

# South African R-CTFL Value Chain Masterplan to 2030

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## Report 4 of 4: Policy, Regulation and Programme Recommendations

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## LIST OF ACRONYMS

AGOA	African Growth and Opportunity Act
BBBEE	Broad Based Black Economic Empowerment
CAGR	Compound Annual Growth Rate
CIP	Competitiveness Improvement Programme
CIT	Corporate Income Tax
CTCIP	Clothing and Textiles Competitiveness Improvement Programme
CTFL	Clothing, Textiles, Footwear and Leather
DSP	Dispute Settlement Panel
The dti	The Department of Trade and Industry
EMIA	Export Marketing and Investment Assistance
EOC	Executive oversight Committee
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GVA	Gross Value Added
HS	Harmonised System
IDC	Industrial Development Corporation
IPAP	Industrial Policy Action Plan
IRG	Internal Reference Group
ITAC	International Trade Administration Commission
MFN	Most Favoured Nation
MST	Minimum Specific Tariff
NULAW	National Union of Leather and Allied Workers
PI	Production Incentive
PRP	Policy, Regulatory and Programmatic
PTA	Preferential Trade Agreement
QLFS	Quarterly Labour Force Survey
R-CTFL	Retail – Clothing, Textiles, Footwear and Leather
ROCE	Return on Capital Employed
SA	South Africa
SACTWU	South African Clothing and Textile Workers Union
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAPS	South African Police Service
SARS	South African Revenue Service
SEZ	Special Economic Zone
WCM	World Class Manufacturing
WTO	World Trade Organisation

## FOREWORD

This report has been proudly compiled for the South African government's Department of Trade and Industry (the dti) by the South African Retail Clothing Textile Footwear and Leather (R-CTFL) Masterplan team, comprising Prof Justin Barnes (project leader), Robert Stewart, Mbongeni Ndlovu, Vuyiswa Mkhabela and Lisa Higginson. Courtney Barnes, Elaine Reddy and Christopher Grant also provided support at various points of the project's completion.

The policy, regulation and programme recommendations presented in this report have been widely workshopped and exhaustively debated with South Africa's major R-CTFL industry stakeholders. Critically, and notwithstanding the intensive industry engagement process, the team has endeavoured to produce a set of recommendations that are independent of any individual stakeholder interests. The recommendations made are focused on ensuring the optimal growth and development of the South African R-CTFL value chain through to 2030, thereby supporting the industrialisation of the domestic economy in alignment with the dti's Industrial Policy Action Plan (IPAP). The project team sincerely hopes that the recommendations contained in this report support the realisation of the South African R-CTFL Masterplan, as articulated in the Phase 3 report. The achievement of the R-CTFL Masterplan vision and associated objectives will play a critical role in the development of South Africa's industrial capabilities and support the realisation of a decent work agenda for South Africans.

The success of the South African R-CTFL masterplan consequently depends less on its content being 100% correct, and more on whether key value chain stakeholders across the private and public spectrum believe in the vision and objectives that have been set and are prepared to set aside legacy-based divisions and work together to achieve the outcomes that have been mutually agreed upon. As highlighted in the masterplan report, the prize is of immense value to value chain stakeholders and South Africa more broadly. The R-CTFL value chain has the potential to support the industrialisation of the domestic economy and increase the wealth and prosperity of all associated stakeholders.

In recognition of the importance of the project, the project team has taken great care in formulating the recommendations presented in this report. While any omissions or errors are those of the masterplan team alone, the input of the Industry Reference Group in guiding, challenging, and supporting the project team's work is gratefully acknowledged. Finally, the project would not have been successfully completed without the professional support of the dti's CTFL sector desk led by Mr Abisha Tembo (supported by Mrs Elaine Smith and Mr Jaywant Irkede), and the critical project leadership role played by the dti's Deputy Director General, Mr Garth Strachan and acting Deputy Director General, Ms Thandi Phele.

## EXECUTIVE SUMMARY

This report details 11 recommendations to be implemented in support of the realisation of the South African Retail-Clothing, Textiles, Footwear and Leather (R-CTFL) value chain masterplan through to 2030. The value chain has major development potential over the period. A growth model tested with industry stakeholders reveals the opportunity for the value chain to add 110,000 jobs to the South African economy (from 210,000 to 320,000 jobs). This is dependent on local CTFL retail sales increasing by R76 billion to 2030, and local manufacturing purchases by R35 billion. This will require structural change within the value chain, with five strategic pillars identified: domestic market growth, increasing purchases from local suppliers, enhancing value chain competitiveness, driving industry transformation, and bolstering value chain skills and technology levels. The 11 recommendations, their impact and rationale, are summarised below. Importantly, the recommendations are highly interdependent. To realise the masterplan's 2030 vision and its associated aspirational objectives, it is essential that all 11 are implemented in a coherent manner, hence the importance of the final recommendation, which is the establishment of an Executive Oversight Committee to oversee the implementation of the balance of recommendations.

Recommendations	Masterplan impact	Masterplan rationale
1. Establish government task team on illegal trading	Significantly reduce illegal CTFL trading	Reduce value chain demand leakage; ensure demand grows at 3% per annum
2. Introduce new SA trading license regime	SA-based retailing to operate on level playing field	All SA-based retailers to have local sourcing offices
3. Introduce restricted points of clearance for CTFL products entering SA	Significantly reduce illegal CTFL importing	Customs to re-establish import controls; reduce value chain criminal activity; secure market-related pricing in SA
4. Explore Introduction of MST reference pricing on CTFL products	Eliminate manipulation of SA's ad valorem based CTFL tariffs	Reduce criminal activity and value chain demand leakage; secure market-related pricing in SA market
5. Establish government task team to eliminate illegal CTFL manufacturing	Level production operating environment within domestic CTFL value chain	Ensure demand growth stimulates legally compliant manufacturers
6. Maintain CTFL value chain tariffs and rebates	Maintain value chain protection while MST and restricted ports of clearance changes have an impact	Illegal competition covered by MST and restricted ports of clearance recommendations
7. PI and CIP to be extended for 5 more years	Maintenance of existing support to value chain	Maintenance of support for value chain until structural failures corrected
8. Introduce investment-based CIT incentive @ 15-30%	Attract investment in key value chain segments; and increase production	Build value chain by securing ROCE for Brownfield and Greenfield investments
9. Align CTFL operating cycle with SA retail market	Improved costs, ROCE and flexibility within value chain	Enhanced SA CTFL value chain competitiveness
10. Establish CTFL specific skills and technology programme	Raise technical, management skills within value chain	Skills development and technology transfer in support of value chain development
11. Establish Masterplan EOC	Ensure successful masterplan implementation	Hold stakeholders accountable for masterplan implementation

# 1. INTRODUCTION

## 1.1. REPORT OVERVIEW AND STRUCTURE

This final phase of the South Africa R-CTFL value chain masterplan project focuses on developing **Policy, Regulation, and Programme (PRP) recommendations** in support of the agreed upon masterplan. It incorporates a review of South African CTFL policies, regulations and major programmatic interventions; and provides a set of recommended changes to align these PRP foundations with the agreed upon masterplan vision, objectives and strategic pillars.

To re-cap, the South African R-CTFL masterplan vision for 2030 is: *A sustainable and dynamic R-CTFL value chain that provides its customers with compelling products and that is invested in growing local capabilities and employment.*

This vision then gives rise to the realisation of eight objectives, which are to:

1. Substantially grow local purchases and by implication local value addition
2. Enhance the value chain's cost, process and product competitiveness
3. Embrace new technologies, especially those that support shorter lead times within the value chain
4. Improve financial returns throughout the value chain to ensure greater levels of investment and by implication expanded economic activity
5. Advance management, technical and operator skills capable of using advanced technologies
6. Transform the value chain through the development of Black and female senior management, and by attracting Black industrialist investment
7. Ensure the South African R-CTFL value chain is recognized as ethical and environmentally responsible
8. Establish a fair and equitable operating environment within the domestic value chain, with this encompassing the elimination of import fraud, and illegal local production activities

These objectives are then further crystallised into a set of five strategic pillars – the successful implementation of which are deemed central to the attaining the objectives, and by implication the realisation of the 2030 vision. The five pillars are domestic market growth, domestic market localisation, competitiveness capability development, value chain transformation, and technology and associated skills development.

Critically, it is recognised that the five strategic pillars need to be enabled through a supportive institutional environment, and appropriately aligned policies, regulations and programmatic (PRP) interventions. This report details the recommendations from the masterplan project team in respect of these PRPs. The recommendations are based on an intensive stakeholder engagement process across the R-CTFL Value Chain over the second half of 2018 and early 2019, as well as additional primary and secondary research covering both South Africa's present PRPs and those of selected competitor economies. Notwithstanding stakeholder engagements, the recommendations are entirely those of the masterplan project team, and do not represent the views of any individual value chain stakeholders.

The report consists of four sections:

1. An overview of South African R-CTFL Masterplan project phases and objectives
2. A summary of the South African R-CTFL value chain research findings
3. An overview of South Africa’s R-CTFL Value Chain Masterplan
4. The masterplan project team’s policy, regulation, and programme recommendations

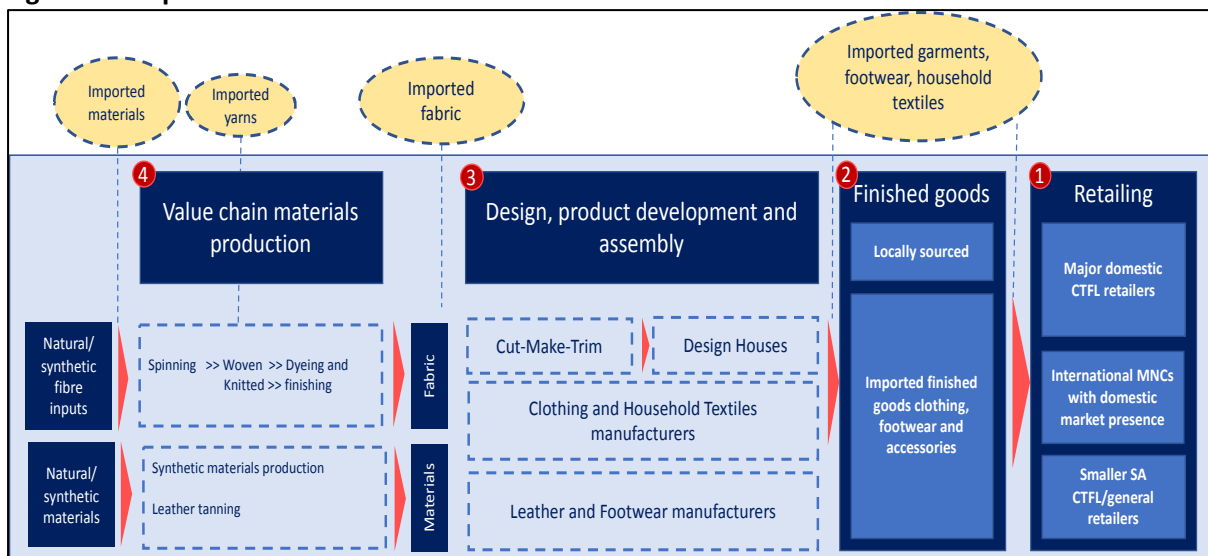
This final report provides only a summary of key insights from previous phases of the research. For more detailed analysis please refer to the individual reports that were compiled at the conclusion of each of the project’s major phases of work:

- Phase 1: SA R-CTFL Status quo analysis (October 2017 – February 2018)
- Phase 2: International trends and case studies (October 2017- February 2018)
- Phase 3: Development of the R-CTFL Value Chain Masterplan (March 2018- June 2018)

## 1.2. R-CTFL MASTERPLAN PROJECT OVERVIEW

A summarised picture of the South African R-CTFL value chain is presented in Figure 1. As highlighted, the focus of the masterplan is restricted to the CTFL value chain feeding into South Africa’s major CTFL retailers, as opposed to the broader CTFL market, which includes government procurement, technical niche markets, and corporate wear markets.

