

CHAPTER 12

NATIONAL INDUSTRIAL PARTICIPATION (NIP) & DEFENCE INDUSTRIAL PARTICIPATION (DIP)

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CHAPTER 12

NATIONAL INDUSTRIAL PARTICIPATION (NIP) & DEFENCE INDUSTRIAL PARTICIPATION (DIP)

12.1 THE PUBLIC PHASE OF THE INVESTIGATION

12.1.1 The role of the Department of Trade and Industry

12.1.1.1 There was testimony during the public phase of the investigation that DTI was tasked with attending to the Industrial Participation Programmes connected to the acquisition of the SDP.

12.1.1.2 The NIP Programme was adopted by Cabinet in 1997. It applies to all public sector procurements where the imported content exceeds 10 million US dollars. It fulfils two roles. The first is as an effective investment and export promotion device that assists in job creation; the second is in the assessment of economic risk. The mission of the programme is to leverage large economic benefits and to support the South African industry by effectively utilising the instrument of government procurement. Industrial Participation projects must be economically and operationally sustainable, even after the discharge period.

12.1.1.3 DTI has been substantially restructured and more resources have been provided to enable the department to regulate and monitor projects such as Industrial Participation. An agreement has also been signed between the governments of South Africa and the United Kingdom in terms of which they would work together to ensure the successful implementation of the Industrial Participation projects. An experienced official of the United Kingdom has already been seconded to DTI to assist in this process.

12.2 THE FORENSIC INVESTIGATION BY THE AUDITOR-GENERAL

12.2.1 Background

12.2.1.1 The Minister of Trade and Industry stated that the decision to procure was the prime decision. However, Industrial Participation in the form of countertrade forms a significant element of the SDP acquisition announced by Cabinet and contracted for on 3 December 1999. According to the Minister, the acquisition was subject to the constraint of affordability and not the industrial participation component of the deal. NIP refers to the National Industrial Participation programme, which is administered by DTI. DIP refers to Defence Industrial Participation, which is administered by Armscor. Direct DIP (DDIP) refers to DIP activities which are directly related to the equipment being acquired through the SDP. Industrial Participation (IP) refers to the combined NIP and DIP elements of the SDP.

12.2.1.2 Uncertainty exists in respect of the adequacy of performance guarantees committed to by the relevant suppliers of the SDP as identified by the various forums listed below:

- (a) The Special Review by the Auditor-General of the selection process of SDP for the acquisition of armaments at DoD, dated 15 September 2000.

Paragraph 3.3 of the Special Review addressing the adequacy of performance guarantees: NIP stipulated: *"All bidders with whom contracts have been finalised had to sign performance guarantees regarding the NIP obligations. The guarantees were on average approximately 10% of the contract price. I am of the opinion that the guarantees, in case of non-performance may be inadequate to ensure the delivery of the NIP obligations. This could undermine one of the major objectives of the strategic defence packages which was the counter-trade element of the armament package deal."*

- (b) The Fourteenth Report of the Standing Committee on Public Accountants (SCOPA) dated 30 October 2000.

Paragraph 3 entitled: "*Offset arrangements - Defence Industrial Participation Programme (DIP) and National Industrial Participation Programme (NIP)*" It was, *inter alia*, stated that concern was expressed by the committee at the Government's announcement of the R104 billion offset. The issue raised by the Auditor-General in this regard was of concern to the committee. The NIP contractual arrangements appear to allow a supplier, once he has supplied the arms and received payment therefor, to pay over a relatively modest sum of money and be unconditionally excused from all offset obligations. Notwithstanding the Departments of Defence and Trade and Industry believing that this is unlikely, the committee remains concerned.

- (c) Summary of background information on the SDP (issued on behalf of the Government of South Africa by the Ministers of Defence, Finance, Public Enterprise and Trade and Industry) dated 15 January 2001.

