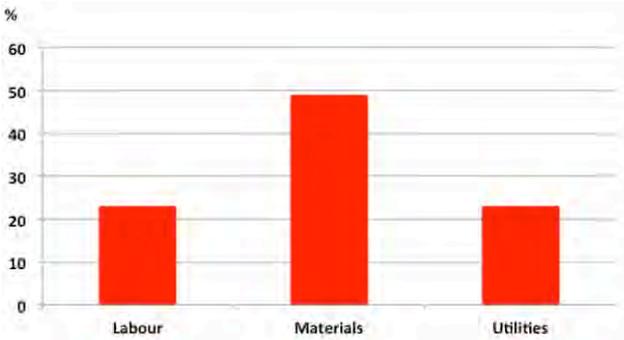


Figure 20: Input cost drivers

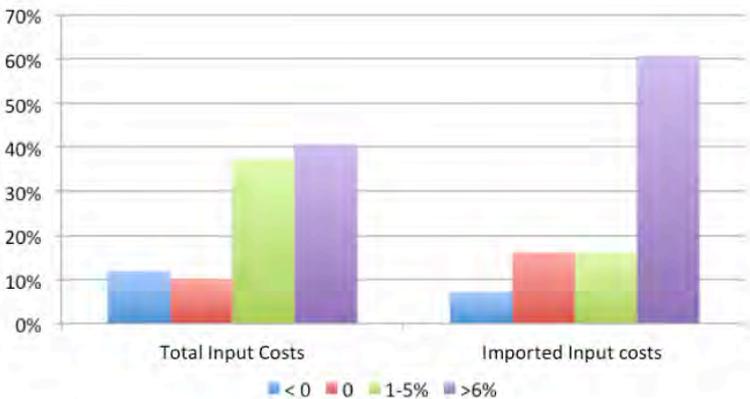


Figure 19: Input cost changes

## Capacity Utilization and Competitiveness

While 45% of respondents noted a decrease in production capacity, 55% noted an increase

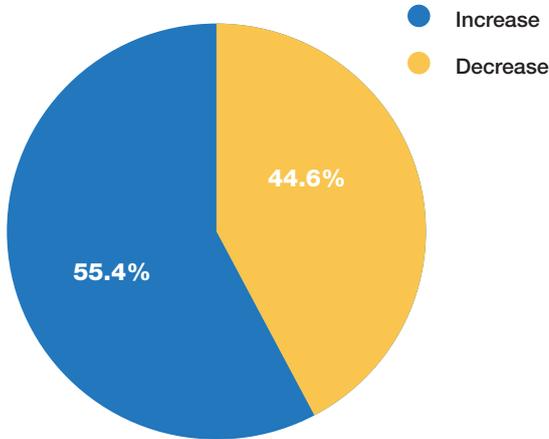


Figure 21: Capacity Utilisation

This is not entirely bad news, and bodes well for the sector competitiveness driven interventions. Respondents not only increased capacity, but also upgraded processes and facilities. Seventy percent of respondents said they implemented new technologies and innovations to improve their production facilities and processes.

This bodes well for competitiveness, and readiness for improved conditions.