**Figure 1: Simplified Retail-CTFL Value Chain**



The domestic clothing, textiles, footwear, and leather (CTFL) value chain feeding into South African retailers has been through a tumultuous period. Imports have displaced large portions of the local supply chain, while South African retail performance has come under intensive pressure as tightening market conditions, international competitors, illegal trading, and credit supply restrictions have reduced their sale of CTFL products in the domestic market. A direct consequence of these developments on local CTFL manufacturers has been more onerous cost, quality, and delivery pressure, contracting order books, and the displacement of local production with cheap imports on seasonal purchases – as retailers look to shore up their own financial positions through the securing of cheaper sources of supply.



Countering these negative trends for local supply, the South African government's Department of Trade and Industry has provided substantial funding support for the manufacturing portion of the CTFL value chain over the last few years. The most important portion of this support has been through the IDC-administered Clothing and Textiles Competitiveness Improvement Programme (CTCIP) and associated Production Incentive and Competitiveness Improvement Programme. Because of this support, many CTFL manufacturers have advanced their competitiveness. At the same time, many domestic retailers have started purchasing from local suppliers on rapid replenishment, Quick Response, and Fast Fashion models that provide them with a competitive advantage in the form of in-season trading capabilities. These models require proximate supply, with local CTFL manufacturers providing South African retailers with substantial competitive advantage where in-season trading capability has been established. This emerging trend is likely to have profound consequences for the future development of the entire value chain.

The establishment of rapid replenishment, Quick Response, and Fast Fashion capabilities consequently represents a common strategic priority for South African retailers and their domestic vendors, particularly if the retailers are to compete more effectively with the entry of global competitors into the domestic market<sup>1</sup>. There is consequently clear, common ground between South African retailers and their key domestic suppliers in respect of the importance of developing productive capabilities that will enable the retailers' supply chains to provide them with world class merchandise on short lead times. Doing so should enhance the strategic and underlying competitiveness position of South African retailers and CTFL manufacturers, with commensurate benefits for employees throughout the supply chain, and within the broader, national economy. Given the international growth aspirations of South African retail, the opportunity may moreover be substantially greater than only capturing local market share for South African CTFL retailers and manufacturers.

Critical questions relate to the extent of the opportunity that exists within retail CTFL supply chains – for domestic, African, and even broader international supply<sup>2</sup>; but localisation, supported by improving firm-level competitiveness, should be a priority throughout the supply chain. Ideally, South African retailers should source their merchandise requirements on a balanced basis, with a portion of purchases locally supplied, and the balance imported either regionally or internationally. This would increase employment and the supply chain's contribution to Gross Value Added (GVA) within the South African economy. Achieving this desired outcome requires value chain engagement, strategic alignment, and programmatic interventions across multiple economic facets, encompassing both macro and micro level factors.

The emphasis on the retail portion of the South African CTFL value chain is critical for three additional reasons:

- (1) Its dynamics are strongly driven by the major retailers selling into the South African market;
- (2) These dynamics are distinctive from those that dominate CTFL manufacturing into designated government, corporate and technical markets; and
- (3) Supply to retailers represents most of the value addition within the South African CTFL value chain.

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<sup>1</sup> For example, Cotton On, H&M, and Zara.

<sup>2</sup> Evidenced through the international expansion of leading South African retailers, including MRP, Pepcor, TFG, Truworths, and Woolworths.

## 2. THE PRESENT POSITION OF THE SA R-CTFL VALUE CHAIN

### 2.1. STATUS QUO ANALYSIS

The South African retail, clothing, textiles, footwear and leather (R-CTFL) value chain is of great importance to the South African economy. The value chain generates an estimated R74 billion<sup>4</sup> in Gross Value Added, or 1.7% of domestic Gross Domestic Product (GDP), while approximately 210,000 jobs (1.33% of total South African employment) are also presently sustained within the value chain. An estimated 120,000 of these jobs are in the retail portion of the value chain, with 90,000 across the various South African CTFL manufacturers supplying into the domestic retail market. The R-CTFL value chain's employment potential is moreover substantially greater than indicated in these figures, with an estimated 165,000 foreign manufacturing jobs sustained by South African CTFL retailing activities<sup>3</sup>.

South African CTFL retailers are estimated to have purchased CTFL products worth R70 billion in 2016, with R43 billion of this total representing clothing products, R12.7 billion textiles products (including home textiles), R11.6 billion footwear, and R2.6 billion leather products. For each of the three largest product categories import purchases are substantially greater than local purchases, with the import estimates for clothing, textiles, footwear and leather products calculated at 53.9%, 56.0%, 61.1% and 48.9% of total CTFL retailer purchases respectively. The manufacturing portion of the R-CTFL value chain has performed poorly over the last few years, despite pockets of stronger performance, and a moderation of the value chain's long-term decline. Value chain production aggregates and capabilities appear to have atrophied over the last decade, while employment has continued to decline, albeit at a slower pace than recorded over the decade to 2010.

Government support in the form of the Production Incentive (PI) and the Competitiveness Improvement Programme (CIP) appear to have had some impact in improving capabilities and performance in certain areas, but the general performance trend of the manufacturing portion of the R-CTFL value chain remains non-dynamic, with limited impact on Gross Value Added (GVA) and employment growth. Despite many individual firm successes, continued firm closures within the value chain over the last five years are testament to its ongoing challenges.

Employment within the manufacturing portion of the value chain is difficult to estimate due to different data sources showing vastly dissimilar levels. The dti's employment estimates appear to be the most realistic and correlate broadly with firm-level data collected through two well established regional CTFL clusters (in the Western Cape and KwaZulu-Natal). Per the dti's estimates, the manufacturing portion of the South African R-CTFL value chain is calculated to provide 90,071 jobs, with 68,757 in clothing, 12,098 in textiles, 8,084 in footwear and 1,132 in leather products and accessories.

Extensive interviews within the SA R-CTFL value chain in late 2017 and early 2018 suggested a range of issues impacting on the value chain's performance. While numerous value chain strengths were identified (e.g. quick response retailing, the availability of labour, and institutional support for the

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<sup>3</sup> Unless directly referenced, all data presented in this masterplan report is derived from the Phase 1 and Phase 2 research reports of the South African R-CTFL value chain masterplan project.

value chain), substantially more weaknesses were identified, including weak human capital and associated skills, outdated production processes and equipment, and deficient supply chain capabilities. This resulted in the identification of more threats to the future of the value chain than opportunities. Major threats highlighted were the introduction of inappropriate government policies, the continued growth of imports, international retailers growing their footprint in South Africa while not purchasing anything locally, and increasing corruption within government administered services, such as import control. More positively, several opportunities were identified, ranging from quick response capability development, regional and international export growth (via South African retailers), and investment in new technologies, leading to local value chain capability development.

## **2.2. COMPARATOR ECONOMY LESSONS**

Competitor research reveals that South Africa’s comparative R-CTFL value chain performance has been poor and that there is much to learn from the economies reviewed as part of Phase 2 of the Masterplan project. Many developing economies have performed considerably better over the last decade in respect of their CTFL exports, domestic market performance, value chain deepening, competitiveness upgrading, and employment growth. The findings reveal the extent of the comparative underperformance of the manufacturing portion of the South African CTFL value chain over the last decade, as well as the associated socio-economic consequences of this underperformance. Importantly, the various case studies contradict the view that labour costs are the primary reason for the decline of the South African CTFL value chain, and that the primary opportunity to develop the value chain lies in progressively lowering wages. Turkey is a particularly striking example in this regard. It employs seven times more people than South Africa within the manufacturing portion of its CTFL value chain, and yet has a substantially higher minimum wage. Brazil similarly has a higher minimum wage, and yet employs ten times more people in its CTFL sector than South Africa (although its domestic market is also seven times larger). Poland and Romania also have higher minimum wages and continue to perform strongly in the CTFL value chain, while Morocco and Colombia have similar minimum wages to South Africa.

Table 1 below depicts the comparative size of the CTFL sectors in a selection of competitor economies. As highlighted, when adjusted for their different population sizes, every economy analysed employs substantially more people in their CTFL sectors than South Africa. The final column of Table 1 is particularly instructive. It reveals that the comparator economies employ between 12% (Morocco) to nearly five times more people in their CTFL manufacturing sectors than South Africa (Turkey and Colombia). While one can argue over the individual reasons why the economies reviewed are performing better than South Africa in respect of their CTFL production, the substantial underperformance of the domestic CTFL value chain is laid bare by the findings presented. Based on the comparative employment levels of the ten economies reviewed, adjusted for population differences, the domestic CTFL industry should be employing 172% more South Africans.

**Table 1: Comparative profile of case study economies**

Country	Monthly CTFL wages (US\$)	CTFL employment	Population	CTFL employment per SA population	Index, SA=100
Brazil	287,9	2 076 000	207 652 865	<b>558 946</b>	243
Colombia	250,0	946 000	48 653 419	<b>1 087 072</b>	473
Indonesia	152,1	3 435 000	261 115 456	<b>735 487</b>	320
Malaysia	222,1	215 000	31 187 265	<b>385 427</b>	168
Mexico	157,2	1 127 000	127 540 423	<b>494 034</b>	215
Morocco	265,0	163 000	35 276 786	<b>258 333</b>	112
Poland	389,7	191 000	37 948 016	<b>281 401</b>	122
Romania	344,0	260 000	19 705 301	<b>737 685</b>	321
Thailand	237,0	848 000	68 863 514	<b>688 474</b>	299
Turkey	517,0	1 467 000	79 512 426	<b>1 031 516</b>	448
South Africa	<b>266,9</b>	<b>230 000</b>	<b>55 908 865</b>	<b>230 000*</b>	<b>100</b>

\* According to South Africa's labour force survey. We estimate only 145,000 formal jobs within the R-CTFL value chain, which is aligned with the dti's estimations

CTFL value chain success amongst the economies reviewed appears to be strongly correlated with the market access advantages they have secured, whether in the form of export market access (e.g. Turkey, Morocco, Mexico, Poland, Romania) or domestic market protection (e.g. Brazil, Colombia, Thailand); the breadth and depth of their value chain capabilities (across all the economies reviewed), and the success of government CTFL policies and incentives (again, across all the economies reviewed).

The South African CTFL value chain's duty structure appears to provide each of the value chain linkages with substantial trade protection relative to the comparator economies analysed. As highlighted in Table 2, South Africa's clothing tariff of 45% is higher than every economy reviewed, with the average for the ten economies less than half the South African MFN rate (at 21.6%). Similar findings emerge for footwear (30% versus 18.1%), leather products (30% versus 15.1%), fabric (22% versus 13.6%) and yarns (15% versus 5.9%). In fact, only Brazil has higher tariffs than South Africa (for footwear, fabric and yarn).

**Table 2: Comparative CTFL tariffs by value chain link**

Economy	Clothing	Footwear	Leather products	Fabric	Yarns
South Africa	45	30	30	22	15
Brazil	35	35	21	26	16
Colombia	40*	10	15	10	-
Indonesia	24	25	17	10	5
Malaysia	1	-	-	10	5
Mexico	21	18	17	10	6
Morocco	23	22	23	10	3
Poland	11	8	5	8	4
Romania	11	8	5	8	4
Thailand	29	29	28	-	6
Turkey	11	8	5	8	4
Average (excl. SA)	<b>21.6</b>	<b>18.1</b>	<b>15.1</b>	<b>13.6</b>	<b>5.9</b>

Source: WTO tariff download facility

\*Colombia applies a variable tariff depending on whether declared values meet weight-based thresholds

A major issue for the South African CTFL value chain is that its import duties are easy to avoid. Brazil has a comparable CTFL tariff structure to South Africa; and while this has resulted in a similarly stunted export focus, the level of CTFL imports entering the Brazilian economy represent only a fraction of those entering South Africa. With a market seven times the size of South Africa's, Brazil recorded only US\$2.3 billion in CTFL imports in 2016, relative to South Africa's figure of US\$2.6 billion. Similarly, Colombia, with a market size almost identical to South Africa's and with similar levels of market protection (at least at face value), only imported US\$1.3 billion, exactly half South African levels (that research suggests is undervalued by a full 37.5%). The only conclusion that can be drawn is that South African policy measures and interventions aimed at protecting the domestic market are ineffective relative to the comparator economies concerned – resulting in substantial GVA and employment losses for the domestic economy.