In terms of the said summary by the Ministers it was, *inter alia*, stated, that: "*Firstly, these guarantees are in line with the National Industrial Participation Programme adopted by the Cabinet in 1997 and best international practice; and if the matter is studied more carefully the deterrent losses that will be suffered by the prime contractors if the total obligations are not met are considerable*".

12.2.2 Scope of the forensic investigation

12.2.2.1 The mandate was to determine whether the statement by the Ministers, namely that:

- (a) The performance guarantees were in line with the NIP Policy.
- (b) The performance guarantees were in line with best international practice.
- (c) The terms of the contracts addressed the issue that the deterrent losses that would be suffered by the prime contractors if the total obligations were not met would be considerable.

12.2.2.2 Consequently, the following investigation procedures had to be performed:

- (a) Ascertain what the trends are in international norms for NIP guarantees.
- (b) Determine what the Industrial Participation policy was.
- (c) Review the progressive realisation of NIP and DIP by conducting a high-level overview of what was promised for NIP and DIP.
- (d) Ascertaining controls in place to ensure that NIP and DIP offers are actually realised.

12.2.3 Scope limitation

12.2.3.1 The final composition of the industrial participation commitment was made up of approximately 86% NIPs and 14% DIPs.

12.2.3.2 The view was therefore held that the major focus area of the forensic investigation had to be on the activities pertaining to NIP and the controls implemented by the Department of Trade and Industry in relation thereto. Access to personnel and records pertaining to events subsequent to

3 December 1999 (being the date of signing of the contracts) was, however, granted to the investigation team for a limited purpose.

12.2.3.3 Reasons furnished by DTI for not granting unlimited access were that:

- (a) They were of the view that the scope of the investigation did not extend beyond 3 December 1999.
- (b) Confidentiality agreements concluded with prime contractors prevented disclosures in this regard.

12.2.3.4 Consequently, this chapter only addresses information relevant to DIP as ascertained from information made available by Armscor and the information pertaining to NIP that was obtained from the limited documentation made available in this regard.

12.2.4 Investigation conducted

12.2.4.1 The following procedures were performed:

- (a) An understanding of the guarantee provisions contained in the IP programme applicable to South Africa was obtained.
- (b) A comparison was made between the industrial participation obligations and performance guarantees that had been committed to in terms of the contracts and the requirements of the IP programme.
- (c) A comparison was made between the industrial participation commitment contracted for in each programme and the contract price in the agreement.

12.2.5 Cabinet approved policy

12.2.5.1 The performance guarantees contained in the IP Programme adopted by Cabinet in 1997 were:

(a) NIP

For any single contract exceeding US\$10 million, or multiple contracts of US\$3 million over two years, exceeding US\$10 million in total, the obligation required in terms of industrial participation was required to be equal to or exceed 30% of the imported content. The performance guarantee required was 5% of the NIP obligation.

(b) DIP

For contracts exceeding US\$10 million an obligation required in terms of DIP to be equal to or exceed 50% of the contract price. The performance guarantee required was 5% of the unfulfilled portion of the commitment.

12.2.6 The industrial participation requirements of the SDP

The request for proposals pertaining to the SDP required a combined obligation of at least 100% of the contract price for industrial participation, and an acceptable performance guarantee.

12.2.7 Obligations contracted for in SDP

12.2.7.1 The following table illustrates the percentage of the industrial participation obligation contracted for in relation to the contract price as stipulated in the agreement:

Programme	Value of IP obligation ZAR* million	Contract price ZAR million	Approx % of obligation to contract %
Corvettes	20 267	5 473	370
Submarines	19 680	4 289	459
LUH	6 137	1 532	400
LIFTS and ALFAs	55 606	13 680	407

* Converted at an exchange rate of 1US\$ = R6.40; Euro 1 = R6,50 as stipulated in the contract.

