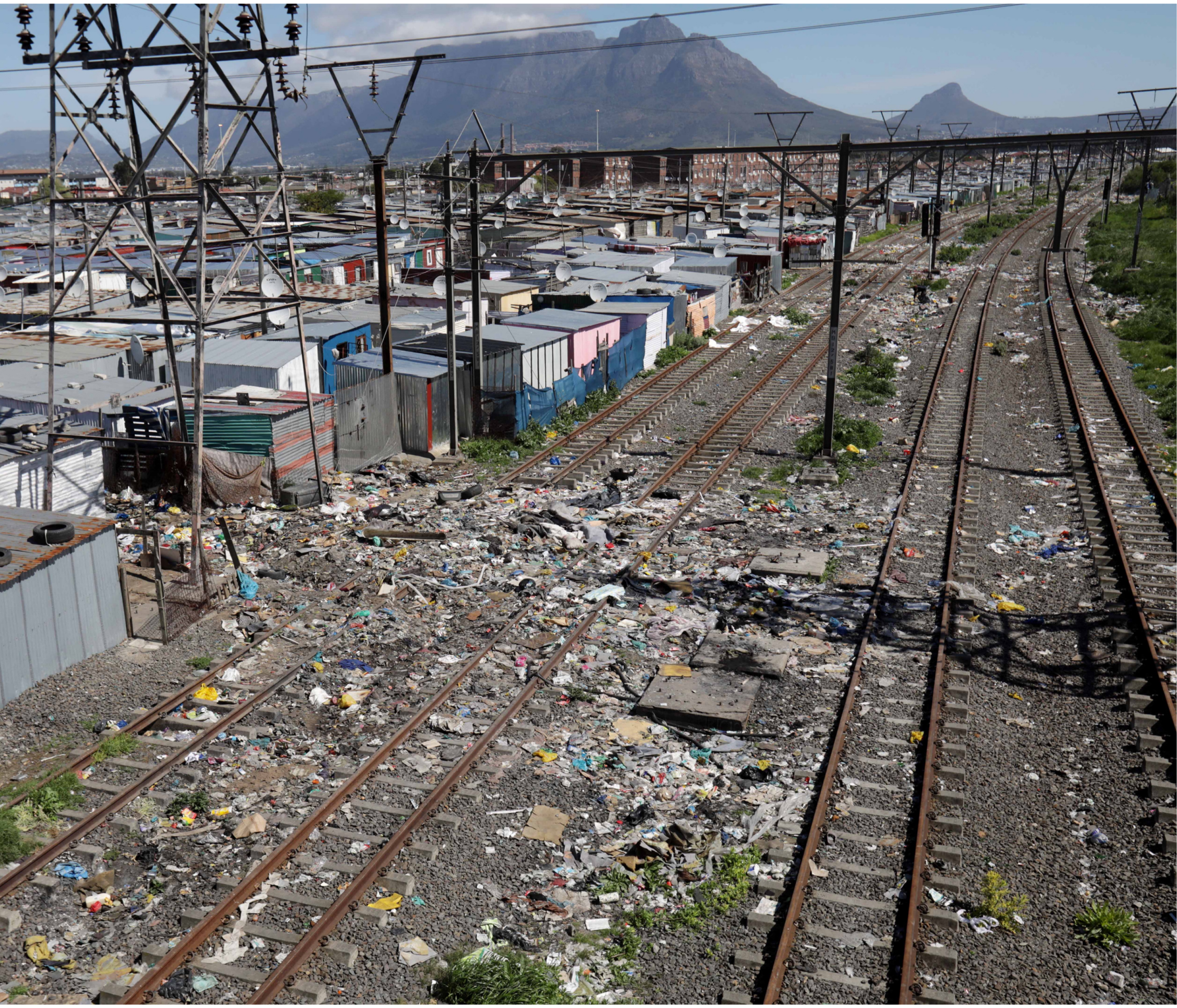
Accelerating South Africa's Infrastructure Programme

What is holding us back?



THE GROWTH AGENDA
Priorities for mass employment and inclusion

CDE

About CDE

The Centre for Development and Enterprise (CDE), an independent policy research and advocacy organisation, is South Africa's leading development think tank. Since its establishment in 1995, CDE has been consulting widely, gathering evidence and generating innovative policy recommendations on issues critical to economic growth and democratic consolidation. By examining South African and international experience, CDE formulates practical policy proposals outlining ways in which South Africa can tackle major social and economic challenges. CDE has a special focus on the role of business and markets in development.