Policy lessons from comparators are valuable. Mexico has implemented an importer registry and the establishment of reference prices for specific HS code groupings (largely anti-counterfeiting measures), while Indonesia limits the flow of imports through a small number of ports for the purposes of better supervision and customs control, and Colombia sets a base duty on the weight of CTFL products. Colombia's initial weight based minimum price was challenged at the World Trade Organisation (after a complaint from Panama) and later amended to function as a threshold, combined with a strict import licensing regime imposing various restrictions and additional requirements for importers who wish to bring in products below the thresholds.<sup>4</sup>

In comparison to the economies analysed, South Africa's regional trade agreements appear to provide comparatively limited market opportunities for either domestic retailers or manufacturers. This is a direct result of low per capita incomes in proximate markets, and the extent to which these markets are supplied with pre-owned imports. While South Africa has preferential trade access into the EU and has AGOA access (although on a restricted basis), it is compromised by its lack of proximity to the high value EU market and its comparatively limited capabilities relative to full-package suppliers located in Turkey, and other Central European and North African locations. Importantly, Turkey, Morocco and Colombia (into the United States) have attempted to amplify their proximity and trade access advantages by streamlining customs processes, and subsidising buyers operating in their countries. This has not occurred in South Africa.

While many of the comparator economies reviewed benefit from regional trade agreements, evidence suggests the opposite for South Africa. Latent export potential to SADC may exist, but the impact of the SADC agreement to date has been the supply of SADC products into South Africa from selected economies, some of which (e.g. Mauritius) import Asian labour to supply the South African market. Nevertheless, regional trade agreements present clear future market opportunities, as well as the opportunity for product specialisation, value chain deepening, and the creation of value chain points of difference through quick response supply.

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<sup>4</sup> More detailed explanations of the Colombian MST model and Indonesian restricted ports model are included as case studies in the Appendix.

Of all the economies reviewed, the Turkish CTFL industry appears to have most successfully transitioned to supplying export (and domestic) customers with increasingly higher value-added products and services (based largely on in-season trading capabilities) over the past two decades, with Colombia and Morocco driving similar initiatives more recently. The suite of support provided by these case study economies are extensive, ranging from tax exemptions for extended periods, to grant and Corporate Income Tax (CIT) based investment incentives, to design and product development support, to the provision of discounted bulk infrastructure, and various forms of product, process and functional upgrading support. While South Africa has the PI and CIP, these are small scale interventions relative to the more aggressive support mechanisms evident across the manufacturing segments of competitor CTFL value chains. A key additional component to this challenge is skills development, which features as a consistent support element across the comparator economies analysed. Relative to the broader set of comparator economies reviewed, the structure and mechanisms for support in South Africa are often vastly different from the tax-based incentive structures employed. For potential FDI, this may render South Africa less attractive for CTFL investment than international alternatives. There is also an obvious lack of support for export-focused growth in South Africa unless a CTFL manufacturer is in a Special Economic Zone.

In contrast to South Africa, the comparator economies do not appear focused on building entire CTFL value chains to compete internationally. While some of the most successful comparator economies, such as Turkey and Thailand, have deep value chain capabilities and complementary clothing-textiles, and footwear-leather/synthetic material supply chains, the balance of the economies appear to have concentrations of capability in only one segment of the value chain. For example, Mexico, Poland, Romania, Colombia, Morocco and Indonesia appear to be apparel focused, with large textiles imports. Brazil's highly insulated value chain has deep capabilities across all production segments, while Malaysia appears to favour textiles over clothing. This observation holds important lessons for South Africa: While vertical capabilities can certainly augment value chain competitiveness, they are not a pre-requisite for international or domestic market competitiveness in respect of downstream CTFL manufacturing.

These findings are not intended as direct benchmarks for the development of the South African R-CTFL value chain masterplan. The country has a legacy based CTFL industry with unique strengths, weaknesses, opportunities and threats. The development of the masterplan needs to relate directly to these dynamics, as opposed to attempting to mirror policies and regulatory interventions in other economies. Conversely, a myopic focus on domestic dynamics is potentially very limiting to the identification of value chain development opportunities, hence the importance of the case studies presented. Government industrial policy, in the form of tariffs, preferential market access, appropriately aligned incentives, labour market interventions, firm upgrading and skills provision support, and institutional and infrastructural backing (often in public-private partnerships), all appear to have played critical roles in framing the development of CTFL value chains in successful comparator economies. It is critical that these are understood, and their respective potential lessons for South Africa noted.

## 3. THE SOUTH AFRICAN R-CTFL VALUE CHAIN MASTERPLAN

### 3.1. INDUSTRY VISION AND OBJECTIVES TO 2030

Based on its recent performance, there is justly general pessimism amongst stakeholders as to the immediate future of the value chain. However, regional masterplan workshops completed across South Africa in April 2018 revealed many positive stakeholder insights into the future development potential of the South African R-CTFL value chain to 2030. As importantly, value chain stakeholders expressed a determination to ensure the value chain contributes to the socio-economic development of South Africa and expressed clear commitment to supporting the successful implementation of the South African national government’s Industrial Policy Action Plan (IPAP) – hence the aspirational vision and associated objectives that were crafted from the industry engagement process.

Critically, the value chain objectives respond directly to the deficiencies and opportunities identified within the South African R-CTFL value chain over the course of the masterplan research process, as well as the lessons from the international comparator economies reviewed. However, progressing from positive intent to an actual development plan for the value chain requires a clear perspective on the development potential of the R-CTFL value chain to 2030. This is articulated below.

### 3.2. KEY R-CTFL VALUE CHAIN DEVELOPMENT OBJECTIVES TO 2030

The consumption of CTFL products in the South African market is ultimately determined by the disposable income of domestic consumers, while the consumption of CTFL products from South African retailers is determined by the extent to which the retailers attract consumer purchases over alternative market channels. If South African CTFL retailers are to drive the development of the local value chain (as per this masterplan) they will need to secure reasonable growth rates going forward. They will simultaneously need to purchase an increasing portion of their CTFL requirements from local sources, as opposed to imports, with this only occurring if the manufacturing portion of the South African CTFL value chain substantially advances its competitiveness, and government agencies enhance the policy and regulatory environment within which the value chain operates. Based on these assumptions, the estimated potential impact of a successful R-CTFL masterplan on the SA R-CTFL value chain through to 2030, is presented in Table 3.

**Table 3: Summary of Key SA R-CTFL value chain masterplan objectives**

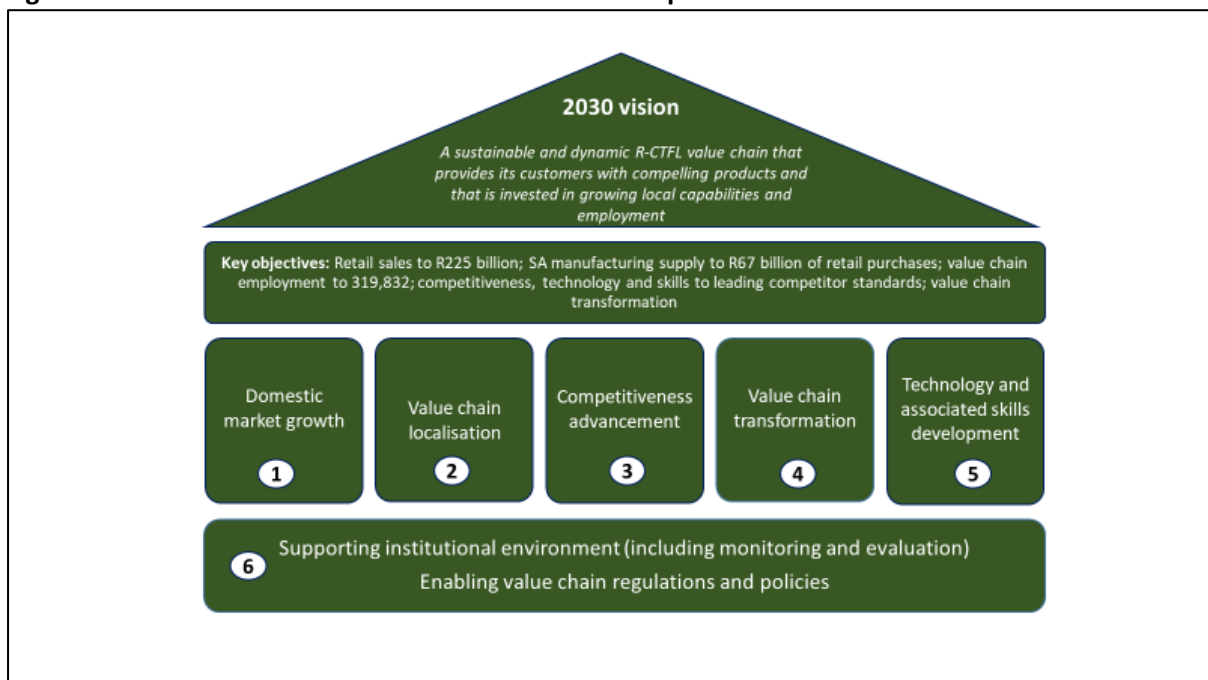
KPI	Base	2030 objective	Change	Change %
SA CTFL retailer sales (R million)	R 148,837	R 225,129	R 76,292	51.3
Retailer purchases from SA CTFL manufacturers (R million)	R 31,264	R 66,158	R 34,894	111.6
SA as portion of SA retailer purchases	44.7%	62.5%	17.8%	39.9
R-CTFL value chain employment	210,071	319,832	109,761	52.2
R-CTFL manufacturing employment	90,071	155,974	65,903	73.2
CTFL manufacturing GVA per employee	R 159,217	R194,561	R35,345	22.2

As highlighted in Table 3, the South African R-CTFL masterplan model is based on South African retailers growing at an average annual rate of 3% and local CTFL manufacturers at a rate of 5.5%. This would lead to the manufacturers gradually increasing their share of South African retailer supply to 62.5% in 2030 (from 44.7% in 2016). To achieve this outcome the manufacturing portion of the value chain is modelled to substantially advance its productivity – at an annual rate of 1.5% of sales. Based on these calculations, employment within the R-CTFL value chain would increase by almost 110,000 (to 320,000), with 66,000 of these jobs being generated in the manufacturing portion of the value chain, and the balance of 44,000 in retail. In constant 2016 Rand terms, these rates of change would result in total retail sales increasing to R225 billion over the period (from R149 billion). This would result in retailer purchases increasing to R106 billion in 2030 (from R70 billion in 2016), with domestic purchases amounting to R66 billion of this total (an increase of almost R35 billion on 2016 levels), resulting in annual CTFL importing levels remaining stable at around the R40 billion mark.

### 3.3. SA R-CTFL MASTERPLAN FRAMEWORK

Realising the masterplan’s aspirational vision and associated objectives requires institutional coordination, as well as a range of policy, regulatory and programmatic (PRP) interventions. Based on the extensive local and international research completed for the SA R-CTFL masterplan, five pillars have been identified as key focus areas to be actioned through to 2030. As outlined in Figure 2, these five pillars are envisioned to actively support the realisation of the 2030 value chain vision, with two critical inter-related qualifiers – that a foundational institutional structure is established to guide the implementation of the masterplan, and that a supportive PRP environment is established to underpin the development of the value chain.

**Figure 2: The South African R-CTFL Value Chain Masterplan**



Each of the five pillars, as well as the supporting foundation of the SA R-CTFL masterplan, are briefly explained below.