12.2.7.2 *The Industrial Participation obligations that were contracted for as compared to IP Policy*

- (a) The contracts were concluded in US\$ and in Euro. The following conversion rates, as stipulated in the contracts were used to convert to Rand: US\$1 = R6.40, EURO 1 = R6.50.
- (b) As illustrated in the table above, the combined industrial participation for both NIP and DIP contracted for in each programme was in excess of the 100% of contract price as required by the SDP request for proposal, as well as the 30% and 50% of the contract price required by the NIP and DIP policies respectively.

12.2.7.3 *Performance guarantees contracted for*

- (a) Cabinet approved policy stipulates a performance guarantee of 5% of the industrial participation obligation. In the SDP acquisition the performance guarantees that were contracted for were calculated as a percentage of the contract price. During a consultation with the Armscor DIP Division Manager, the reason furnished for this was that, in all the programmes, the amounts offered by bidders and contracted for in terms of the industrial participation obligation were well in excess of the 100% minimum requirement. The calculation of the performance guarantee on

the increased obligation would unduly prejudice, and could possibly discourage, the increased industrial participation offered.

- (b) The following table illustrates the performance guarantees relevant to the obligations contracted for:

Programme	Guarantee as % of contract price
Corvettes	10% of foreign content
Submarines	10% of contract price
LUH	10% of contract price
LIFTS and ALFAs	10% of contract price

12.2.8 Best international practice

12.2.8.1 Various publications including, inter alia, the following have been studied to conduct research:

- (a) The Australian Countertrade Association.
- (b) Access Business Online.
- (c) UK Ministry of Defence Website.
- (d) National Commission on Use of Offsets in Defense Trade – US.
- (e) Offset Program Department, Ministry of Finance; Kuwait.
- (f) Finland’s New Offset Guidelines – industrial participation expected from foreign sellers.

12.2.8.2 Detailed procedures performed in respect of best international practice were as follows:

- (a) An understanding of prevailing best international practice with regard to industrial participation obligations, performance guarantees and penalties was obtained.

- (b) A summary of information with regard to the industrial participation obligations, performance guarantees and penalties was compiled from the contracts.
- (c) A comparison was made between international standards and the SDP industrial participation obligations, performance guarantees and penalties as contracted for.
- (d) Research was conducted on countertrade from the following sources:
- Internet
 - Libraries
 - Various magazines on countertrade
- (e) Consultations were held with identified experts in DIP. (The information on NIP was limited due to the scope limitation on the investigation with regard to access to information at the DTI).

12.2.8.3 The following table summarises relevant results of research conducted into trends in international practice on countertrade:

Country	Area of application	IP Obligation	Value threshold	Discharge period	Penalty*
Philippines	All government purchases	50% of contract value	US\$1 million	5 to 10 years	5% to 100%
Saudi Arabia	All government purchases	35% of contract value	All purchases	10 years	Blacklist
UAE	Defence purchases	60% of contract value	All purchases	7 years	8,5%
South Korea	All government purchases	50% of contract	US\$1 million	Purchase contract period	10%
Canada	All government purchases	30% of contract price	C\$2 million	Purchase contract period	2,5% to 12%
Greece	Defence purchases	60% of contract value	All purchases	Purchase contract period	10%
Australia	All government purchases	30% of contract value	US\$2,5 million	Purchase contract period	Blacklist
Kuwait	All government purchases	30% of contract value	US\$1 million	8 years	6%

Country	Area of application	IP Obligation	Value threshold	Discharge period	Penalty*
Thailand	All government purchases	50% of contract value	US\$5 million	Purchase contract period	5%
Taiwan	All government purchases	30% of contract value	US\$5 million	10 years	None
Netherlands	Defence purchases	100% of contract value	US\$3 million	Maximum 10 years	5%
Sweden	Defence purchases	50%-100% of contract value	All purchases	Purchase contract period	Negotiated
Denmark	Defence purchases	100% of contract value	US\$15 million	Purchase contract period	Blacklist
South Africa	All government purchases	30% of imported content – NIP	US\$10 million	7 years	5%
	SDP	100% of contract price	All contracts	7 – 9 years	10 % of contract price

* Based on IP obligation

12.2.8.4 With reference to the above research conducted, the following observations were made:

The area of application differs from country to country. South Africa's policy of requiring IP in respect of government imports can be compared to countries such as Thailand, Kuwait, Philippines, Saudi Arabia, South Korea, Canada, Australia and Taiwan, which also require industrial participation for government purchases.