CDE disseminates its research and proposals to a national audience of policy-makers, opinion formers and the wider public through printed and digital publications, which receive wide media coverage. Our track record of successful engagement enables CDE to bring together experts and stakeholders to debate the policy implications of research findings.

Series Editor: Ann Bernstein

This report is based on a workshop conceived and then chaired by Ann Bernstein with help from a number of advisors in government and the private sector, which took place on 14 October 2021. The report was written by Dr Stefan Schirmer, CDE's Research Director, with assistance from Sibongile Nkomana and Rehan Visser.

Photo credit: Railway lines outside Cape Town, South Africa, 2020. Picture taken by Esa Alexander, Sunday Times

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Introduction

On 14 October 2021, CDE convened a workshop with leading people from the financial sector and senior government officials responsible for the state's infrastructure drive (see list of participants). The government is committed to an infrastructure-led strategy to rejuvenate the South African economy. It is a key pillar of the President's October 2020 Economic Reconstruction and Recovery Plan (ERRP), with talk of investments in water, energy, sanitation, housing, roads, health, education, and public transport. Given South Africa's fiscal situation, the government cannot afford large outlays on infrastructure and needs private sector investment to get this vision off the ground. There have been moves to include the private sector in the financing of specific assets, but progress has been inordinately slow.

The core goal of the workshop was to identify the blockages holding back the infrastructure programme and to pinpoint the changes required to accelerate progress.

Opening the workshop, CDE's executive director **Ann Bernstein** said: "We have to be concerned about the capacity of the state to finance infrastructure, to manage the infrastructure programme, and to create an environment in which businesses and competitive markets can thrive and expand. In this reality, how can we reorient the state in the interests of national development?

"There is an enormous focus on projects involving the state, but we should also bear in mind that considerable infrastructure could be built by the private sector if policy changes were made. We have seen a very positive move with the gazetting of an amended schedule 2 of the Electricity Regulation Act, which allows private entities to generate up to 100MW of electricity without a generation licence. There are many other reforms that could build on this momentum, from establishing a trading platform for electricity, to expediting water-use licensing processes and finalising the Mineral and Petroleum Resources Development Act (MPRDA) and Mining Charter, as well as other reforms to dramatically improve the environment for mining investment. We also need to involve third parties in fixing and expanding rail infrastructure, a decision on e-tolls in Gauteng, and to get rid of the uncertainties created around property rights throughout the country, especially in the agricultural sector.

> **"Not one new significant government-led infrastructure project has broken ground since Cyril Ramaphosa took over as head of government."**
>
> Richard Wainwright

"Taking these steps could lead to a sea change in the desire of businesses to invest in our country, including in crucial aspects of our infrastructure but reform has to be implemented speedily and effectively.

"At the same time, the private sector remains willing and able to participate in well-designed, state-led infrastructure projects, but there are no projects coming to market."

In this short report, we summarise what the various workshop attendees said about the realities facing the implementation of an infrastructure programme in South Africa. We highlight some of the core issues that emerged from the conversation, and we outline what, in CDE's view, needs to be done to turn all the talk and goodwill about an infrastructure-led recovery into the kind of action that will contribute to generating accelerated economic growth.

What did the private sector say?

> **"There is an enormous focus on projects involving the state, but considerable infrastructure could be built by the private sector if policy changes were made."**
>
> Ann Bernstein

Most of the speakers representing the private sector, especially the banks and investment funds, pushed similar themes, which they saw as crucial to get the infrastructure programme off the ground. They focused on resolving the issues that would make it possible for the private sector to invest and called for the prioritisation of a few big projects as catalysts for growth, rather than tackling a plethora of issues all at once.

Richard Wainwright, Chief Executive Officer of Investec Bank Limited and Chairman of the Banking Association of South Africa (BASA), noted that for many years before the Covid-19 pandemic, South Africa's growth rate was too low to accommodate the aspirations of the country's people, leading to discontent, unrest, and fractious politics. This in turn undermined investor confidence, making economic growth increasingly unlikely. A well-designed infrastructure programme could help start to raise business confidence to the levels required to kickstart economic growth. "Such a process could at least move us forward, towards the 4-5 percent growth levels we need," he said.