### **3.3.1. Domestic market growth**

Achieving the South African R-CTFL masterplan's growth objectives is ultimately dependent on three key variables: (1) The growth of the South African CTFL retail market; (2) the proportion of the South African retail market comprising retailers that source their CTFL merchandise in South Africa; and (3) the proportion of CTFL merchandise purchased locally by these retailers. Each of these variables will need to be substantially bolstered to give effect to the masterplan vision and its objectives. For example, will South African retailers grow their sales at a CAGR of 3% if the domestic market performs poorly, or if their ability to trade is restricted? Will retailers who purchase local CTFL merchandise grow their proportion of retail activity if the foreign retailers they compete against can enter the market with full importing models? And, finally will South African retailers increase their proportion of locally manufactured CTFL purchases, if the domestic value chain is not competitive and where under-invoiced and/or illegal imports can easily enter the domestic market? Resolving these questions is fundamental to the South African R-CTFL masterplan's potential success.

Lessons from international competitor economies suggest that demand-side stimulation is critical to CTFL value chain success. Growing demand at each link of the value chain drives upstream value adding activities. With respect to local market optimisation, key lessons include better protection of the domestic market to ensure only legitimately priced products are traded (both locally and internationally) within the value chain. Interventions include the tightening of import controls (ranging from the use of regulation-based non-trade barriers, to the restriction of CTFL imports to selected ports of entry, and the use of minimum specific tariffs) and the incentivising of retailers to purchase locally manufactured CTFL products (e.g. import substitution incentives). Neither of these intervention-types are presently being successfully applied in South Africa. As highlighted earlier, despite South Africa's high comparative ad valorem-based import tariffs, imports are exceptionally high relative to economies with similar wage costs, revealing an excessively strong import bias in the sourcing profile of retailers. Re-balancing this dynamic represents a fundamental masterplan opportunity; with the South African retail market sufficiently large to substantially grow domestic value chain activities.

### **3.3.2. Value chain localisation**

Growing the manufacturing portion of the R-CTFL value chain at a CAGR of 5.5% will require more than simply optimising domestic market opportunities at each link of the value chain. An additional key element will be the active identification and development of new domestic productive capabilities within selected portions of the value chain. As the lead firms within the R-CTFL value chain, it will be incumbent upon South African retailers and their leading value chain partners to identify these opportunities and to potentially coordinate demand frameworks that enable localisation.

The coordination required to deepen localisation will likely fall foul of South Africa's Competition Act, and a special dispensation will therefore need to be sought to facilitate required activities. As per the experiences of successful competitor economies, the realisation of localisation opportunities will also need (a) investment support (in the form of cash grants, corporate income tax benefits, discounted loans, and/or extended loan tenures) and (b) the rebating of upstream tariffs within domestic CTFL value chains – wherever local production capacity is unavailable in commercial volumes and/or values.

Finally, manufacturing stakeholders with institutional memories derived from 20 years of value chain decline are likely to struggle embracing new opportunities. Securing foreign direct investment (FDI) within selected portions of the CTFL value chain may therefore be a critical masterplan requirement. The 10 competitor economies reviewed highlighted substantially more successful CTFL value chains and thus targeting the firms that operate in these economies for FDI in South Africa may support the more rapid advancement of domestic CTFL capabilities.

### **3.3.3. Competitiveness advancement**

The competitiveness advancement of the R-CTFL value chain should be a shared, mutually beneficial objective for all stakeholders. More competitive South African retailers will grow their domestic (and international) sales, while more competitive local manufacturers will increase their supply to the South African retailers. The opportunity is multidimensional, encompassing:

- Broad firm-level upgrading within the value chain (quality, delivery reliability, purchase order flexibility, product authenticity, etc.);
- Firm-level product specialisation (advanced fashion product capabilities);
- Process capability development (short lead times to enable in-season trading at South African retailers);
- Securing competitive material inputs at each value chain link;
- Operating adaptable organisational models to align value chain capabilities and associated outputs with variable market demands; and
- Deepening collective efficiencies in areas of concentrated CTFL value addition – most notably Cape Town, and Coastal and Northern KwaZulu-Natal.

Each of the six elements highlighted above are interdependent, with their progress to 2030 likely to substantially support the realisation of the masterplan vision and its aspirational objectives. South Africa's struggling CTFL production, despite competitive wages and high ad valorem tariffs, point to a failure in the administration processes intended to support the domestic value chain, as well as a generally uncompetitive production capability. The R-CTFL value chain requires the correction of both these elements to realise its potential, hence the importance of continuing to focus on the value chain's competitiveness advancement.

### **3.3.4. Value chain transformation**

Positively supporting the transformation of South African society is a fundamental South African R-CTFL masterplan objective, and as such is one of its five key pillars. In alignment with the dti's principles of Broad Based Black Economic Empowerment (BBBEE), value chain transformation has several focus areas. First, tied to the anticipated major employment growth within the value chain through to 2030, it is key that the employee cohort brought into the industry broadly represents the demographic profile of South African society (in terms of race and physical abilities), although it is anticipated that more women than men will be employed – as per the existing profile of the CTFL value chain. This racial, gender and physical ability representation should be evident across the full spectrum of value chain employment categories, inclusive of operators, artisans, professionals, management, and executives. Second, given the value chain's advancing technology and associated skills requirements, it is critical that black South Africans are included in the advanced technical and management skills development processes developed in support of the masterplan.

Third, the development of the manufacturing portion of the South African R-CTFL value chain should prioritise majority black-owned firms wherever this is possible. The South African R-CTFL value chain has not transformed at a rate seen in other economic sectors primarily because of the poor financial returns presently being secured by CTFL manufacturers, while local retailers are unlikely to further transform their ownership structures given their public listings and substantial levels of established foreign shareholding. The direct consequence is a need for South African retailers to drive preferential procurement within their local supply chains. In combination, the domestic market growth, localisation, and competitiveness advancement pillars should create a more attractive investment space for black industrialists to enter the value chain. As black and female representation increases at executive management levels within established firms, the value chain should also begin to generate its own internal transformation dynamic. It is critical that this objective is closely monitored through to 2030, with remedial actions to be enacted to ensure a smooth progression towards its realisation, as opposed to simply a statement of intent.

### **3.3.5. Technology and associated skills development**

The fourth industrial revolution, or “Industry 4.0”, will profoundly impact the South African R-CTFL value chain to 2030. From the digitalisation of design and pre-production processes, to the use of artificial intelligence to analyse market trends and point of sales trade performance, to the transfer of this information through the value chain on a real-time basis, the use of additive manufacturing technologies (such as digital printing), robotics and new synthetic materials, and the fundamental reorganisation of supply chains and factory spaces, the consequences are clear: Not only does the South African R-CTFL value chain need to close the technology and competitiveness gap with leading international standards, it needs to simultaneously embrace entirely new technologies and the operating models these technologies give rise to. Support for design, product development, production, and supply chain innovation within the R-CTFL value chain is therefore critical, both at abstract and more applied levels. Several of South Africa’s more successful CTFL competitor economies have provided generous support for technology development, with Turkey the most prominent and successful example.

Tied directly to the technology advancements required within the R-CTFL value chain is the need for substantially greater levels of technical and managerial skills development. The value chain is suffering from a dearth of management and technical skills that is directly impacting on firm-level efficiencies and broader capabilities, and therefore stifling the realisation of emerging opportunities. To achieve a 5.5% CAGR through to 2030, while simultaneously improving productivity levels at a CAGR of 1.5% and closing the technology gap with leading international competitors, requires a fundamental shift in both the quantity and quality of management and technical skills available to CTFL manufacturers. Two key elements appear central to the correction of the value chain’s short-term skills position: (a) Increased managerial and technical skills training within firms and broader support institutions, and (b) the importation of required skills. While the former opportunity is well understood, the latter requires careful consideration. For example, Indonesia has opened its CTFL value chain to skilled immigration to de-bottleneck its skills shortfalls in critical management and technical positions, with positive competitiveness outcomes.

## 4. POLICY, REGULATORY AND PROGRAMMATIC RECOMMENDATIONS

Substantial Policy, Regulatory and Programmatic (PRP) changes are required to support the masterplan's five strategic pillars. These PRP elements are focused on below, with 11 recommendations made. The recommendations are grouped into three areas, with each area covering a critical strategic weakness within the R-CTFL value chain. The first relates to securing demand growth within the SA R-CTFL value chain, the second to enhancing government policy support for the SA R-CTFL value chain, and the third, to introducing enhanced programmatic interventions to support the realisation of the masterplan.

### 4.1. SECURING OPTIMAL VALUE CHAIN DEMAND

#### 4.1.1. Recommendation #1: Establish a government task team focusing on illegal trading

Illegal trading is a critical and growing concern across all stakeholder groups within the R-CTFL value chain. To address this ongoing challenge, it is recommended that the dti establish a senior government task team consisting of representatives from the South African Revenue Service (SARS) and law enforcement agencies to urgently resolve illegal retail trading in both urban and rural communities. The broad objectives of the task team should initially include:

- Expanding legally compliant South African retailing
- Providing the formal, tax compliant R-CTFL value chain with demand momentum by reducing demand "leakage" created through the illegal importing of products
- Re-establishing the tax integrity of the R-CTFL value chain
- Re-establishing pricing integrity within the R-CTFL value chain

Most stakeholder engagements emphasised that there will need to be political buy in and coordination across government departments, including SARS and the South African Police Service (SAPS), to address the problem. The senior government task team must be able to ensure that coordination across government entities takes place to improve outcomes and secure the integrity of the domestic market and its local value chain as an urgent priority.

<b>Masterplan requirement:</b> Elimination of illegal CTFL trading in the South African retail market, thereby growing demand for legal products within the domestic CTFL value chain.
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#### 4.1.2. Recommendation #2: Introduce new South African trading license regime

Domestic market competition from multinational retailers without any local sourcing was identified as a key obstacle to the realisation of the masterplan. To address this concern, it is recommended that amendments are made to South African CTFL retail license requirements. The revised retail license should include a local sourcing infrastructure requirement for any retailers operating in South Africa. This would not be a local content requirement, but rather a forced opportunity enabler, thereby providing South African CTFL manufacturers with the opportunity to potentially supply the multinational retailers. A clear definition for what constitutes a minimum local sourcing infrastructure needs to be developed for implementation, with

the following working definition proposed: *A sourcing office can be any size or dimension, but must contain the following functional areas, with associated staff and equipment: Product sampling; product development; product costing; product planning, vendor communication; vendor coordination; and product sourcing.* The establishment of these functional areas should be vetted by an appointed dti agency prior to the granting of a trading license in South Africa.

This recommendation should expand legally compliant South African retailing that has the strategic intent of purchasing from South African vendors, thereby providing the manufacturing portion of the South African CTFL value chain with demand momentum.

**Masterplan requirement:** Retailers operating in South Africa to include the domestic value chain in their sourcing considerations, although with no obligations to purchase locally.

#### 4.1.3. Recommendation #3: Restricted ports of clearance

Duty avoidance, whether in the form of under-invoicing, the misdeclaration of goods, or product smuggling, is a clear blight on the domestic value chain. Research highlighted this as the most pressing and substantial issue impacting on the R-CTFL value chain, with the integrity of South African customs almost universally questioned in stakeholder engagements. Based on learnings from elsewhere, most notably Indonesia, it is recommended that South Africa work to re-establish the integrity of CTFL import controls by restricting the ports of clearance for CTFL imports entering the South African market. Indonesia's port restrictions are part of the country's import licensing regime and include several requirements for importers of CTFL products. Colombia has also included a provision for port restrictions in their CTFL import licensing regime but has yet to implement them.<sup>5</sup> Due to South Africa's participation in SACU, and the regional value chains that are emerging with trade partners in the region, it would be impractical to simply close borders altogether. As such, it is recommended that the dti work with other government agencies to **restrict the clearance of CTFL imports** to four entry ports only: Durban seaport; Port Elizabeth seaport; Cape Town seaport; and OR Tambo International airport.

