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## **Briefing note: Industrial policy and the locomotive procurement – Corruption undermines industrial development**

The procurement by Transnet of 1 064 locomotives was hailed as a boon for industrial policy. Transnet consolidated several years of procurement and sent the market signal that there was sufficient demand in South Africa for a major investment by locomotive producers and their suppliers. It also promised to stimulate local manufacturing firms to become suppliers into this global industry and support an export base in these products.

The firms bidding for the locomotive procurement were required to commit to localising their production, investing in local firms and building a competitive local supplier base.

Four firms were awarded the contracts, including China South Rail and China North Rail, which subsequently merged. Yet, research commissioned from the Centre for Competition, Regulation and Economic Development (CCRED) by TIPS under the Industrial Policy Research Programme<sup>1</sup> showed that China South Rail undertook virtually no localisation of production.

The recent leak of emails showing that the Transnet procurement process was hi-jacked helps explain this situation. They reveal that China South Rail paid a staggering 20% of the R50 million paid for each locomotive – some R10 million apiece - in “fees” to an intermediary company that facilitated its bid.<sup>2</sup> In total, it paid over R5 billion for the 500+ locomotives that Transnet will be buying from China South Rail.

TIPS research found that, to date, not one of the China South Rail locomotives has been assembled in South Africa; all have been manufactured in China. It appears that Transnet gave China South Rail “exemptions” on the number of locomotives that needed to be produced in South Africa, even though the procurement programme aimed explicitly to simulate local industry and industrial development.

The findings are verified in scrutinising the import bill for locomotives, which has grown significantly. The imports were less than \$50 million per year through 2013, but then climbed to US\$100 million in 2014 and US\$550 million in 2015.<sup>3</sup> The remaining suppliers to Transnet under this procurement process have lived up to their obligations; they have invested, developed suppliers and are exporting components to the region and

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<sup>1</sup> A recent presentation at a TIPS Development Dialogue is available on the TIPS Website [www.tips.org.za](http://www.tips.org.za) or [online here](#); the full report is Crompton R., Fessehaie, J., Luralyn Kaziboni L. and Tatenda Zengeni T. 2017. *Railway Locomotives and Transnet: A Case Study*. CCRED Working Paper 9/2017. CCRED. University of Johannesburg, available on [www.competition.org.za](http://www.competition.org.za).

<sup>2</sup> AmaBhungane. 2017. *#Guptaleaks: Guptas and Associates Score R5.3bn in Locomotives Kickbacks*. Downloaded from [www.amabhungane.co.za](http://www.amabhungane.co.za) in June 2017.

<sup>3</sup> Crompton R., et al. 2017. *Railway Locomotives and Transnet: A Case Study*. CCRED Working Paper 9/2017. CCRED. University of Johannesburg.

globally. Transnet Engineering has also built its own capabilities to produce locomotives, which is a positive signal.

With the slowing economy, the effects of high-level corruption can now be explicitly felt. Where government policies designed to stimulate industrialisation have been captured, the result is not only corruption and money-laundering, but also weaker foreign direct investment and slower industrialisation.

The state has few tools available to stimulate industrialisation, and the localisation of its procurement is one of its most important levers. Moral outrage aside, when corruption results in the importation of these items, it is a double blow to the economy – South Africa pays more for public investment and also loses the hoped-for stimulus to industry with the jobs and domestic manufacturing opportunities that would have been created.

As a minimum, the remaining locomotives that Transnet will get in 2018 must be locally manufactured, and the cost of each locomotive must be reviewed to ensure they do not incorporate corrupt payments.