In his opinion, the best way to make this happen, "is to get one or two big projects off the ground. If we get the ball rolling, the confidence we generate will be significant".

Wainwright pointed to numerous positive signs. He said that communication between the private and public sectors has improved substantially. He was also very positive about the gazetting of the amended schedule 2 of the Electricity Regulation Act. According to him, despite some constraints around the transmission grid, projects worth billions of rands are in the planning phase. There was concern amongst financiers that this concession would be followed up with restrictive regulations, but, after a series of consultations between business and the Minister of Public Enterprises, Pravin Gordhan, there appears to be broad-based support for the regulations that have been promulgated.

Along with many others, though, Wainwright was frustrated by the general lack of government action. According to him, "Not one new significant government-led infrastructure project has broken ground since Cyril Ramaphosa took over as head of government. This has led to investors, both local and international, questioning our credibility and capacity to set up fast-tracked priority projects." He warned that South Africa needed to appreciate that "without speedy action, investors will lose interest and move on".

In his view, the following issues need to be overcome to signal our intent to potential investors:

- Policy reform has not materialised with sufficient speed and scope.
- The legal and policy framework is fragmented, with overlapping institutional roles and poor accountability.
- On proposed infrastructure projects there needs to be a more pragmatic approach to the requirements for black economic empowerment (BEE), local economic development, and domestic job creation.
- In certain technologically advanced sectors requests for local content are impractical. Our economy has deindustrialised; the local capacity to manufacture many products simply does not exist. If we insist on it, it will make projects expensive and/or cause delays.

James Formby, Chief Executive Officer of Rand Merchant Bank, emphasised the serious lack of capacity within the state and pointed out that the skills within government are currently fragmented across government departments, with pockets of excellence in some departments. One way to address the situation, he suggested, was to "bring skilled people together into a centre of excellence, which can then attract like-minded people. We need to attract people who understand what is required and can then deliver." He also bemoaned the extent to which the infrastructure programme was becoming politicised. "If projects become political, they serve narrow agendas rather than focussing on broader outcomes that will benefit the nation as a whole." Formby agreed that the freeing up of 100MW for private entities was an important step forward. More could be achieved, he said, with further regulatory changes: "For example, you can only have a three-year maintenance contract, when some infrastructure projects require a longer timeframe."

Finally, he pointed out that there is ample capital for bankable projects, but that the key constraint is the shortage of feasible projects being proposed. To address this, he urged the state to do a few projects well, rather than pursue too many simultaneously.

Mike Peo, Head of Infrastructure, Energy and Telecommunications at Nedbank, argued that the broad, multi-pronged approach currently adopted is 'confusing the market': "No one in the investment community – institutional investors, the construction industry, project developers, equity financiers – has a sense of what the first projects will be, so that they can build capacity to participate." He added that, given the capacity constraints in the state, "there needs to be an incredible amount of deregulation to make the work of the Infrastructure Fund and Infrastructure SA much easier".

> **"What investors need are clearly defined projects, a feasible regulatory environment, and certainty."**
> Andrew Canter

Vuyo Ntoi, Managing Director at Old Mutual's African Infrastructure Investment Managers, agreed with Peo. He said that "there needs to be momentum and a credible plan so that we know when projects will come, and at what scale", while **Andrew Canter**, Chief Investment Officer of Futuregrowth Asset Management, said, "What investors need are clearly defined projects, a feasible regulatory environment, and certainty."

Marissa Moore, independent public finance consultant, emphasised the importance of transport infrastructure as key for supporting growth. She highlighted a crucial challenge with respect to e-tolls and the South African National Roads Agency (SANRAL). As she put it, "We require the political will to take people not paying tolls to court. If we do not, there are hundreds of billions of rands in investment that is not going to take place. We are also running into maintenance backlogs." The example of e-tolls acts as a strong disincentive for particular types of private sector involvement in infrastructure projects, since, if users cannot be relied on to pay for services, then the only other way investors can recoup their costs is from tax-payers through the fiscus.

To sum up, the message from private investors and experts was:

- The private sector is ready to invest in critical infrastructure projects that have a good chance of generating a return on their investment.
- Key policy reforms need to be made that will allow private sector investment to take place – quickly.
- The regulatory environment needs to be reformed to make it easier to undertake such projects and to ensure they are completed in a cost-effective manner.