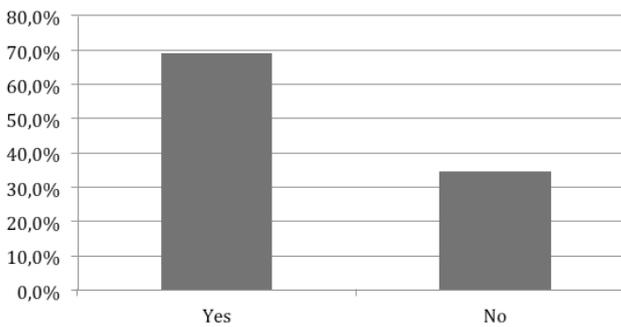


Figure 22: Implementing technology and innovation

Figure 25: Efforts to improve labour productivity and skills

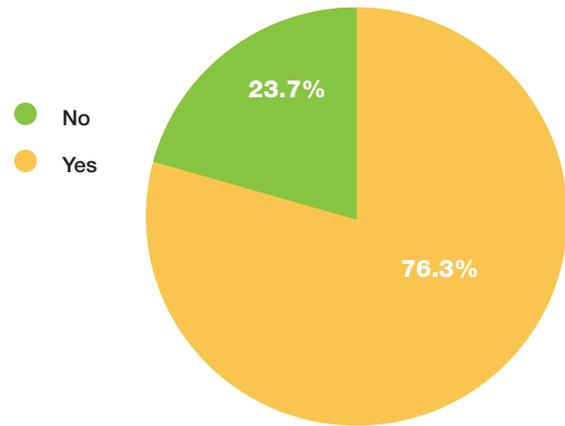
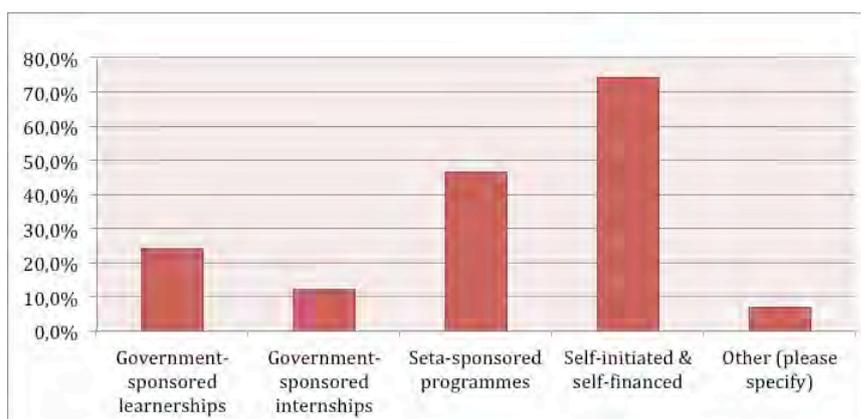


Figure 23: Efforts to improve competitiveness

A whopping three quarters of respondents said they had, in the fourth quarter, implemented new methods towards enhancing competitiveness.

This included new product process innovation, as well as efficient use of resources. To a degree, there was also increased use of technology and mechanization.

- New product/process innovation
- Introduction of advanced manufacturing
- Mechanisation of previously manual functions
- Improved and efficient use of resources/inputs
- Other (please specify)

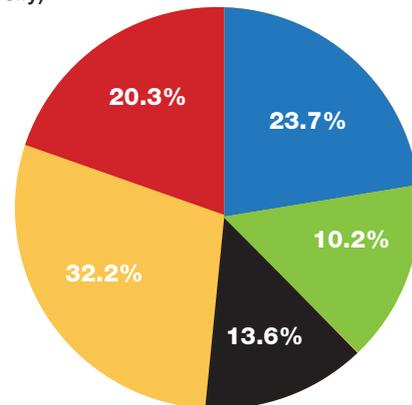


Figure 24: Methods to improve competitiveness

Efforts towards enhancing productivity and competitiveness included skills development. Survey respondents said they had increased and financed training programs and skills develop in order to improve productivity.

## Policy and Government Procurement

An important avenue for growth and sustainability in difficult times is policy and government procurement. This is often important especially for developing firms. In lean times, government spending can act as a buffer or stimulus, and thus it is important to understand how manufacturers respond.

However, when asked about benefitting from government's procurement program, the vast majority of responding manufacturers said they do not benefit from this.

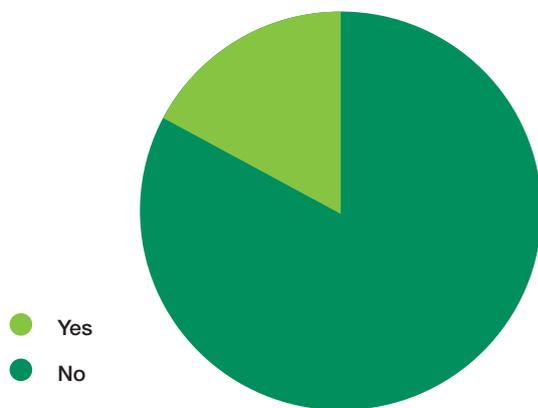


Figure 26: Benefit from government procurement

This is in spite of the fact that government procurement is noted as an important part of their growth and sustainability.

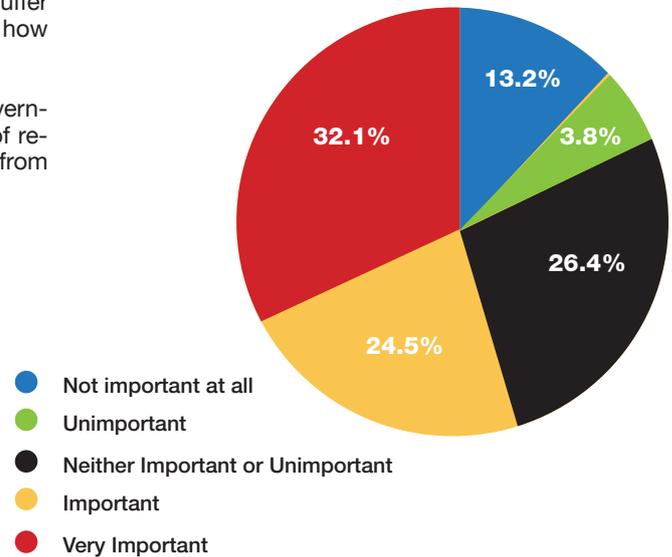


Figure 27: Importance of government procurement

## Conclusions and outlook

It is clear that in keeping with global trends, South African manufacturers are experiencing difficult times.