12.2.8.5 South Africa's policy regarding obligations of the contract value are as follows:

- Obligation of 30% in respect of imported content for national industrial participation (NIP).
- Obligation of 50 % in respect of defence industrial participation (DIP).

12.2.8.6 These percentages compare favourably with percentages required by other countries. However, the percentages obtained for the SDP substantially exceeded the above requirements. Approximately 400% of the contract price was committed for NIP and DIP.

- 12.2.8.7 The norm in international markets covers anything from 20% to 100% obligation of the contract value. Few countries actually require 100% obligation. These include countries such as Sweden (50% up to 100%), Norway, Finland, Denmark and the Netherlands (80% -100%).
- 12.2.8.8 The majority of countries only require 30% obligations, e.g. New Zealand, Kuwait, Canada, Australia & Taiwan.
- 12.2.8.9 South Africa requires industrial participation for purchases exceeding US\$10 million. This compares favourably with Sweden, Finland, and Denmark. However, it appears that the threshold for most countries is approximately US\$1 – US\$5 million.
- 12.2.8.10 South Africa usually reserves the right to impose a 5% penalty on the unfulfilled portion of the obligation. This appears to be the norm in international markets. Few countries require more than 5%, e.g. UAE (8,5%), Norway (10%), Kuwait (6%), Belgium (10%), South Korea (10%), Philippines (5% - 100%). Certain countries do not impose any penalties but have the option to blacklist the companies, e.g. Saudi Arabia, Australia and Denmark.
- 12.2.8.11 In the South African context the format of the performance guarantee was, for example, bank guarantees equivalent to the penalty, furnished by the prime contractors. Sufficient information could not be obtained to draw any conclusion on this aspect for other countries.
- 12.2.8.12 Based on the research conducted, it would appear that the obligations contracted for by the prime contractors in terms of the SDP as well as the performance guarantees in relation thereto, compare favourably with other countries that exercise countertrade practices.

12.2.9 Controls to deter non-fulfilment of obligations

12.2.9.1 Detailed investigation procedures performed in respect of deterrence of losses and progressive realisation of obligations were as follows:

- (a) Control mechanisms built into the contracts were analysed.
- (b) The penalties that would be suffered for non-fulfilment of obligations were determined.
- (c) The deterrent losses if total obligations are not met were evaluated.
- (d) A summary of the performance guarantees as stipulated in the contracts was compiled.
- (e) The bank guarantees provided by the suppliers in respect of the performance guarantees held for both the NIP and DIP obligations, were inspected at the Armscor Finance Division and compared to the contracts.
- (f) The systems used for the management of DIP were recorded by means of:
 - Completion of internal control questionnaires.
 - Conducting of walk through tests.
 - Meetings/enquiries from senior DIP staff.
- (g) The documentation for a DIP claim was inspected and the process verified for approval of these claims by:
 - Observing a meeting between contractors and subcontractors.

- Observing a DIP Committee (DIPCom) meeting.
 - Perusal of minutes of the DIPCom meetings.
 - Attendance at a field visit to a subcontractor.
- (h) The capacity of the DIP department for handling the SDP portfolio was evaluated with reference to:
- Resources of the department.
 - Skills of the team.
 - Competency of the team.
 - Experience of the team.
- (i) Other factors that could contribute to the controls in place or prevent non-adherence to the fulfilment of the DIP obligations by contractors were considered. These included, *inter alia*:
- Inquiry into failure and successes of any DIP programmes in the past.
 - Inquiry into future plans for the management of the SDP portfolio.
 - Inquiry into the history of any performance guarantees being withheld.
 - Inquiry into other possible factors which could influence the non adherence to the fulfilment of the DIP obligations, for example, the reputation of contractors, the method of dealing with default/non-performance and corrective measures/ incentives to discourage non-fulfilment of obligations.