- Extensive government demands about including local beneficiaries, local content rules and the pursuit of goals such as BEE that detract rather than enable the profitable conclusion of projects are blocking progress.
- A much more focussed approach to infrastructure projects that are bankable by the private sector is required. A few big and impactful projects need to be identified and implemented as quickly as possible

What did the government say?

Government speakers pointed to various complications and challenges. **Dr Kgosientsho Ramokgopa**, head of both ISA and the IIO in the Presidency (see box on page 5), said there were a lot of projects in the development phase, but none has yet reached the stage where shovels are 'in the ground'. He mentioned 272 projects that have been pitched. His unit is focussing on 76, of which 50 have been developed but are not yet ready to be implemented. According to Ramokgopa, finalising these projects will still take a long time because of at least five challenges that need to be overcome before the programmes could take off effectively:

- Misalignment between various levels of the state. He pointed out that "budget cycles and planning horizons are asymmetrical" and that national, provincial, and municipal governments rarely act in unison.
- Unwieldly regulation. This prevents public-private partnerships (PPPs) from materialising. Ramokgopa pointed out that "PPPs constitute only 2 percent of public sector infrastructure funding".
- Lack of skills, both technical and financial. These deficits hinder the formulation of well-designed projects that could be taken to market. "The private sector is better at packaging projects," he said.
- The 'construction mafia', as local people who go to construction sites and extort money from the contractors are known. This challenge can be combatted, he argued, by a policy that provides "a uniform, universal approach on how local communities can benefit from infrastructure projects". In an interview in the Sunday Times days after the workshop, Ramokgopa characterised the problem as follows: "Thugs arrive on site brandishing guns, saying they want 80 percent of the project and literally taking over the site." He said his office had long argued for a dedicated unit to deal with the construction mafia. "We have made that case and the President said it was a matter he was taking up with the Minister of Police."
- More broadly, he suggested that "infrastructure should not be looked at one-dimensionally"; instead, "we need to strive to ensure greater levels of inclusion, because ordinary people and non-state actors criticise government if they do not see the direct benefits to communities".

> **"We need to strive to ensure greater levels of inclusion, because ordinary people and non-state actors criticise government if they do not see the direct benefits to communities."**
>
> Dr Kgosientsho Ramokgopa

Kgathatso Tlhakudi, Director-General of Public Enterprises, criticised the view that "BEE, transformation, and social responsibility are not important, and should not affect delivery". This ignores the reality, he claimed, "that infrastructure projects are undertaken to solve social disparities". In Tlhakudi's view, "Bringing in those who have been on the outside for so long must be at the centre of the conceptualisation and development of these projects. Projects should not be about returns only; hence, regulation is going to be key."

The danger with this approach was highlighted by **Karen Breytenbach**, previously with the National Treasury's PPP unit, who spoke about her experiences with adding numerous poorly defined 'social inclusion goals' to state projects. These diluted the focus of projects, increased costs and prevented many projects from delivering the core outputs they were designed for. To change this, Breytenbach explained, the government "needs a better understanding of what we want to achieve, spell it out clearly, and then design the project to achieve that goal".