Research undertaken to explore the potential impact of such a measure, found that currently more than 77% of CTFL imports are cleared in these four locations already.<sup>6</sup> Legitimate imports from the SADC region are generally transported to distribution hubs in the Gauteng, Western Cape or KwaZulu-Natal, so the impact for the formal retail value chain is not likely to be severe. This measure is urgently required to improve monitoring and enforcement of regulations to protect the industry from illegal activities.

The objectives of this measure include re-establishing control over CTFL imports entering South Africa; reducing criminal activity within the value chain; and ensuring fair competition in the domestic R-CTFL value chain. Concentrating imports through specified ports increases the ability to monitor imports, enforce trade policy and enables the introduction and testing of new technologies, as well as the critical need for capacity building of customs officials, specifically around CTFL products.

One of the critical concerns raised in consultations with stakeholders was the potential for leakage of imports passing through borders and being cleared in the four locations. This is a serious concern, and

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<sup>5</sup> Further details on the Indonesian and Colombian model are included in the appendix

<sup>6</sup> Based on CTFL customs value data obtained from SARS for 2018

it is therefore also recommended that the dti work with SARS to improve processes to prevent such leakage, potentially through digital monitoring verification systems and import licensing requirements.

**Masterplan requirement:** Substantial reduction in illegal and under-invoiced imports entering the South African R-CTFL value chain.

#### **4.1.4. Recommendation #4: Introduction of minimum specific tariffs**

In addition to ports of clearance restrictions, it is also recommended that the dti urgently establish a task team to investigate the introduction into South Africa of Colombia's Minimum Specific Tariff (MST) model to eliminate under-invoicing, illegal imports and the misdeclaration of imports. The task team should include representatives from ITAC, SARS, SACTWU, NULAW, and the industry, and should visit Colombia as soon as is possible.

Research into the successful Colombian model indicates that due to ongoing WTO complaints lodged by Panama, Colombia has had to adjust its MST model to ensure WTO compliance. The most recent review of Colombian trade policy indicates the use of weight-based thresholds to identify CTFL products with declared values that are lower than reasonable estimates of defined material costs as part of the country's import licensing regime. Products below the threshold are required to submit additional documentation proving the origin of the items, as well as the accuracy of the declared values and the final retailing customers in Colombia. Importers who are unable to provide sufficient evidence are required to post a bond to secure the items while the dispute is resolved, with significant penalties associated with any identified under-invoicing or product misdeclarations. It is important that the dti understand the motivation and impact of these measures, in order to craft a suitable response for South Africa. It is evident that Colombia is fully committed to the implementation of the measure to address illegal imports and under-invoicing.

The objectives of the weight-based price thresholds include eliminating criminal activity within the CTFL value chain; re-establishing market related pricing mechanisms within the R-CTFL value chain; and ensuring ad valorem tariffs are not abused by importers. As per the Colombian model, it is recommended that the MST thresholds established for South Africa are based on historical import prices from all trading partners; and an evaluation of material prices. Per the Colombian experience, it is also important that the thresholds are updated annually, or when necessary should significant changes arise necessitating adjustments.<sup>7</sup>

**Masterplan requirement:** Substantial reduction in illegal and under-invoiced imports entering the South African R-CTFL value chain.

#### **4.1.5. Recommendation #5: Establish task team to eliminate illegal CTFL manufacturing**

In addition to the trade remedies above, it is recommended that the dti establish a government task team to eliminate illegal CTFL manufacturing in South Africa. Optimising the growth potential of legally compliant manufacturers in South Africa is only possible if the costing differences between legal and illegal local producers is corrected. This requires the closure of all CTFL manufacturers that are not

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<sup>7</sup> More detail on the Colombian model is provided in Appendix A.

paying South Africa’s minimum wage, and the remediation of CTFL manufacturers that are paying the minimum wage, but that are not compliant with national bargaining legislation (wherever these apply). The objective of the masterplan is to rebuild the legally compliant CTFL value chain supplying into South African retailers, as this aligns fully with the national government’s decent work agenda for the country. It is therefore imperative that illegal domestic competition is not the primary beneficiary of the major trade policy changes enacted.

The task team needs to be sensitive to potential employment losses within the value chain as a result of the closure of illegal manufacturing plants, and hence should attempt to support remediation activities wherever possible. However, the differential structure of domestic competition cannot continue if the masterplan is to be successful. Illegal manufacturing will continue to erode profits in the formal, legally compliant value chain, and undermine the potential for improved wages – especially as productivity increases (in alignment with the recommendations presented below).

<p><b>Masterplan requirement:</b> Substantial reduction in illegal CTFL manufacturing within the South African R-CTFL value chain, thereby driving the growth and development of legally compliant firms.</p>
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## **4.2. ENHANCED GOVERNMENT SUPPLY SIDE SUPPORT**

Government support in the form of the Production Incentive (PI) and the Competitiveness Improvement Programme (CIP) appears to have had a generally positive impact in improving capabilities and performance within the CTFL value chain, although the general performance trend of the manufacturing portion of the R-CTFL value chain remains non-dynamic, with limited Gross Value Added (GVA) and employment growth. Despite many individual firm successes, continued firm closures within the value chain over the last five years are testament to its ongoing challenges.

### **4.2.1. Recommendation #6: Extend the PI and CIP for a further five years**

To ensure continued development support for the manufacturing portion of the CTFL value chain it is recommended that both the PI and CIP be extended in their present formats for another five years. This will ensure policy continuity and provide the value chain with continued resources as it attempts to upgrade and develop capabilities in the face of severe international competition. To improve the outcomes of both programmes it is however recommended that the dti amend the qualification criteria for the PI and CIP. Support should focus on employment and technology additionality across the CTFL value chain (including non-retail supply but excluding base materials). Firms that are growing should receive augmented support relative to firms that are largely non-dynamic. Before the recommended five-year extension ends, it is imperative that a review is undertaken mid-programme to provide certainty to the value chain on the future position of the PI and CIP, with its impact to be carefully evaluated as part of the masterplan’s monitoring and evaluation process.

<p><b>Masterplan requirement:</b> Continued upgrading within the CTFL value chain, especially if import leakages are resolved and fair pricing within the domestic value chain is re-established.</p>
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#### 4.2.2. Recommendation #7: Introduction of investment support for CTFL manufacturing

To augment the PI and CIP, and to provide the CTFL value chain with the best opportunity to upgrade and take advantage of demand opportunities, it is recommended that the dti immediately introduce investment support for R-CTFL manufacturers. It is recommended that this take the form of a Corporate Income Tax (CIT) based investment incentive that targets capital expansion and productivity enhancing technologies and equipment. It is recommended that the support level be set at 15% to 30% of the qualifying investment, with the differential based on employment impacts; value chain bottleneck priorities; and the introduction of advanced manufacturing capabilities (including green technologies, new materials, additive manufacturing and digital technologies). This support would be aligned with the support being provided to firms in comparator economies, most strikingly Thailand and Turkey.

The way the proposed CIT benefit could work is as follows:

- A firm makes an investment. In this example, the investment is R100m, but it could be any amount.
- The firm receives a CIT benefit of up to 30% of the investment amount. In this case the firm has made a labour-intensive investment and so it receives the full 30% CIT benefit.
- The firm now has a CIT credit with the SARS worth R30m.
- The firm generates R20m in profit in its first year of operation. At SA's 28% CIT rate, this translates into a CIT payment of R5.6m.
- The firm lodges the R5.6m against its R30m CIT credit, and receives an updated reconciled tax credit of R24.4 million (R30m minus R5.6m).
- The firm keeps lodging its CIT profit payments to SARS against its CIT credit until its CIT tax credit is fully used. At this point the firm begins paying full CIT.

Further modelling of the fiscal implications based on historical investments and anticipated future investments, particularly in response to the fourth industrial revolution, will be required to motivate the CIT measure to National Treasury.

**Masterplan requirement:** Substantially increased investment in the manufacturing portion of the CTFL value chain – in terms of additional capital equipment and new technologies.

#### 4.2.3. Recommendation #8: Maintenance of CTFL tariffs and rebates

The South African CTFL value chain's duty structure should provide each of the value chain linkages with substantial trade protection. However, ad valorem tariffs are only likely to be effective if paired with restricted ports of clearance (recommendation #3) and the introduction of a weight-based minimum duty (recommendation #4). It is therefore recommended that the existing tariff dispensation within the CTFL value chain remains unchanged, thereby allowing time for the restricted ports of clearance and weight-based minimum duty to positively impact on the performance of the value chain.

The South African CTFL value chain has a complex set of over 50 rebates in place to ensure that the downstream manufacturers of products are not disadvantaged by upstream tariffs on imported materials that are no longer available in South Africa. Notwithstanding some concern relating to the potential for import leakage as a result of these rebates, it is recommended that the rebates are maintained and even extended, but with two important adjustments. The first is that rebates should



only be granted with strict conditionalities, including that firms are bargaining council compliant, and in good standing with South Africa's tax authorities. The second, is that rebate enforcement needs to be substantially bolstered. Stakeholder engagements revealed major concerns relating to the effectiveness of existing monitoring mechanisms that are likely to be leading to substantial rebate abuse. To ensure pricing integrity within the CTFL value chain and to ensure that incorrectly declared products are not brought into South Africa under rebate, it is critical that rebates are closely monitored and compliance with product specifications and volume thresholds are strictly adhered to.

**Masterplan requirement:** Fair protection for the domestic CTFL value chain where local production capacity exists and can be developed; but access to globally competitive material inputs where this capacity does not exist.

### 4.3. PROGRAMME INTERVENTIONS

The two programme recommendations below are deemed critical to the sustainable development of the South African R-CTFL value chain. It is however recognised that both are complex, hence the recommendations being couched in institutional terms, rather than encompassing specific interventions.

#### 4.3.1. Recommendation #9: Aligning the SA R-CTFL value chain's annual operating cycle

It is recommended that the dti establish a stakeholder engagement process to interrogate and agree on changes to the South African R-CTFL value chain's annual operating cycle. It is imperative that production capacity is better aligned with the distinctive seasonal demand profile of the South African retail market. This would involve increased summer production and reduced winter production, as well as more operating flexibility within selling cycles. As an example, in-season trading flexibility needs to be adjusted to align with weekly commodity purchasing variances. Per the successful model applied in Turkey, this could relate to differential weekly work hours that consider the likelihood of market demand variances. Extending factory operating hours to ensure improved capital utilisation, especially as new capital is introduced as a result of recommendation #7, could also have a major positive impact on the value chain.

The masterplan team is acutely aware of the sensitivities associated with this recommendation. However, operating rigidities within the value chain are a major constraint to its competitiveness and sustainability, especially when compared to comparator economies. If the value chain is to attract major new investment (including FDI) resolving these rigidities is essential.

**Masterplan requirement:** Enhanced operating flexibility and lead time responsiveness within the South African R-CTFL value chain, as well as improved operating costs.

#### 4.3.2. Recommendation #10: Skills and associated productivity development

There is a major contradiction in the existing support landscape for the CTFL value chain. At one level, the dti has recognised the potential of the value chain to create employment, move up the value chain, and compete internationally; and at another level, there is no longer even a CTFL-dedicated sector

education training authority for the value chain. And yet the relationship between skills development and productivity growth is clearly recognised in all the successful comparator economies scrutinised as part of the masterplan research process. The comparator economies all have effective skills development programmes in place to support the competitiveness and associated development of their CTFL manufacturing sectors.

Given the masterplan's recognition of the need for a 1.5% annual improvement in the value chain's overall productivity to 2030, and stakeholder perceptions of major skills gaps in respect of the value chain's present position, it is recommended that the dti initiate engagements with the Department of Higher Education and Training and the Fibre Processing and Manufacturing Sector Education and Training Authority to establish a CTFL-specific skills development and technology transfer process to support the realisation of the masterplan.