- (j) Conducted a high-level overview of what controls were in place to ensure that NIP and DIP promised were actually realised.

12.2.9.2 A summary of the milestones contracted for with respect to the progressive realisation of the NIP and DIP was compiled. These milestones relate to the relevant discharge period of each programme and are significant for the following reasons:

- (a) Performance guarantees are furnished by all the prime contractors. They are approximately 10% of the contract price.
- (b) These guarantees (both DIP and NIP) are held in the form of bank guarantees, which are in the custody of the Finance Department of Armscor.
- (c) The projects are formally evaluated during each milestone period as specified in the contracts.
- (d) Upon attainment of the relevant milestones, after certain processes have been followed, the bank guarantees held for performance are reduced proportionately.

12.2.9.3 At the date of compiling this report most projects were approximately one year old and all the DIP programmes were on target in relation to the second milestone. Some contractors had exceeded their milestone targets.

12.2.9.4 The contracts were reviewed to determine the consequences for prime contractors of not meeting their obligations in terms of provisions contained in the contracts. The following table highlights the relevant provision in this regard:

Programme	Performance guarantee	Breach remedy period	Reduction of guarantee on achievement of milestones	Obligation fulfilled on payment of penalty
Corvettes platforms	7,5% Contract price	90 days	Yes	D DIP No Other Yes
Corvette combat suite	10% foreign content of contract price	60 days	Yes	D DIP No Other Yes
Submarines	10% Contract price	60 days	Yes	No
LIFTS	10% Contract price	60 days	Yes	Yes
ALFA	10 % Contract price	60 days	Yes	Yes
LUH	10 % Contract price	60 days	Yes	D DIP No

12.2.9.5 The following observations with regard to contractual provisions as identified in the table above have been noted:

- (a) The guarantees held are reduced proportionately upon attainment of the predetermined milestones. Upon breach of the contract, however, the contractor is given notice in writing to rectify the situation in either sixty or ninety days as specified within the relevant contract. Alternatively, a claim can be made against the performance guarantee held in the proportion that the unfulfilled portion of DIP activities bears to the total price of obligations.
- (b) Payment of damages will not release the prime contractor from the obligation to perform the relevant activities on certain elements of the following contracts:
 - Corvettes, Direct DIP.
 - Light Utility Helicopters (LUH) Direct DIP.
 - Submarines.

- (c) However, for the other programmes, as indicated in the table above, claiming the penalty is deemed to be fulfilment by the prime contractor and therefore it discharges the contractor from the milestone obligation.
- (d) It was noted that regarding industrial participation obligations, the prime contractors could, upon payment of the penalty, be discharged from fulfilment of outstanding obligations as is permitted by the contractual provisions.
- (e) With regard to the review of other contractual control measures pertaining to the progressive realisation of NIP and DIP, the following observations have been made:
- Claims submitted by contractors are deemed to be approved if no correspondence to the contrary has been received within three months of having submitted the claim. There is the risk of contractors being entitled to credits merely through the passage of time, without the necessary verification processes having been followed by the DIP Division. This could be further exacerbated if insufficient resources are available within the division to verify the claim adequately.
 - The credits towards the discharge of the NIP and DIP obligations can be claimed on presentation of signed contracts with local suppliers. There is therefore a risk that activities relating to the attainment of milestones might be recognised prior to the actual commencement of work. There could therefore be a possibility of milestones claimed being overstated, with a resultant reduction of performance guarantees held merely upon the signing of contracts. Given the fact that the claims are approved and authorised for reduction of

performance guarantees on achievement of six-monthly milestones, the minimum period that a credit may be claimed without evidence of the work being done is therefore six months.