Who is responsible for the state's infrastructure programme? A complex situation

- The Investment and Infrastructure Office (IIO) was established by President Cyril Ramaphosa "to co-ordinate and align the work of various structures responsible for economic and social infrastructure development". Housed in the Presidency, the IIO is run by Dr Kgosientsho Ramokgopa.
- Infrastructure South Africa (ISA) is responsible for infrastructure policy thinking and monitoring development of the Strategic Infrastructure Projects (SIPs) under the guidance of 'de facto CEO' Dr Kgosientsho Ramokgopa. It wrote the draft National Infrastructure Plan 2050, published in August 2021, for the Department of Public Works and Infrastructure (DPWI).
- ISA will report to the Presidential Infrastructure Coordinating Council (PICC) on whether objectives are being met. The PICC was created by the National Infrastructure Development Act of 2014, which grants no formal powers to the council. The PICC can only "prioritise" and "steer" projects.
- The Infrastructure Fund is situated within the Development Bank of Southern Africa (DBSA). The fund's core objective is "to transform public infrastructure through bespoke blended financing solutions by sourcing and blending capital from the private sector, institutional investors, development finance institutions (DFIs), and multilateral development banks" and, "where appropriate", it will also "arrange, coordinate, structure, and engage with financial institutions and the market to develop financial instruments that will enable investments in the projects" it seeks to finance.
- The DBSA also housed the Infrastructure Investment Programme for South Africa (IIPSA), which was set up to support the development of both national and regional infrastructure projects, under the guidance of National Treasury and the Department of International Relations and Cooperation (DIRCO) . This programme shifted to the Treasury in 2021.
- The Municipal Infrastructure Grant (MIG) aims to eradicate municipal infrastructure backlogs in poor communities to ensure the provision of basic services such as water, sanitation, roads, and community lighting. The Department of Cooperative Government and Traditional Affairs (COGTA) is responsible for managing and transferring the MIG to other state entities. It also provides support to provinces and municipalities on implementing MIG projects. National government transfers more than R40 billion annually to municipalities to assist them with funding infrastructure investment.
- Other than the DPWI, DIRCO, and COGTA, departments with a focus on infrastructure include the Department of Public Enterprises, the Department of Transport, the Department of Water and Sanitation, the Department of Mineral Resources and Energy, and the National Treasury.

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Dorcas Kayo, Director of Infrastructure Finance at the National Treasury, explained that the Public Procurement Bill and the PPP framework were being reviewed to remove major impediments to bringing in private sector investors and providers into state-designed projects. She explained that the National Treasury is "undertaking intensive work to re-draft the legislation, to make sure there is alignment between the Bills and other existing laws".

To make these changes, the National Treasury must follow Constitutional requirements and processes, including having extensive consultations, which is slowing down progress on making these revisions. Although she was reluctant to offer firm timelines, Kayo said she hoped that the Treasury could implement the recommendation of the PPP review by the second quarter of 2022.

"[Of the] 272 projects that have been pitched... [our] unit is focusing on 76, of which 50 have been developed but are not yet ready to be implemented...This will take a long time..."
Dr Kgosientsho Ramokgopa

Catherine Koffman, Group Executive of Project Preparation at the DBSA, argued that it was difficult to know where the government should focus its attention, as its focus is broader than economic interests. Specifically, the government confronts competing socio-economic and development interests, which creates complex challenges.

To sum up, the message from government was:

- Some legislation relevant for private sector involvement in infrastructure projects is recognised as acting as a major blockage and must be changed. The state has begun this process, but it is long and cumbersome.
- There are capability challenges and a lack of coordination within the state that are preventing the development of clear project proposals, with which the private sector could effectively engage.
- The realities of South Africa demand that government programmes must have multiple goals, including community participation, transformation, localisation and local economic development.
- The government is answerable to a broad constituency. It is therefore difficult to prioritise a few realisable projects designed to have maximum economic impact.
- Crime is a threat to infrastructure projects. Improving 'community involvement' in projects is an important way to solve this challenge.

A global perspective

Ricardo Hausmann, Professor at Harvard University's John F. Kennedy School of Government and head of Harvard's Growth Lab, offered insights from his experience with infrastructure programmes in other countries.

He raised the following issues for South Africans to consider:

- Investment is never the end goal, but rather a means to create value. The hope is that the value generated will more than cover the investment costs. But investment is just the cost, not the ultimate goal. From the public sector's perspective, the job is not done when a set of investors is identified and the project is officially initiated. It needs to think about how the implementation of the project will ensure the desired outcomes, which should be about generating maximum benefits for the society.
- The pre-investment stage is often a binding constraint. There appears to be a bottleneck in South Africa

with the state not having the capacity to develop investable projects for the private sector. Pre-investment activities are costly and risky because you are never sure whether the project will be feasible and taken up until after the pre-investment stage is complete. That is why it is hard to get the private sector to take these risks on.