Despite challenging circumstances, it is encouraging to see that a significant number of local manufacturers are many implementing measures to become competitive and foster resilient and increased growth.

We however caution that the labour environment which has been relatively stable over the past quarter, is a factor that could negatively impact on the sector given current challenges. In addition, rising costs will be of key importance in the manufacturing sector as we consider potential hikes in electricity prices on top of the increasing costs of borrowing.





“From Global Challenges to  
Grand Manufacturing Opportunities:  
Leading towards Growth  
and Sustainability”

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# THE WORLD MANUFACTURING FORUM (WMF) 2016 BARCELONA

The World Manufacturing Forum (WMF) is an internationally-recognised assembly which aims to shape global, regional, national and industry-specific manufacturing policy. The highly-regarded and invitation-only event also explores industry megatrends and provides high-level networking opportunities.

The WMF2016, to be held 3-4 May 2016 in Barcelona, will be the fourth big-budget edition to assemble global policy experts, industry leaders from large multinationals to small-to-medium sized enterprises (SMEs), and academic leaders to discuss the policy, economic, social and technical challenges that influence the global manufacturing industry. The themes to be explored are as follows.

- 21st Century manufacturing
- Manufacturing investment: a bridge to economic growth
- Small is beautiful (SMEs)
- Manufacturing intelligence
- Social innovation and metropolitan manufacturing
- Enhancing the manufacturing base in emerging economies
- Circular manufacturing
- Disruptive strategies towards the next manufacturing era

At the last WMF held in Milan in July 2014 more than 400 selected delegates listened to leaders in manufacturing from around the globe including Mauro Piloni, Global VP for Product Innovation at Whirlpool; Philippe Charlès, CEO of Delmia at Dassault Systèmes; Tomas Hedenborg, Group CEO of Fastems Oy Ab; Dianne Chong, VP – Materials & Manufacturing at Boeing; Enrico Krog Iversen, CEO of Universal

Robots; Bernd Liepert, CTO of KUKA AG; Riccardo Tarantini, CEO of COMAU; Anton S. Huber, CEO of the Industry Automation Division of Siemens AG and Matteo Marini, CEO and Country Manager of ABB Italy to name but a few.

The WMF is an initiative of the Intelligent Manufacturing Systems (IMS) Programme and is supported financially by the European Commission. Due to South Africa's membership of the IMS Programme, the organisers of the WMF2016 have indicated that South Africa may constitute a delegation of approximately 30 individuals from the public and private sectors to attend the event.

If you are interested in attending, contact Garth Williams at the Department of Science and Technology (DST) on [garth.williams@dst.gov.za](mailto:garth.williams@dst.gov.za) or 082 267 1246 no later than 15 March 2016 for more information.

Kindly note that while the WMF is free to attend, each approved delegate must pay for his/her costs of attendance. Also note that the DST, as the supporter of South Africa's IMS Programme membership reserves the right to constitute the South African delegation list for submission to the WMF programme committee for its consideration.

Information concerning the WMF2016 can be found at [www.worldmanufacturingforum.org](http://www.worldmanufacturingforum.org).





A carbon tax is a tax levied on the carbon content of fuels. It is a form of carbon pricing. Carbon is present in every hydrocarbon fuel (coal, petroleum, and natural gas) and is released as carbon dioxide (CO<sub>2</sub>) when they are burnt.

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# THE CARBON TAX: ONE PIECE OF A COMPLICATED PUZZLE

**Gaylor Montmasson-Clair**

**Assistant Programme Manager: Sustainable Growth**

**Trade & Industrial Policy Strategies**

*Briefing note*

South Africa has embarked on the necessary transition to a low-carbon economy. The South African Government is progressively establishing the mix of measures aimed at supporting this challenging, although rewarding, transformation. A carbon tax has been proposed by the National Treasury as part of the package.