- The credits towards the discharge of the NIP and DIP obligations can be claimed on presentation of invoices from local suppliers. It is submitted that this should be the preferred option for all the programmes and will facilitate a fairer reflection of the milestones achieved. It would also reduce negative cashflow implications and is less susceptible to potential manipulation where credits are allowed on presentation of contracts.
- In the event of there being a breach of the contract solely due to a local supplier defaulting, the prime contractor retains the credits and is deemed to have fulfilled its NIP and DIP obligations.

12.2.9.6 All the contracts have a clause relating to independent audits conducted on NIP and DIP claims, except for the NIP on the LUH. However, the audits are not mandatory, but are discretionary in that the respective NIP and DIP divisions *"have the right to effect audits"*. In most programmes, the party responsible for audit costs is determined by the extent of the discrepancy identified by the audit. If the discrepancy is less than 5% of the claim, the NIP or DIP division bears the cost. If the discrepancy exceeds 5% then the seller bears the cost of the audit. The degree of discretion allowed in the execution of audits and the corresponding responsibility for the costs thereof could create the opportunity for manipulation by, for example, neglecting to call for an audit to avoid the responsibility for the cost of the audit. It is submitted that a better control measure would be for example, the requirement of mandatory audits in respect of claims having a value in excess of a prescribed materiality threshold.

12.2.9.7 A review of the internal and accounting controls within the DIP Division of Armscor was conducted through consultations with relevant employees, system walk-through tests and inspection of documentation. Tests conducted with reference to the documentation and procedures outlined above indicated that the system was found to be operating as described.

12.2.10 Review of capacity within Armscor's DIP Division

12.2.10.1 Consultations with Armscor personnel indicated that no increased staffing requirements were identified as a result of the SDP acquisition.

12.2.10.2 The establishment of the DIP Division comprises one senior manager, two managers and three administration staff. During the investigation the post of senior manager, which was previously vacant as a result of the resignation of Mr J van Dyk, was filled.

12.2.10.3 The total DIP obligation in terms of the SDP is approximately R14 billion. These obligations are to be fulfilled over a period of 108 months. At the date of the investigation, most of the programmes were in their first year of implementation. Controls exercised over the monitoring of project progress by the existing staff complement of Armscor appear to be well managed at this stage of the process.

12.2.10.4 However, additional resources may have to be considered as the projects increase over time.

12.2.10.5 The composition of the DIP Division of Armscor, at the date of the investigation, comprised of well skilled and adequately equipped staff.

12.2.10.6 During the investigation nothing came to the attention of the investigation team to suggest that the division is not competent in the execution of their tasks. Project progress and monitoring thereof were well documented.

12.2.11 Other factors that were considered which could impact on the successful outcome of IP obligations.

12.2.11.1 There has not been any significant failure of DIP programmes in the past.

12.2.11.2 To date, no performance guarantees have been withheld for non-fulfilment of DIP obligations.

12.2.11.3 According to the DIP manager the strongest deterrent against non-fulfilment of obligations was that the reputation of the contractors was at stake. All the prime contractors in the SDP were of high standing in the arms industry. The possibility of having reputations impaired and the consequent loss of future contracts could have far-reaching implications. Some countries, e.g. Saudi Arabia are known to "*blacklist*" defaulting contractors. This apparently could preclude the contractor from all future business.

12.2.11.4 The DIP manager informed the investigators that every effort is made to encourage the contractors to fulfil their obligations. These include, *inter alia*:

- (a) Encouraging dialogue between the prime contractors and the local suppliers to keep projects on track.
- (b) Facilitating/arbitrating in disputes between the contractors and the local suppliers.