- A centre of excellence that has the capacity to execute pre-investment work on projects is a good idea. In some countries, there are units like this that sell the investable projects once pre-investment is completed, which then provides the resources to pay for the unit. Moreover, such a scheme also creates an incentive to do it properly.
- It is a bad idea to involve the private sector as a way of gaming public accounting. If, in a situation where public funds are severely restricted, the state just substitutes PPPs for state-procured investments, but the money to pay for those investments will come out of the fiscus, that is just disguised public debt. The involvement of the private sector in this way does not change the real burden on the taxpayer; it merely makes the public sector's balance sheet look better than it is. It is therefore important to draw a distinction between projects that pay for themselves and projects that will require taxpayer assistance. Because negotiations between the private sector and the government are often opaque, it is easy to increase the attractiveness of projects by transferring risk back to the fiscus. Sometimes that is important for feasibility, and some transfers of risk back to the fiscus are warranted. However, there are many instances in other countries where, behind closed doors and in small print, too big a burden was transferred to taxpayers.
- There is a fundamental trade-off between the social transformation generated by finalised projects and the benefits that can be generated by including people in the making of the project. I am astonished at the levels of exclusion in South Africa caused by the lousy and expensive supply of electricity and internet services. That level of exclusion can never be overcome by creating a few 'tenderpreneurs' in the investment process. The goals of inclusion and transformation can be much more readily achieved by focusing primarily on maximising the number of beneficiaries that finalised, well designed projects can generate.

"The goals of inclusion and transformation can be much more readily achieved by focusing primarily on maximising the number of beneficiaries that finalised, well designed projects can generate."

Prof Ricardo Hausmann

CDE reflections on the conversation

During the discussion, several core themes emerged that point to the main causes behind the delay in launching the infrastructure programme. This section groups comments around these themes.

Much more urgency

Government representatives at the workshop were all committed to making the infrastructure programme work and recognised that there are serious constraints within the state preventing the roll out of various projects they would like to see. A more capable state and well drafted legislation are crucial elements that need to be in place both for an ambitious infrastructure programme and for the long-term prosperity of South Africa. However, these are extremely challenging objectives. It will take a long time to get to the point where we have achieved the requisite improvements within the state; all the initiatives currently underway to bring these changes about are mired in bureaucratic complexities and wrangling.

The acknowledgement of past failures and the determination and commitment to bringing about improvements expressed by senior government officials participating in the workshop is encouraging. However, the country cannot afford to wait. What we need, as so many recognise, from the President down, is immediate action. Successful public-private projects were executed in the 1990s and early 2000s. Perfection should not be the enemy of the good by first trying to revisit all aspects of the delivery model. Once we initiate some feasible projects, improvements will emerge as we learn by doing, together.

Has the state really accepted what needs to change to bring the private sector in?

The complexities of the infrastructure programme, widely dispersed throughout many government institutions and departments, is striking. How is this all brought together? The people in charge of the different parts of the bureaucratic puzzle are working towards an approach that is, in essence, little different than what has been unsuccessful before. They are committed to a state-centred approach, which seeks to achieve as many targets as possible. A partnership approach would be more ready to compromise and take into account the concerns of the private sector.

The government officials who spoke at the workshop acknowledge that private sector financing of infrastructure projects is essential, and that the state has been largely denuded of skills, hence the involvement of private capacity working with government. However, in many respects they are essentially planning for a time in the undefined future when state capacity is vastly improved. The harsh realities of where we are now – a weak state, rampant corruption - are often glossed over in the approach to what needs to be done.

The way forward is to allow private sector agents to come in because they are incentivised to do so. They have the resources and skills to plan, finance, and run large infrastructure projects, but they will not do so unless they see the possibility of defensible returns. Every financial sector speaker explained that the bottom line for their involvement is a reasonable expectation that the project's returns will justify the risks they are asking their depositors, shareholders, pensioners and policy holders to take on. These risks, in the form of large initial construction costs and then ensuring operationality over decades, are often substantial.

"Perhaps the private sector is not being strong enough on which projects it wants to see."

Jacko Maree

Projects need to be designed, and regulations and safeguards must be implemented, to reduce the risks of corruption, monopoly power and malfeasance. The financial sector cannot prudently invest the funds of others without these assurances, no matter what the terms. It is important to find the critical areas where big investments can be brought in quickly as a catalyst for growth and confidence in the economy.

At the same time, the private sector needs to clarify exactly what its position really is. Business needs a clearer, stronger message that makes their requirements crystal clear. Business should not get caught up in the complexities of the bureaucracies they have to work with. Most of the financial sector speakers pointed to the importance of initiating a few big projects that do not require a lot of legislative and bureaucratic tweaking, but are they communicating this effectively? Have they focussed strongly enough on signalling a new approach and making it happen? **Jacko Maree**, Presidential Special Investment Envoy, was one participant who was concerned. "Perhaps the private sector is not being strong enough on which projects it wants to see," he said.