The proposed tax seeks to oblige polluters to internalise the external costs of emitting greenhouse gas (GHG) emissions. A marginal carbon tax rate of R120 per tonne of carbon dioxide equivalent (tCO<sub>2</sub>e) would apply during a first phase (from 2017 up to 2020). However, a number of exemptions and offset mechanisms are proposed to ease the burden on emitters, resulting in an effective tax rate between R6-48 per tCO<sub>2</sub>e. Uncertainties around socio-economic impacts and institutional mechanisms have led the Davis Tax Committee to recommend the introduction of the tax with an initial zero liability, to provide companies and government the opportunity to plan accordingly and fine-tune systems.

The proposed carbon tax rate is situated at the lower end of the spectrum compared to existing schemes. South Africa would be one of the early adopters and first developing countries to implement a carbon tax. About 40 jurisdictions have implemented a carbon price, most of them European countries.

Overall, further efforts are required to ensure the complementarity of the proposed scheme with other climate change mitigation instruments as well as the country's energy and industrial policies. This challenge finds particular expression in the design of the tax, the timing of its implementation and its integration with other measures. The lack of details and certainty about complementary measures has raised concern about the neutrality (on revenues and electricity

prices) and progressivity of the scheme. Furthermore, no clarity has been provided about the medium-term changes (beyond 2020) under consideration.

The impacts of the proposed tax on the economy is a contentious point, particularly in the current economic conditions. Research suggests a marginal negative impact on economic growth in the short term and positive benefits in the longer run. While the carbon tax may generate a short-term loss in competitiveness in some sectors, it may help reduce South Africa's vulnerability to climate change response measures by other jurisdictions and position the country as a leading green economy. In any case, impacts will not be uniform across the economy and society, and will require tailor-made responses by Government.

*From a climate change perspective, the success of the carbon tax will hinge on the transformation of South Africa's energy systems, which accounts for the lion's share of the country's GHG emissions. In the current setting, it remains unclear whether the carbon tax would successfully trigger the necessary shift in the quantity and the quality of energy use.*

In the end, the success of South Africa's ambitions on the three fronts of climate change mitigation, energy security and industrial development will depend on the ability to adopt an integrated and holistic view bringing it all together, prioritising the efforts while supporting the development of the economy and a trajectory shift towards a low-carbon path.

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# THE CARBON TAX BILL: A PERSPECTIVE BY ARCELORMITTAL SOUTH AFRICA LTD

On the 2nd of November 2015 the long awaited Carbon Tax Bill was published by the National Treasury for public comment.

In general the Bill can be summarized as follows:

- The design and structure remains similar to what was published previously in the 2013 Carbon Tax Policy Discussion Document, but the complexity has increased significantly, especially when it comes to calculating the tax-free thresholds.
- The increased complexity in calculating tax-free thresholds is caused by the fact that emissions are now categorised into three groupings namely process, combustion and fugitive emissions.
- The rate remains unchanged at R120/tCO<sub>2</sub> above a tax-free threshold.
- The 10% per annum escalation referred to in the previous Policy Discussion Document is not mentioned anywhere in the new Bill, but provision is made for the Minister of Finance to announce new rates in future.
- Provision is made in the Bill for implementation on the 1st of January 2017.
- The Customs and Excise Act will be the instrument for tax collection purposes.
- The tables provided for calculation of the tax-free thresholds are conflicting each other as to where the iron and steel industry's emissions exactly fit in.
- Emission calculation methodologies in the Bill are not aligned with the calculation and reporting methodologies that are currently developed by the National Department of Environmental Affairs [DEA], yet it is stated that emission data provided to the DEA will form the basis for tax calculation purposes.
- In the Media Statement that accompanies the Bill, it is stated that the electricity levy will be reduced as a complementary measure in order to reduce the impact that the Carbon Tax may have on the price of electricity. It is further stated that the overall impact of the Carbon Tax on the price of electricity will be neutral.

Further engagement with Treasury has confirmed that there is indeed a commitment from Treasury's side to keep the effect of a Carbon Tax on the electricity price neutral. This is good news for the iron and steel industry as the financial impact of the proposed carbon tax will now be less when compared to the previous Carbon Tax Discussion Paper. Iron and steel makers however have significant direct emissions (the bulk is direct scope 1) and here unfortunately there are no significant changes that may relieve the tax burden when compared with the previous Discussion Paper except for the additional relief granted when a company participates in DEA's Carbon Budget instrument to curb emissions.

As a matter of fact, the complexity that was added by distinguishing between the various emission categories (process, combustion and fugitive) will place a huge burden on companies as the calculation of the tax-free threshold is now highly complex, especially for a sector like iron and steel. In the previous Discussion Paper it was far easier as all scope 1 emissions were considered without categorisation, and in the event of a company having process emissions an additional 10% tax-free threshold applied. The calculation methodology should be as simple as possible and ArcelorMittal South Africa Ltd [AMSA] will definitely pursue this aspect further in its deliberations with Treasury.