- (c) Encouraging the contractors to continue with the nominated local suppliers unless this is no longer feasible.
- (d) Enquiring whether the contractor is being unreasonable or unrealistic in demands on local suppliers.
- (e) Conducting site visits to local suppliers.
- (f) Maintaining offices/sites abroad to inspect progress of prime product and, where relevant, adherence to DIP obligations.

12.2.12 High-level overview of what was offered for NIP and DIP

- (a) Detailed procedures performed in respect of what was offered for NIP and DIP were as follows:
 - (i) Analysed all the final contracts concluded with prime contractors.
 - (ii) Summarised the NIP and DIP terms from the contracts.
 - (iii) Drew a comparison between the NIP and DIP that were contracted for and that promised in the bids by the relevant contractors.
 - (iv) Analysed the presentations made to Cabinet in November 1998, with regard to the preferred bidder, and compared this to what was offered in the bids.
- (b) A review of the total NIP and DIP contracted for, compared to the values offered by preferred bidders presented to the Cabinet in November 1998, is illustrated in the following table:

Programme	IP value presented to Cabinet Rm	Contracted IP Value R	Difference Rm	Comment
Corvettes	16 007	20 267	4 260	Favourable variance
Submarines	30 274	19 780	-10 494	Unfavourable variance
LUH	4 685	6 137	1 452	Favourable variance
LIFTS / ALFAS	56 893	55 606	-1 287	Unfavourable variance
Total	107 859	101 790	- 6 069	Unfavourable variance

- (c) Due to reductions in quantities contracted for compared to quantities offered, as well as tranching options with regard to the LIFT and ALFA programmes, meaningful comparison between offers received and what was contracted for from a high-level perspective could not be achieved.
- (d) However, in total, there does not appear to be a material difference between the value of R108 billion presented to Cabinet and the value of R102 billion finally contracted for. The differences highlighted above are addressed under the separate programme reports.

12.3 FINDINGS

12.3.1 Industrial Participation obligations committed to by suppliers and contracted for, were in excess of the minimum requirements of both the National Industrial Participation programme approved by Cabinet and the 100% of contract price as stipulated in the RFP.

12.3.2 The performance guarantees, although based on contract price as opposed to the value of Industrial Participation obligations, were found to be reasonable in view of the higher value of the obligations and because the obligations were in excess of the IP policy requirements approved by Cabinet. This allays the concern raised in the Special Review by the A-G as well as the 14th report of SCOPA.

- 12.3.3 South Africa requires Industrial Participation for purchases exceeding US\$10 million. The threshold for most countries is approximately US\$1 – US\$5 million.
- 12.3.4 South Africa reserves the right to impose a 5% penalty on the unfulfilled portion of the Industrial Participation obligation. This appears to be the norm in international markets.
- 12.3.5 In the South African context the format of the performance guarantee was, for example, bank guarantees equivalent to the penalty, furnished by the prime contractors.
- 12.3.6 Based on the research conducted, it would appear that the Industrial Participation obligations contracted for by the prime contractors in terms of the SDP as well as the performance guarantees in relation thereto, compare favourably with the position in other countries that exercise countertrade practices.
- 12.3.7 It was noted that in some instances regarding Industrial Participation obligations, the prime contractors could, upon payment of the penalty, be discharged from fulfilment of outstanding obligations as is permitted by the contractual provisions.
- 12.3.8 Although the findings support the statement made by the Minister of Trade and Industry pertaining to the guarantees being in line with best international trends, as well as with the NIP policy, it appears that intended controls contained within contracts were potentially deficient and may therefore, in certain instances, not be sufficient to deter prime contractors from fully meeting their obligations.

12.4 RECOMMENDATIONS

It is recommended that DTI and DoD obtain legal opinion pertaining to the controls in respect of the effective implementation of the NIP and DIP programmes respectively, to ensure that prime contractors fully meet their obligations, as contained in the relevant agreements.