Another area of concern is that, although there are obvious benefits for firms if this happens, the private sector should not be looking to extract guarantees from the Treasury that will bail them out if and when projects run into trouble. South Africa cannot afford this kind of fiscal commitment at the moment. It leads very quickly to the 'gaming of public accounts', which Hausmann warned against. Consequently, only well-structured projects with credit-worthy entities committed to viable offtake agreements will have a chance of attracting private sector investors.

Policy reform is 'free'

A focus on policy and regulatory reforms would unleash new investment, and is, as Bernstein mentioned, an approach that makes few if any demands on public funds. The recent and welcome reforms in electricity and ports, as well as subsequent collaborative developments that have reportedly emerged with respect to the development of ports, should serve as the model for the way forward.

We need similar action in other crucial areas; for example, in opening up access to railway operations for private operators. **Mesela Nhlapo**, Chief Visionary Officer at the African Rail Industry Association, highlighted that "All we need is the go ahead for third-party access to rail infrastructure that is currently being under-utilised. The President announced on 15 October 2020 that this would happen, but 12 months later we have heard nothing. In anticipation of such an announcement, we spoke to Agri SA, the petroleum industry and big forestry companies, and they are all keen to move more of their goods on rail. We are not asking government for money."

Adopting a more urgent and positive attitude towards opening access to the private sector and implementing the necessary reforms to make that a reality, will not become a drain on the fiscus. It requires leadership and focus, and it could lead to positive outcomes at a time when the country is desperate for those.

What kind of projects are appropriate for private sector investment?

Government is committed to a broad infrastructure programme, with multiple goals and in response to a wide range of demands across society. What the private sector needs, at least under current circumstances, is a few, well defined, bankable projects that can generate a realisable revenue stream and start to build confidence that the government's approach to private investment is changing.

It is absolutely vital that the government is clear on what infrastructure the state must pay for with tax money, perhaps with private sector involvement as contractors to build the road or the sewerage works or the school, and the kind of projects that could be funded by users and largely run by private investors.

An understanding of these realities exists on both sides, but there is a lack of clarity about the differences between projects, a general unwillingness to prioritise, and a tendency on both sides to talk vaguely about a general infrastructure programme, which will involve both the state and the private sector and will emerge sometime in the future, as opposed to concrete and detailed talks about specific projects.

> **"Bringing in those who have been on the outside for so long must be at the centre of the conceptualisation and development of these projects."**
>
> Kgathatso Tlhakudi

This leads to confusion across the board and creates unrealistic expectations.

Private investors have an interest in spelling out clearly what kind of infrastructure projects it can fund without significant government assistance and which ones the government should cover a significant proportion of the costs for. It should also spell out clearly what kind of infrastructure should be prioritised. The 76 projects being focused on by ISA cannot all be priorities for private sector investment.

"[We hope] that the National Treasury [can] implement the recommendations of the PPP review by the second quarter of 2022."

Dorcas Kayo

Private sector secondment for what?

Both government and private sector speakers said that the decision by the Banking Association of South Africa (BASA), the Association for Savings and Investment South Africa (ASISA) and their member companies to second senior members of staff to ISA to alleviate capacity constraints within that organisation was an indication of a new level of goodwill between the two. While such developments must be seen in a positive light, it is also important to ensure that this goes beyond feel-good factors for the parties involved.

There are dangers with the way in which this secondment has happened. Placing some private sector experts within a bureaucracy struggling to deliver investable projects to the market, in a context where the legislation is currently not conducive to PPPs, and where there may be questions about the bankability of many of the projects which the government has prioritised, may not be the optimal use of that expertise. If this private-public cooperation fails to bear fruit soon, it may lead to rising frustration on both sides and a rapid reduction in levels of goodwill.

Formby's suggestion of creating a 'centre of excellence' may be one way to tackle this challenge, but then a big issue that remains unresolved is whether this form of cooperation will actually lead to a change in the way the private sector and the state cooperate. As indicated above, the only way to ensure that the infrastructure programme has the galvanising impact on the economy that we need is if the state and private sector work together in an entirely new way. The secondment initiative must be part of the process of bringing this about. Individual companies and organised business associations need to be crystal clear on exactly what they are trying to achieve with the national infrastructure drive and how best to maximise their contribution.