A further concern is to align the CO<sub>2</sub> calculation methodology presented in the Bill with the methodologies that are currently being designed by the DEA. Off-set projects could assist in increasing AMSA's tax-free threshold further by 5% to 10%, depending on the emission type, but currently AMSA does not have projects that qualify when considering the basic criteria. A new Off-set Discussion Paper will be published within the next 6 months by the National Treasury, but informal discussions with Treasury revealed that the basic criteria for off-set projects will remain, namely that such a project may not be related to activities that are liable for carbon tax.

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**The Davis Tax Committee Report on Carbon tax was published on 13 November 2015 and comes out in support of a Carbon Tax, but recommends that it be implemented at a zero rate for an initial period.**

The report is critical of DEA's Carbon Budget emission reduction instrument as there are principle differences that may hinder alignment in future, the Carbon Tax touching on intensity principles whereas the Carbon Budgets entail absolute caps placed on emissions. The report pleads for further alignment between the Carbon Budgets and Carbon Tax instruments. AMSA supports the view expressed in the report that the timing of the tax should be reconsidered and strongly supports alignment between the tax and the Carbon Budget instruments. AMSA firmly believes that there should only be one instrument applicable to South Africa to curb emissions. Currently we have different state departments running with different instruments and this will place a major burden on industry from an administrative and financial point of view.

**AMSA remains firmly opposed to the proposed Carbon Tax as:**

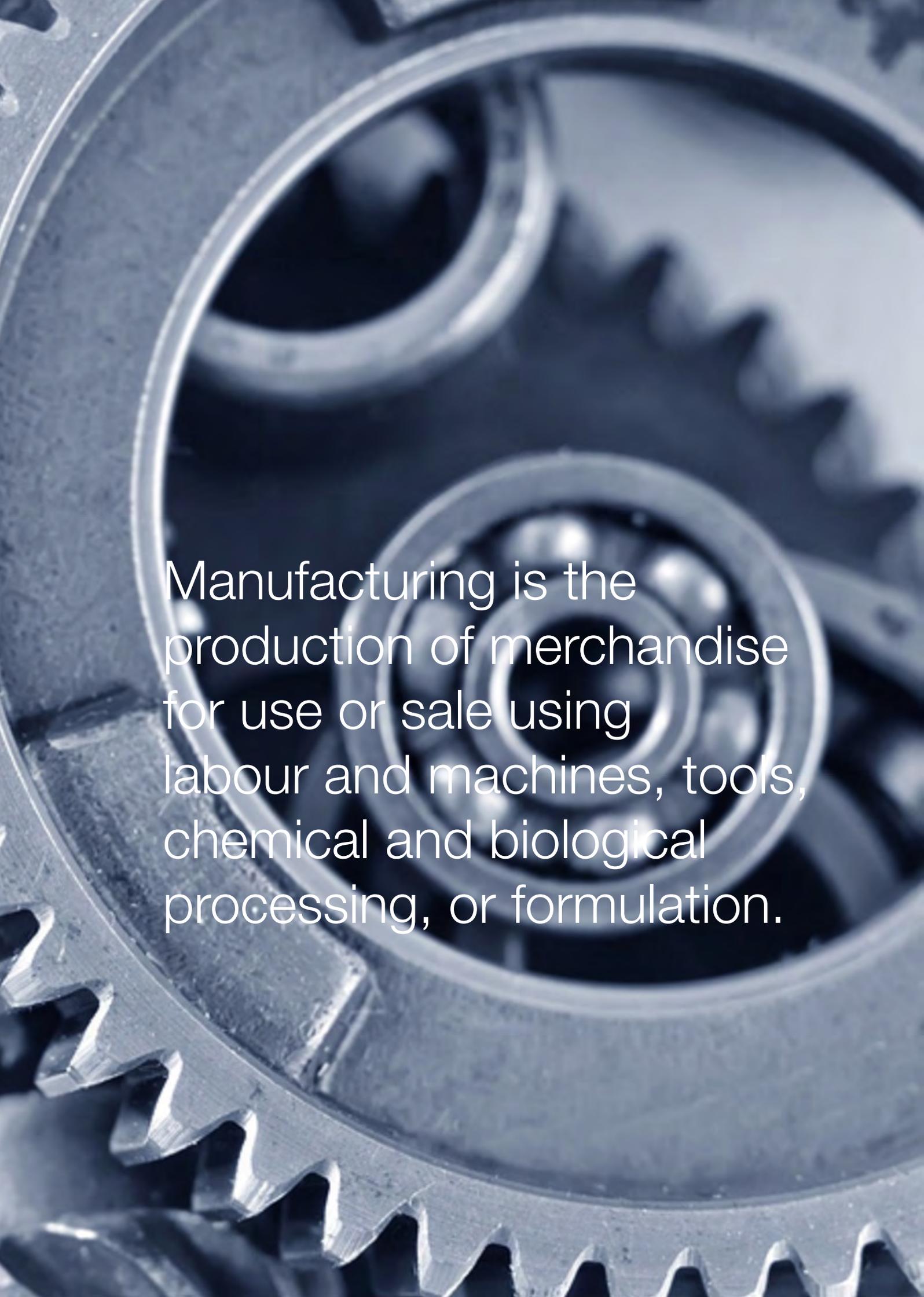
- there is no alternative technology that can be used to produce steel and reduce emissions to the extent required, so the effect of the Carbon Tax would not incentivise a change in behaviour but rather be a penalty – which is contrary to the main purpose of the Carbon Tax
- the projected Carbon Tax burden would be significant and would threaten not only AMSA's viability but also the viability of the iron and steel industry and the South African economy
- the industry would be exposed to imports not subject to a similar tax making the South African industry uncompetitive or not viable at all
- the ability to pass on the Carbon Tax to customers is limited, especially for the export market thereby reducing potential export revenue for South Africa