In response to the challenges of insufficient high level technical and professional skills with the value chain, it is recommended that the dti also initiate engagements with relevant government departments to facilitate the potential employment of expatriates with scarce skills across key technical and management areas. To ensure this does not displace skilled South African professionals, it is recommended that further research is completed on models used in other countries to secure skills transfer to local employees. This is particularly important in respect South Africa's employment equity requirements.

**Masterplan requirement:** Increasingly skilled employees within the South African CTFL value chain, and an associated ability to absorb more advanced value chain technologies.

#### **4.3.3. Recommendation #11: Establishing an EOC to implement the masterplan**

Implementing the recommendations outlined above will require stakeholder support for the masterplan. The five masterplan pillars will be difficult to implement, with the potential for coordination failures and conflict between stakeholders. It is therefore recommended that a coordinating institutional structure is established to drive the implementation of the masterplan. The masterplan has a clear vision and associated set of objectives, that if realised will substantially transform the South African R-CTFL value chain – to the benefit of all value chain stakeholders and broader society. However, the masterplan will not be realised without continued positive and aspirational intent that will only be fostered if an active institutional process is established.

It is therefore critical that a representative institutional body is established to guide, monitor and evaluate the South African R-CTFL value chain's progress to 2030. The institution should be responsible for leading the masterplan's implementation and should ensure that each of the five pillars are consistently focused on, thereby ensuring implementation accountability across the spectrum of responsible stakeholders. The institution should consequently be recognised as the formal industry development council of the South African R-CTFL value chain.

Chaired by senior dti leadership, the institution should comprise the senior leadership of the value chain, inclusive of retailers, design houses, clothing, textiles, footwear and leather (and accessories) manufacturers, SACTWU and NULAW's most senior leaders, and selected representatives from the broader value chain, particularly where these representatives have a key role in implementing the recommendations presented in this report and embedded within the pillars of the SA R-CTFL

Masterplan. A base monitoring and evaluation framework will need to be developed for the masterplan, with the measures and the realisation of the associated targets integral to its success.

It is critical to emphasise that the realisation of the South African R-CTFL 2030 masterplan is likely to be fraught with challenges and it is therefore essential that an institutional approach is taken to support its completion. The recommended institution will need to work to overcome challenges to the masterplan's realisation and provide recommendations on shifts in policy and/or value chain regulations and programmes where results are sub-optimal. Importantly, it will also need to recognise and amplify the impact of masterplan programmatic, regulatory and/or policy successes wherever this is required. Evidence from successful competitor CTFL economies is clear: Success is not determined by once-off PRP interventions, but through careful and deliberate shifts shaped by the establishment of institutionalised learning processes that have proactively corrected PRP failures; and worked to amplify successes wherever these have been experienced.

The masterplan project team's recommendation on the composition of the oversight committee is based on the success of the Thailand Textile Development Institute who developed, and now oversee the implementation of the long-term "Thailand Textile and Fashion Industries Development Strategy 2015 - 2030". The strategy aims to promote the Thai textile and clothing industries, in an increasingly competitive market as well as to reinforce the ambitious goal of elevating Thailand as a global fashion leader.

To drive the implementation of the South African R-CTFL value chain masterplan it is therefore recommended that the dti establish a R-CTFL Value Chain Masterplan Executive Oversight Committee (EOC). The EOC should meet every six months and comprise the following value chain representatives:

- Chaired by the Minister of Trade and Industry
- Representatives from retail and relevant industry associations from the manufacturing portion of the value chain (Clothing, textiles, footwear, and leather)
- Representatives from the two major labour unions operating within the value chain
- Representatives from the dti, and other government departments

<p><b>Masterplan requirement:</b> A functioning, transparent public-private oversight committee that effectively guides, monitors and evaluates the progress of the masterplan through to 2030.</p>
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#### **4.4. SUMMARY OF SA R-CTFL MASTERPLAN RECOMMENDATIONS**

The 11 recommendations outlined above are summarised in Table 4 below. As highlighted, there is a clear rationale for each of the recommendations, with their impact of critical importance to the realisation of the masterplan's vision, and associated objectives through to 2030. The implementation of the 11 recommendations will drive the development of the value chain across each of the five identified strategic pillars, which are to optimise domestic market growth, drive increased localisation, enhance competitiveness upgrading, transform the value chain, and advance the value chain's technology and associated skills profile.

**Table 4: Summary of SA R-CTFL masterplan recommendations**

Element	Recommendations	Impact	Rationale
1. Secure optimal value chain demand	1. Establish government task team on illegal trading	Significantly reduce illegal CTFL trading	Reduce demand leakage within value chain; ensure demand growth exceeds 3% per annum
	2. Introduce new SA trading license regime	SA-based retailing to operate on level playing field	All SA-based retailers to have local sourcing offices
	3. Introduce restricted points of clearance for CTFL products entering SA	Significantly reduce illegal CTFL importing	Customs to re-establish control over CTFL imports entering SA; reduce criminal activity within CTFL value chain; secure market-related pricing in SA market
	4. Explore Introduction of MST reference pricing on CTFL products	Eliminate manipulation of SA's ad valorem based CTFL tariffs	Reduce criminal activity and demand leakage within CTFL value chain; secure market-related pricing in SA market
	5. Establish government task team to eliminate illegal CTFL manufacturing	Level production operating environment within domestic CTFL value chain	Ensure demand growth stimulates legally compliant CTFL manufacturers
2. Enhance government support for the value chain's development	6. Maintain CTFL value chain tariffs and rebates	Maintain CTFL value chain status quo while MST and restricted ports of clearance changes are enacted, and their impact monitored	Illegal competition covered by MST and restricted ports of clearance recommendations
	7. PI and CIP to be extended for 5 more years	Maintenance of existing support to value chain	Maintenance of support for CTFL value chain until structural failures corrected
	8. Introduce investment-based CIT incentive @ 15-30%	Attract investment in key value chain segments; and increase production	Re-build value chain by securing ROCE for Brownfield and Greenfield CTFL investments
3. Programme interventions	9. Align CTFL operating cycle with SA retail market consumption	Improved costs, ROCE and operating flexibility within SA value chain	Enhanced SA CTFL value chain competitiveness
	10. Establish CTFL specific skills and technology programme	Raise technical and management skills within SA CTFL value chain	Skills development and technology transfer in support of value chain development
4. Masterplan implementation	11. Establish masterplan EOC	Ensure successful implementation of masterplan	Hold stakeholders accountable for masterplan implementation

## 5. APPENDIX A: MASTERPLAN EXTENSION CASE STUDIES

Lessons from international competitor economies emphasised the importance of demand-side stimulation for value chain success. With respect to local market optimisation, it is critical to secure better protection of the domestic market to ensure only legitimately priced products are traded (both locally and internationally) within the value chain. Two key interventions emerged from the comparator review, for further analysis and testing:

- Minimum specific tariffs in Colombia
- Restricted ports of entry in Indonesia

These considerations were tested with the Masterplan Industry Reference Group (IRG) on the 28<sup>th</sup> of August 2018 and resulted in several concerns and objections being raised with the masterplan team that necessitated further research and analysis. Following further engagements with the dti, the project, which was due to conclude in November 2018, was extended to May 2019 to allow for further engagement with stakeholders and a more in-depth assessment of the implications of these recommendations for R-CTFL value chain stakeholders. The focus of the extension was further research on the Colombian MST model and Indonesian restricted ports of entry as well as a deeper understanding of the mechanisms, and potential implications of these measures in the South African context. This appendix provides an overview of the extension research.

### 5.1. MINIMUM SPECIFIC TARIFFS: LESSONS FROM COLOMBIA

A specific duty or tariff is a form of tariff that is applied on volumes (usually by weight) rather than prices of traded goods. The main reason for using specific duties is that they are less sensitive to fluctuations in the price of imported goods (which is often an issue for commodities and agricultural products). However, the effect of a specific duty varies inversely with changes in the unit price of goods and thus taxes more severely the lower grades of an imported commodity.

Specific (and compound) duties are often used by developed countries to regulate imports of agricultural products. Apart from several smaller developing countries, the use of specific duties by developing countries is much more limited. Although specific duties are mostly related to the agricultural sector, they are also utilized in the textile and apparel sectors.

#### 5.1.1. Colombia Trade Policy review

Since 2010, the Colombian Government has been engaged in a Structural Tariff Reform (REA)<sup>8</sup>. According to Colombian authorities, the aim is to tackle problems associated with the tariff structure, such as the negative effective protection and high tariff dispersion harmful to national competitiveness and exports, which were accentuated by changes in the Andean Community rules and the signing of free trade agreements. The REA was a response to requests from the private sector and underwent a series of amendments<sup>9</sup>. Tariff cuts were also part of the Productivity and Employment Promotion Plan (PIPE) fostered by the National Government.<sup>10</sup>

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<sup>8</sup> Decrees No. 4.114 and No. 4.115 of 2010

<sup>9</sup> Decrees No. 492 of 23 February 2011, No. 511 of 24 February 2011, No. 765 of 17 April 2012, and No. 882 of 30 April 2012.

<sup>10</sup> Decrees No. 1.755 of 13 August 2013 and No. 1.625 of 14 August 2015.

On the 23<sup>rd</sup> of January 2013 the government temporarily imposed mixed tariffs on imports of clothing and footwear products<sup>11</sup>. The reason given was the high level of technical smuggling by means of under-invoicing. In June 2013 Panama requested WTO-notified consultations with Colombia on the proposed measures. This dispute concerned a compound tariff imposed by Colombia to imports of textiles, apparel and footwear, consisting of: (i) a 10% ad valorem component and (ii) a specific component, which varied according to the import value and customs classification of the merchandise. Panama challenged the compound tariff in certain situations where, in its view, the measure necessarily resulted in duties in excess of bound rates set forth in Colombia's Schedule of Concessions (35% or 40% ad valorem, depending on the product), in a manner inconsistent with Article II:1(a) and (b), first sentence, of the GATT 1994.

In response, Colombia argued that the imports affected by the compound tariff constitute “illicit trade” as they are imported at “artificially low prices” in order to launder money. In Colombia's view, Article II of the GATT 1994 did not apply to illicit trade and, therefore, the WTO panel should reject Panama's claims under this provision. The panel report, circulated in November 2015 noted that Colombia's compound tariff applied to all imports of the products at issue, without distinguishing whether those imports constituted “licit” or “illicit” trade, or are being used for money laundering. The Panel found that the compound tariff resulted in duties in excess of the bound rates set forth in Colombia's Schedule of Concessions in certain circumstances, and that its policy was, therefore, inconsistent with Article II:1(b), first sentence, of the GATT 1994. The compound tariff was also found to be inconsistent with Article II:1(a) of the GATT 1994, as it accorded less favourable treatment than that provided for in Colombia's Schedule of Concessions.

After an unsuccessful appeal from the Colombians on the 21<sup>st</sup> of July 2016, Colombia stated that it intended to implement the Dispute Settlement Panel's (DSP) recommendations and rulings in a manner that respected its WTO obligations and that it would need a reasonable timeframe to do so. It was subsequently granted until the 22<sup>nd</sup> of January 2017 to action the panel recommendations.

With the aim of pursuing measures to prevent and control customs fraud in clothing and footwear imports and to bring these measures in line with the WTO provisions, the Colombian government then issued Decrees No. 1.744 and No. 1.745 on the 2<sup>nd</sup> of November 2016. Decree No. 1.744 established for one year a tariff of 35% for footwear and 40% for clothing (Colombia's maximum bound WTO rates). These tariffs are applied when the declared f.o.b. prices of imports of these goods are equal to or less than established specific thresholds. Decree No. 1.745 of 2 November 2016 introduced mechanisms for strengthening the risk management system and customs control relating to possible situations of customs fraud affecting imports of clothing and footwear, regardless of the country of origin and/or provenance, where the declared f.o.b. price was less than or equal to specific threshold established in the Decree.