It should also be pointed out that the South African economy is not growing as it should and the viability of the iron and steel industry globally is under threat. The introduction of a carbon tax in this economic climate will have a severe and irreparable impact on the steel industry and therefore the South African economy with the very real possibility that local steel manufacturing capacity and capability could be lost.

**The next steps regarding the Carbon Tax Bill will be:**

- To continue lobbying for a special dispensation for iron and steel as the sector is technically constrained, trade exposed and prone to the carbon leakage phenomenon. Due to these concerns the EU made favourable concessions in the past for iron and steel makers in terms of the EU ETS.
- To clarify all the technical uncertainties in the Bill by means of further engagement with National Treasury.

*AMSA is a Manufacturing Circle member, and provides this comment on the Carbon Tax Bill within the context of the South African iron and steel industry.*



Manufacturing is the production of merchandise for use or sale using labour and machines, tools, chemical and biological processing, or formulation.

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# The Manufacturing Competitiveness Enhancement Programme (MCEP): A Review

The Manufacturing Competitiveness Enhancement Programme (MCEP) is an incentive offered by The Department of Trade and Industry (the dti). It was launched in June 2012, designed to support enterprises in the production sectors of the economy soon after the onset of the global economic recession to weather adverse market conditions, secure higher levels of investment, raise competitiveness and retain employment. At inception, it was envisaged that the R5.8bn programme would run for six years until 2018, subject to the availability of funds.

However, in October 2015 the dti announced the temporary suspension of new applications with immediate effect. This was due to the large number of applications across the manufacturing sectors which far exceeded funds set aside for the programme. Over R5 Billion was fully committed.

The announcement impacted on several Manufacturing Circle members and the manufacturing industry in general. The Manufacturing Circle therefore undertook a survey to inform an understanding of the programme's background, current situation, challenges encountered and proposed way forward.

## Background

MCEP caters to manufacturers not covered by sector specific incentives, such as those available to companies in the automotive and clothing and textiles sectors. The programme comprises two components, namely Production Incentives and Industrial Financing Loan Facilities, detailed as follows:

### Production Incentives

- **Capital Investment**  
The objective of this incentive is to support capital investment in equipment upgrading and expansions that will lead to creation of new jobs and retention of existing jobs.
- **Green Technology and Resource Efficiency Improvement**  
The objective of this incentive is to support projects with green technology upgrades and business development activities that will lead to cleaner production and resource efficiency as well as engineering and conformity assessment services that support the green economy through the manufacturing sector.
- **Enterprise-Level Competitiveness Improvement**  
The objective of the incentive is to enhance the competitiveness of enterprises through the enhancement of conformity assessments and improving processes, products and related skills development through the use of business development services.
- **Feasibility Studies**

### Industrial Financing Loan Facilities

- **Pre/Post-Dispatch Working Capital Facility**
- **Industrial Policy Niche Projects Fund**

The Industrial Financing Loan Facilities are loan products managed by the IDC, and fall outside the scope of this discussion.

*This assessment focuses on the three key Production Incentives being Capital Investment, Green Technology and Resource Efficiency Improvement, and Enterprise-Level Competitiveness Improvement.*

The application process for these Production Incentives involves an applicant forecasting an investment budget for a two year period, against which cash grants are approved by the dti on a cost sharing basis established according to stipulated financial criteria. Applications need to be submitted at least two months prior to commencement of commercial use of the assets or undertaking activities applied for. If approval is not obtained within two months of application, investments by the Applicant from this point onwards can be eligible for grant claim, provided that the dti has been informed of this intention.

Submission of claims by the successful applicants to the dti are typically in two parts. For capital investments the first claim is generally after the start of commercial production of the acquired capital equipment, and the second at the completion of the project as approved.

For business development services and other activities, grant disbursement is made upon completion of activities. Where the duration of activities exceeds 12 months, two claims can be submitted, the first at the end of 12 months and the second at the completion of the activities.

At inception, MCEP required that applicants were to achieve at least level four B-BBEE contributor status in terms of the B-BBEE codes of good practice, or must submit a plan to demonstrate how they would progress towards achieving level four B-BBEE contributor status within a period of two years.



This requirement was subsequently revised, where from 1 June 2015 only applicants that achieved at least a level four B-BBEE contributor status would be considered for MCEP and no plans would be accepted from that point onwards.

### Current Situation

Significant uptake of the programme is evidenced by dti approvals in excess of R5 billion reached more than two years earlier than the anticipated MCEP end date in 2018.

This is supported by the results of the Manufacturing Circle survey. Sixty nine responses were surveyed comprising both Manufacturing Circle members and general industry participants representing a total possible forecast investment value of R3,1bn. Of the 69 applications submitted, 41 approvals were obtained for a grant value of R723m. Of the R723m approved grant value, R280m (or 40%) of claims had been submitted to dti for payment at the time of the survey and R196m had been paid.

Forty three percent of the applicants had a level 4 B-BBEE scorecard and higher at the time of application.

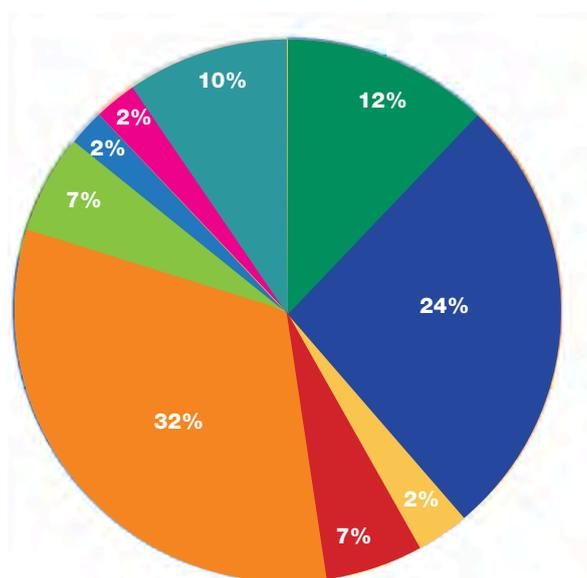
Applications predominantly represented the metals and machinery (32%) and food and beverage (24%) sectors.

All three key Production Incentive components featured, with notable combination of various component types:

Programme Type	No. Applications
Capital	17
Enterprise Comp	2
Capital + Enterprise comp.	15
Capital + Green	4
Capital + Green + Enterprise Comp	3
<b>TOTAL</b>	<b>41</b>

The majority of the applications emphasised the assistance of the MCEP in installation of new plant and machinery to enhance productivity and reduce operational costs, thus enhancing competitiveness and business growth; and retaining, if not increasing, employment. Total employment numbers at the time of application comprised 21 330, with an anticipated increase of 630 jobs at the completion of the projects applied for.

Statistics produced by the Incentive Consultants Association (ICA) support these findings. The ICA collects data for all applications assisted by ICA affiliated firms, representing approximately 72% of all MCEP approvals.



- Chemicals & Petroleum
- Food, beverages & Tobacco
- Furniture, recycling & other
- Glass for building industry
- Metals & Machinery
- Non-metallic minerals
- Radio, TV and Communications
- Transport Equipment
- Wood, paper & printing

Approval times from submission averaged 6 months from the programme's inception in June 2012 until late 2013, and then lengthened thereafter to an average of 14 months, with some approval times in excess of 18 months. Similarly, increasing lead times during the progress of the programme were experienced between claim submission and payment.

Statistics produced by the Incentive Consultants Association (ICA) support these findings. The ICA collects data for all applications assisted by ICA affiliated firms, representing approximately 72% of all MCEP approvals.