Panama challenged the additional measures to combat under-invoicing contained in Decree 1.745 but were unsuccessful as the panel found that the tariffs provided for in Decree No. 1744/2016 were not inconsistent with Colombia's obligations under GATT 1994, and that Panama had failed to demonstrate that the specific bond and the special import regime were inconsistent with the WTO Agreement. The panel concluded that Colombia had implemented the recommendations and rulings

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<sup>11</sup> Decree No. 074 of 2013

of the DSP in Colombia — Measures Relating to the Importation of Textiles, Apparel and Footwear to bring its measure into conformity with its obligations under the WTO Agreement.

In November 2017, the Government of Colombia extended for two more years the measure affecting imports of goods entering at prices below or equal to the specific thresholds established in the decrees.<sup>12</sup> Decrees No. 1.744 and No. 1.786 established a 40% tariff on product imports classified in chapters 61 and 62 of the National Customs Tariff, where the declared f.o.b. price was less than or equal to US\$10 per gross kg, and a 35% tariff on imports whose declared f.o.b. price was lower than or equal to: US\$6 per pair for imports under HS headings 6401, 6402 and 6404; US\$10 per pair for imports under heading 6403; and US\$7 per pair for imports under heading 6405. In the case of imports of HS 6406.10.00.00, the 35% tariffs applied when the declared f.o.b. price was less than or equal to US\$5 per gross kg, while for goods in chapters 61, 62 and 64 from a special customs zone or a free zone the provisions of these decrees would apply only when entering the national customs territory. Decree No. 2.218 of the 27<sup>th</sup> of December 2017 replaced Decree No. 1.745 and widened the range of imports covered to include fibres, yarns and woven fabrics, as depicted in Table 5.

**Table 5: Price thresholds for Colombian CTFL imports**

Tariff heading	Threshold US\$/kg gross or per pair
<b>Yarns</b>	
52.05 54.02 55.09 55.10	2.00
<b>Fibres</b>	1.00
55.03 55.04 55.05 55.06 55.07	
<b>Woven fabrics</b>	
52.08 52.09 52.10 52.11 52.12 53.09 54.07 54.08 55.12 55.13 55.14 55.15 55.16 56.01 58.01 58.02 58.03 58.04 58.05 58.06 59.01 59.03 59.06 59.07 59.10 59.11 60.01 60.02 60.03 60.04 60.05 60.06	2.50
<b>Clothing</b>	
61.01 61.02 61.13 61.14 62.01 62.02 62.05 62.11	10.0
61.04 61.10 61.12 62.06	8.0
61.03 61.05 61.06 61.07 61.08 61.09 61.11 61.15 61.16 61.17 62.03 62.04 62.07 62.08 62.09 62.12 62.13 62.14 62.15 62.16 62.17	5.0
<b>Other made up textile articles</b>	
63.01 63.02	2.0
63.03	1.5
63.04	4.5
<b>Footwear</b>	
64.01 64.02 64.04	3.0
64.03	8.0
64.05	4.0
6406.10.00.00	2.0

Source: Decree No. 2.218 of 27 December 2017

To determine the thresholds of Decree No. 1745/2016, Colombia estimated the implicit price of imports (US\$/net kg; US\$/pair) per tariff heading. For this purpose, consideration was given to the prices used by the DIAN to establish risk profiles and the information on monthly imports of products during the period 2010-2017 (excluding imports registered under the re-import regime and the temporary import systems for inward processing). Using this information, the threshold was estimated in terms of the average value of the implicit price corresponding to the tenth percentile of each tariff heading group, for the period 2010-2017.

<sup>12</sup> By Decree No. 1.786 of 2017

**Table 6: Variable tariff according to thresholds**

Product	MFN tariff where f.o.b. price does not exceed the respective threshold	MFN tariff where f.o.b. price exceeds the respective threshold (Decree No. 4927/2011 and amendments thereto)
Chapter 61	40%	15%
Chapter 62	40%	15%
Chapter 63	No differentiated regime	
Headings 64.01 to 64.05	35%	15%
Heading 64.06	No differentiated regime	
- Subheading 6406.10.00.00	35%	10%

Source: WT/DS461/RW dated 5 October 2018

In 2018 the National Government of Colombia announced that thresholds would be revised annually or earlier when foreign trade trends warrant doing so. It also provides that, in order to import the covered products at a price lower than or equal to the threshold, a number of requirements must be satisfied.<sup>13</sup> These include (1) submission of a customs declaration at least one month in advance of the arrival of the goods in the national customs territory, (2) legalised certification of the supplier abroad, (3) a list of distributors in Colombia of the imported good, and (4) proof that the value to be declared for the imported goods corresponds to the price actually paid or to be paid. In the event of a dispute concerning goods values when inspected, the importer may obtain their release by lodging a guarantee for a value equivalent to 200% of the difference between the importer's declared f.o.b. price and the amount resulting from multiplying the unit threshold price established in Decree No. 2.218 by the quantity imported.

Panama notified the DSP on the 20<sup>th</sup> of November 2018 of its decision to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel in this case. The 60-day period expired on 19 January 2019.

### 5.1.2. Colombia trends

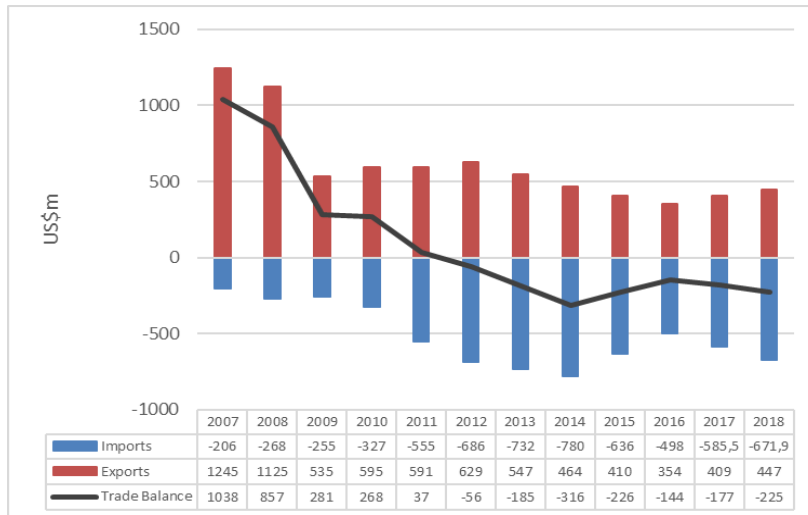
Overall trade figures show a decline in imports over the period, although there appears to be an increase from 2016-2018 across all subsectors. The limitation of these figures is that they indicate the total values of imports and exports over the period. There may be several factors that influence the change including global macroeconomic conditions, political and economic conditions affecting trade partners, fluctuations in the exchange rates and the impacts of other trade, investment and economic policy measures.

The case study presented here finds that Colombia has in fact implemented several measures over the period, although the MST and the associated import license and registration procedures appear to be the most significant measures affecting imports. Important to consider here that an increase in customs value could also indicate an improvement in customs compliance and a reduction in under invoicing, not only an increase in the volume of imports. Tracking the Colombian peso/USD exchange rates over the period indicate fluctuating rates and periods of instability around 2008/2009 and 2015.

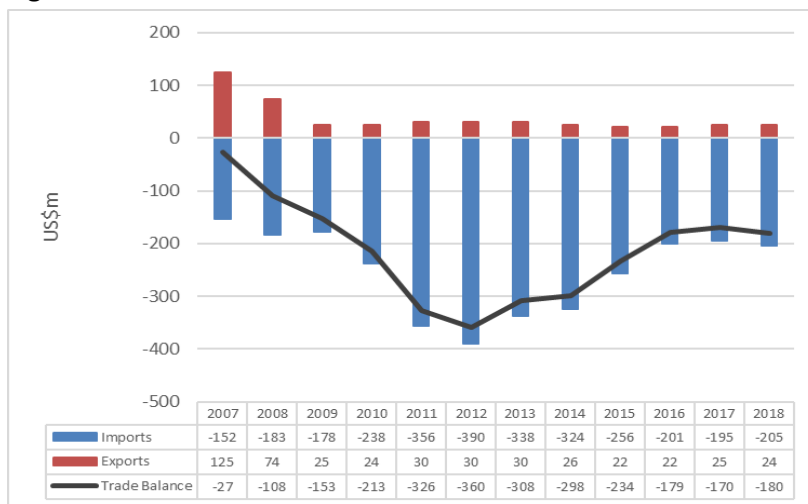
<sup>13</sup> Decree No. 2.218



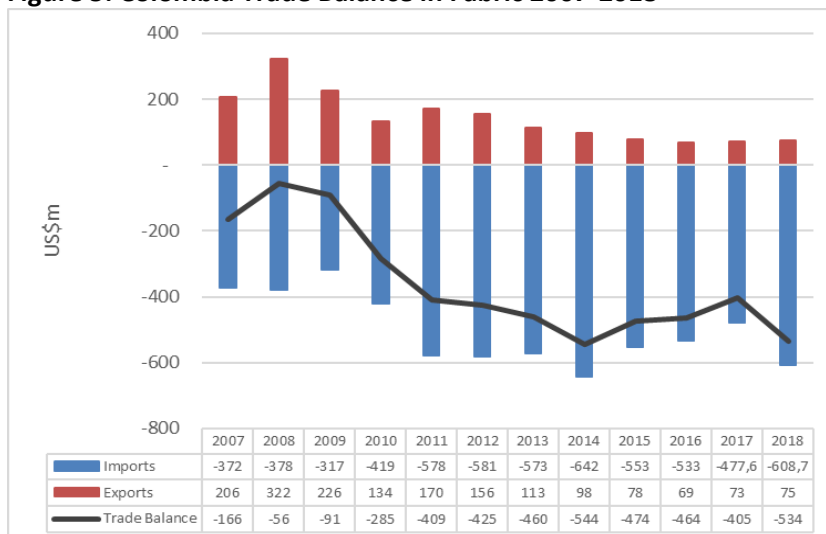
**Figure 3: Colombia Trade Balance in Apparel 2007-2018**



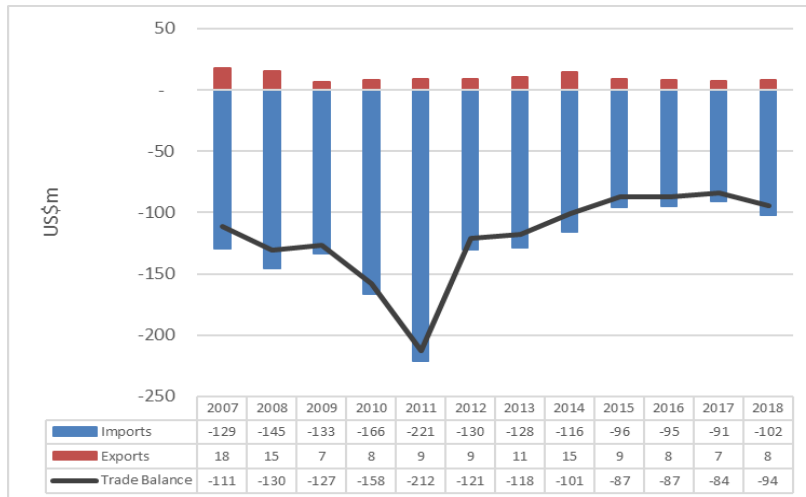
**Figure 4: Colombia Trade Balance in Footwear 2007-2018**



**Figure 5: Colombia Trade Balance in Fabric 2007-2018**



**Figure 6: Colombia Trade Balance in Yarn 2007-2018**



### 5.1.3. Additional WTO disputes related to MST

In 1993, through Resolution No. 811/93; Argentina imposed minimum specific import duties on approximately 200 categories of textiles and apparel which were to remain valid until January 31, 1995 with the possibility of a single, non-renewable extension of six months. The Presidential Decree No. 2275/94 dated December 23, 1994 extended the application of the minimum specific duties until December 31, 1995 and further expanded the number of affected categories of merchandise. As per Article 15 and Annex XII to the Decree, minimum specific import duties applied to categories of textiles and apparel (HS Chapters 51 to 63) and footwear (HS Chapter 64). On September 22, 1995, this Decree was further modified by two resolutions – (a) Resolution No. 304/95, which applied to textiles and apparel and increased the rate of specific duties for several textiles and apparel tariff lines; and (b) Resolution No. 305/95, which applied to footwear.

The purpose behind imposition of Minimum Specific Import Duties (DIEM) was to counteract the injury allegedly suffered by Argentine manufacturers as a result of imports of textiles, apparel and footwear at prices lower than the production costs in the countries of origin or lower than international prices. Argentina calculated an average import price for each relevant Harmonized System (HS) tariff line of textiles, apparels and footwear. It then multiplied the average import price by the bound rate of 35 per cent thereby resulting in a specific minimum duty for all products in that category. For textiles, apparel or footwear, depending on the customs value of the goods concerned, Argentina applied either the specific minimum duty applicable to those items or the *ad valorem* rate, whichever was higher.<sup>14</sup>

In January 1997, the United States requested the Dispute Settlement Body ("DSB") to establish a panel (WT/DS56/5) after failing to reach a mutually satisfactory solution with Argentina on the specific tariffs. The USA claimed that Argentina's measures were "inconsistent with the obligations of Argentina under Articles II, VII, VIII and X of the GATT 1994; Articles 1 through 8 of the Agreement on

<sup>14</sup> *supra* note 3, Para 2.6

Implementation of Article VII of the GATT 1994; and Article 7 of the Agreement on Textiles and Clothing".

The USA argued that, even if Argentina's minimum specific import duties, as applied, did not exceed 35 per cent ad valorem, they still violated Article II because each of Argentina's specific duties had the potential to exceed 35 per cent ad valorem with respect to some imports. In fact, in all instances, the specific duties had the potential to exceed Argentina's tariff binding. This was especially true with respect to low cost products for which specific duties comprised a greater percentage of value than higher priced merchandise. Thus, by their very nature, the specific duties denied Argentina's trading partners the predictability and security for which they had negotiated a 35 per cent ad valorem binding.

The Appellate Body found Argentina's measure was, in fact, inconsistent with Art. II:1(b). It held that "the application of a type of duty different from the type provided for in a Member's Schedule is inconsistent with GATT Art. II:1(b), first sentence, to the extent that it results in ordinary customs duties being levied in excess of those provided for in that Member's Schedule." In this case, the Appellate Body concluded that "the structure and design of the Argentine system is such that for any DIEM... the possibility remains that there is a 'break-even' price below which the ad valorem equivalent of the customs duty collected is in excess of the bound ad valorem rate of 35 per cent."

#### **5.1.4. Lessons for the SA R-CTFL Value Chain Masterplan**

It is important to understand the reason why Panama has been the primary source of dispute with Colombia in respect of the MST. A key source of cheap imports, mostly from China, is through the Colon Free Port in Panama. Although the disputes were observed by other trade partners, all WTO complaints were raised by Panama. Although there are concerns about the movement of goods through South Africa's land borders originating outside of the region, no compelling suggests this is a significant threat to the CTFL industry. In the South African context, the measure is intended to address illegal imports, and misdeclaration of customs values for all CTFL products from all regions, rather than targeting specific products.

The detailed Colombia case study and the brief Argentina overview highlight the risk of introducing an MST as both led to WTO trade disputes. It is possible that affected trade partners may consider raising a dispute against South Africa should their exports be negatively impacted by the measure. However, as the Colombian case illustrates, it is possible to amend the measures to bring them in line with WTO rules. South Africa would therefore benefit enormously from understanding how the Colombian model evolved.

The Colombian rationale for an MST related mainly to illicit activities (smuggling, money laundering) and the negative impact that under-invoicing was having on their domestic industry. Correa (2018) estimated that more than 200,000 jobs were shed across the formal and informal CTFL value chains in Colombia in recent years; hence the urgency and determination of the national government to resolve illicit trade. The impact of the new measures is difficult to precisely estimate, but the fact that the Colombians have continued to pursue an MST model suggests that they believe that it is effective. Importantly, the thresholds are just one of several interventions in the industry, including not only those mentioned here (import licensing requirements) but also greater enforcement, seizure of illicit products and legal punishment for those who are implicated in criminal activity.

## **5.2. RESTRICTED PORTS OF ENTRY: EVIDENCE AND IMPLICATIONS**

A scan of the literature related to restricted ports of entry showed that various countries have used the measure, usually as part of an import licensing process, to control imports. They tend to be temporary measures that are relaxed if, and when, congestion and inefficiency threaten broader economic objectives. Two key CTFL examples were explored: Colombia and Indonesia.

### **5.2.1. Indonesia**

Indonesia's positioning as a clothing and textiles manufacturing hub in South East Asia has been impacted by the exponential growth of China over the last couple of decades. Nonetheless, it remains a significant global player, ranking 12<sup>th</sup> in respect of clothing exports, and accounting for approximately 2% of global export aggregates. In addition to a range of government incentives to support industry growth and partly in response to a rapidly growing middle class and surging imports, Indonesia has imposed import controls to restrict imports on over 500 products into Indonesia, including clothing, textiles, electronics, toys, footwear, food and beverages. Such imports are subject to special licensing, must undergo pre-shipment inspection, and can only enter the country through five designated seaports or any international airport as follows: Belawan in North Sumatera, Tanjung Priok in Jakarta, Tanjung Emas in Semarang (Central Java), Tanjung Perak in Surabaya (East Java), Soekarno Hatta in Makassar (South Sulawesi), or any international airport.

On the 30<sup>th</sup> of July 2015, the Indonesian Ministry of Trade announced regulation 53/M-DAG/PER/7/2015 introducing new import restrictions specifically for textiles produced using the batik-technique. With the new provisions, all importers of the good must apply for a special permit ("TPT Batik" and "TPT Motif Batik") in addition to an import license and points of entry were restricted to just three seaports and one airport (art. 13 of the regulation). Furthermore, batik imports require a report from an independent surveyor on its origin.

The regulation was due to come into effect 90 days after its announcement. However, on the 15<sup>th</sup> of October 2015, the Indonesian Trade Ministry issued regulation 86/M-DAG/PER/10/2015 cancelling the introduction of the batik import permit before the import restriction came into force, apparently, as a result of a conflicting economic stimulus package emphasising trade liberalisation and port efficiency.

In May 2018, Indonesia consequently announced that it would open eight ports to international shipments. The announcement did not provide specific details around the products included or whether there would be any exemptions, as was the case in previous port restrictions which were applied to certain products only. Although various concerns have been raised by WTO members about the complexity, lack of transparency and trade-impairing effects of Indonesia's import licensing requirements, including port restrictions, the provisions for CTFL products have not been formally challenged through the WTO and the country continues to use restricted ports of entry.

### **5.2.2. Colombia**

Colombia has also restricted ports of entry for CTFL products to improve customs control and counteract smuggling, under-invoicing and asset-laundering. The measures were first introduced in

2005 and 2006 and were specifically targeted at textiles and footwear products arriving from Panama and China.

While the country had 26 ports of entry available at the time (eleven of which were authorised to import textiles and footwear) the resolutions limited the entry of specific products to Bogotá airport and Barranquilla seaport. Panama launched a dispute with the WTO but following consultations between the two countries these measures were waved and the dispute was settled. In 2007, however, Colombia reinforced similar measures resulting in two major implications for textiles, apparel and footwear: i) ports of entry were limited to Bogotá and Barranquilla, with the consequence for non-compliance including seizure and forfeiture of the goods, and (ii) the presentation of an advance import declaration was required, and in the case of textiles, additional special legalization requirements had to be met.<sup>15</sup>

In April 2009 a WTO panel decided on the case against Colombia that had been initiated by Panama again in July 2007, finding these restrictions to be discriminatory and thus violating WTO law, but also raised doubts as to their efficiency in general. In 2010, Colombia made a submission to the WTO indicating that the challenged ports of entry measure had been terminated in its entirety. Colombia then started to explore alternative interventions to address ongoing concerns about imports, particularly those from the Colon Free Trade Zone, which were suspected to consist largely of cheap Chinese reexports. Colombia has made provisions for restricted ports in its new import licensing regime but has not yet implemented them.

### 5.2.3. Lessons for SA R-CTFL Value Chain Masterplan

The details of the Indonesia restricted ports measure, included as part of the import licensing requirements appear to still be in place, although this may not be the case, since the country has been under pressure to reduce its non-trade barriers and to improve the efficiency of its ports and logistics as part of the country’s economic development policy. The use of this measure is indicative of its perceived effectiveness, even if only applied temporarily, or for targeting specific products. Critically, the restriction of ports is part of the country’s import licensing regime, and not a standalone intervention. The positive and negative impacts consequences for South Africa, per the Indonesian and Colombian experiences, are summarized below.

Positive impacts	Negative impacts
<ul style="list-style-type: none"> <li>• Better oversight of customs to reduce illegal activity</li> <li>• Increased volume of products for comparison (reference pricing and/or minimum weight thresholds)</li> <li>• Improved capacity of customs officials through specialist training and exposure</li> <li>• Ability to test and adopt new technologies and digital processes for customs clearance.</li> <li>• Increased duty revenue</li> </ul>	<ul style="list-style-type: none"> <li>• Logistics problems amplified by underdeveloped infrastructure and congestion at ports.</li> <li>• Could potentially be challenged through the WTO</li> <li>• Potential for leakage of products between entry port and clearance office</li> </ul>

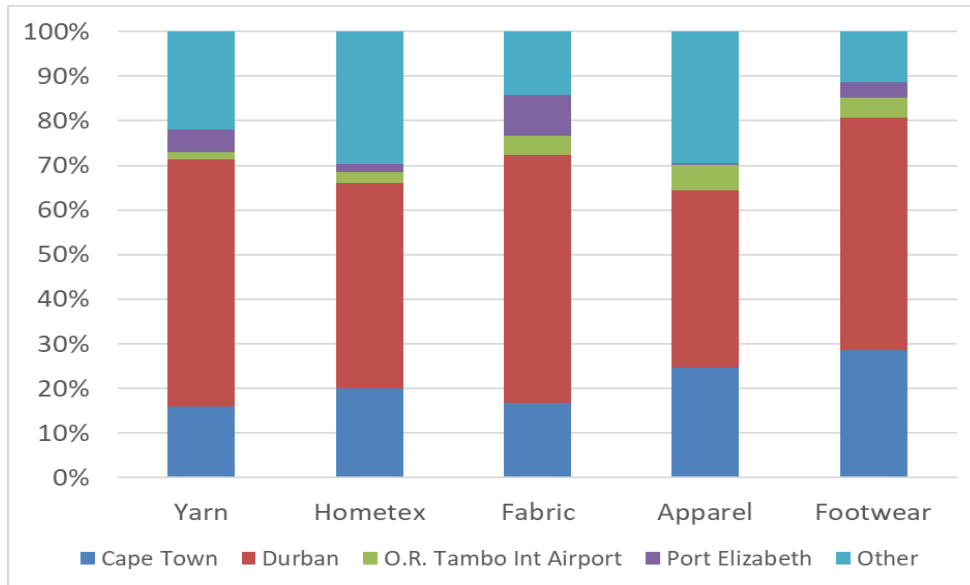
Indonesia is a country comprising multiple islands, and that it shares land borders only with Timor leste, Papua New Guinea and one of the islands of Malaysia. This means that most trade takes place

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<sup>15</sup> ICTSD (2010)

through maritime ports or international airports and customs clearance tends to occur at the port of entry. In response to concerns raised about the potential impact of the port restriction on customs efficiency, the masterplan team undertook an analysis of SARS trade data for CTFL products, for 2018. Figure 7 shows that the majority of CTFL imports are cleared in the Durban port, with the four recommended ports of clearance accounting for 77% of total CTFL imports in 2018. The restricted ports of clearance recommendations are therefore very unlikely to lead to significant delays in CTFL customs clearances.

**Figure 7: CTFL imports by customs value per customs clearing office, SARS, 2018**



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