MCEP Stats ICA Sept 2015		
Applications		
	Number	Value
Submissions	1 212	R10 936 058 385
Adjudicated (approved / rejected)	833	R8 262 716 960
Outstanding	379	R2 673 341 425

Cumulative totals as at September 2015 indicate that 1 212 applications totaling R10,9bn in value were submitted. Of these, 833 (R8,26bn in value) were adjudicated (either approved or rejected) and 379 (R2,67bn in value) were outstanding.

Claims		
	Number	Value
Submissions	549	R1 969 139 520
Paid Out	416	R1 436 118 762
Outstanding	133	R533 020 758

From a claims point of view, as at end September 2015 ICA statistics indicate that 539 claims of R1,97 billion were submitted, and R1,44bn had been paid out:

## Challenges Encountered

in October 2015 the dti announced the temporary suspension of new applications with immediate effect due to the large number of applications across the manufacturing sectors which far exceeded funds set aside for the programme. Over R5 Billion was fully committed to approvals under the programme. At parliament earlier in the year, it was noted that only R1,5bn (30%) in payments had been made.

This information communicated by the dti, corroborated by results of the MC survey and ICA statistics reflects discrepancies between applications approved, claims submitted and claims paid.

MCSurvey Results		
	Number	Value R000
Applications Adjudicated (approved/ rejected)	69	807 163
Applications Approved	41	720 355
Claims Submitted*	43	290 359
Claims Paid Out*	29	195 660
Applications Approved/ Applications Processed		89%
Claims Submitted/ Applications Approved		40%
Claims Paid Out / Claims Submitted		67%
Claims Paid Out / Applications Approved		27%

\*Note: Typically 2 claims per Application

## Discrepancy between Applications Approved and Claims Submitted

A significant difference exists in applications approved and claims submitted. The value of claims submitted only represent 40% of applications approved.

A contributing factor noted by respondents is the change in submission requirements relating to B-BBEE codes during the course of the programme, which were applied retrospectively to applications submitted but not yet approved, creating confusion between applicants and the dti in terms of the interpretation of the requirements and administration thereof.

In addition, although not noted by respondents, contributing factors could also be deemed to include approved capital investment projects with long implementation lead times; successful applicants delaying investment commitments post approval for economic or other reasons or companies simply submitting applications beyond what they intend to actually invest.

## Discrepancy between Claims Submitted and Claims Paid

The information gathered through the Manufacturing Circle survey and that provided by the ICA indicates that 67% and 73% respectively of claims submitted were paid out. Although reasons were not provided by respondents, contributing factors could include processing times between claim submission and payment; and payment values being lower than claims submitted due to varying interpretations of what was claimable during processing.



## Proposed Way Forward

The introduction of MCEP was a positive intervention that has encouraged investment, as evidenced by the number of applications and claims submitted.

Under the current programme, there however exist discrepancies between the value of applications approved and claims submitted, and between the value of claims submitted and payments made. This indicates delays that have developed in the programme's implementation.

It is important to understand the factors contributing to these delays. Due to the benefits of MCEP enjoyed by Manufacturing Circle members, the industry as a whole and the economy in general, the Manufacturing Circle is ready to engage with the dti in further assessment.

Furthermore, it is acknowledged that MCEP was initiated to assist the manufacturing industry in turbulent economic times. Given that economic conditions have not materially improved, the Manufacturing Circle strongly motivates that the reinstatement of the programme in April 2016 be considered in support of the dti in its efforts to increase manufacturing in South Africa.

Particularly in the context of tightening budget constraints, the Manufacturing Circle looks forward to engaging discussion to also include a review of MCEP's design and implementation to achieve effective spending, or in colloquial terms, a better bang for our buck.



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The Manufacturing Bulletin is an initiative of the Manufacturing Circle. It aims to serve as a voice for manufacturing in South Africa with insightful analysis of trends as well as informed comment on what needs to be done to ensure that South Africa's manufacturing base is nurtured and grown.

The Manufacturing Circle is made up of a number of South Africa's leading manufacturing companies from a wide range of industries. Some of the members are South African exporters of manufactured goods, others are locally focused companies competing with imports from around the world. There is one common denominator among them and that is a passion for manufacturing coupled with a fervent belief that for South Africa to be strong, its manufacturing must be strong.

A strong and developing manufacturing sector will drive the creation of skilled and semi-skilled jobs in the South African economy – jobs not just in the large manufacturing companies but critically also in entrepreneurial small companies. New jobs go hand in hand with an increase in fixed investment in plant and buildings – a further multiplier of economic growth. Job creation is a primary objective of the Manufacturing Circle.

Manufacturing holds the key to a growing and employing South African economy and the Manufacturing Circle is playing a key role in finding that future.

#### Research and Analysis



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#### Funding and Support



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