Infrastructure projects and local communities

In contrast to a view that working with communities is a straightforward process that can be achieved through a basic commitment to consultation, all indications are that the process is often incredibly fraught. Any notion of a singular 'community' needs to be eliminated. Rather than it being merely a matter of 'meeting with the community' and setting aside certain activities 'for them', the reality is that there are either incredibly complex or, more usually, absent structures that could represent the interests of 'the community' as a whole. In most cases, it is a few prominent, politically connected, or criminal individuals who put themselves in a position to monopolise any benefits. Frequently, there are deep divisions within communities, which often become violent as they compete for the benefits. Seeking to include self-appointed 'communities' in project construction usually creates more problems than it solves.

Projects with too many objectives cannot deliver results
Ramokgopa and other government representatives made it very clear that the government remains strongly committed to using government-mandated or -financed infrastructure projects as an opportunity to include people in the community in the benefits that constructing these projects provide.

> **"Protecting our existing infrastructure may have bigger returns than creating new infrastructure."**
> Jacko Maree

As Hausmann warned, seeking to include selected groups and generating benefits for local communities represents a cost, and therefore creates a trade-off with respect to the benefits, inclusion and social transformation for millions of people that successful, well targeted infrastructure will deliver. These benefits are inevitably much larger than the benefits that accrue from involving local people and requiring local content in the construction process.

In addition, the recent emphasis on 'localisation', which seeks to force companies to use South African suppliers regardless of relative cost, "will significantly raise costs and lower delivery", as **David Savage**, head of the Western Cape Treasury, put it. In addition, as Breytenbach acknowledged, laying an ever-expanding list of badly defined goals on top of the core objective of improving a road, or the supply of electricity, as quickly and cheaply as possible, increases the complexity of projects and reduces the chances of their success.

Peter Delius, Professor Emeritus at the University of the Witwatersrand, elaborated on this point: "There is a massive literature on developmental projects, which demonstrates that if you load projects with multiple outcomes, you will undermine the ability to deliver on the primary outcomes. Despite the huge and urgent needs our country confronts, we are determined to do everything at once with very limited capacity. The consequence is that we end up doing very little."

'Construction mafias' must be dealt with
Secure property rights and the rule of law are the bedrock on which investors base their decision to invest in long-term projects. Crime represents a threat to social order and signals to would-be investors the possibility that their property will be stolen or commandeered by criminals. 'Construction mafias' – local groups that demand a significant portion of the project's contract, and if their attempts at extortion are unsuccessful, resort to vandalism or otherwise prevent the project from continuing – represent a big hurdle in the way of increased private sector investment in South Africa. Decisive action bringing such extortionists under control, as well as wider lawlessness and crime generally, is essential to encourage investment, raise the growth rate and improve services to firms and households.

Maree drew attention to the vital importance of tackling the breakdown of law and order across the country. He told the story of a mining company unable to get coal out via rail to Richards Bay because the track keeps being vandalised. They had to hire private security to protect the trains, thereby significantly increasing their costs. This, unfortunately, did not solve the problem, and the company has now given up on using the rail link to Richards Bay. It has resorted to sending coal by road and is exploring the possibility of going through Maputo. The pervasiveness of these kinds of challenges, he said, "means that protecting our existing infrastructure may have bigger returns than creating new infrastructure".

> **"We regulate for risks we do not have, while we are not regulating effectively for ones we have, like corruption."**
>
> David Savage

Dealing with such mafias as criminals and reducing criminality in general will not only improve the environment for doing business, it will benefit the vast majority of people in the local area as well. At no time should appeasing 'construction mafias' be confused with the question of ensuring the entire community benefits from a particular project. In fact, the increase in 'construction mafia' activity has coincided with the issuing of a revised Preferential Procurement Policy Framework Act by the National Treasury in 2017. This regulation required the set-aside of at least 30 percent of the value of government construction projects to local businesses. The National Treasury needs to urgently consider revising these regulations to address their unintended consequences.

Project designs must incentivise efficient, market-driven outcomes

A badly designed project, bringing in private providers with little oversight and no incentive to deliver efficiently or in response to real demand, usually leads to new challenges rather than solving an existing one. For instance, giving private providers a monopoly does not guarantee lower costs. What matters in generating efficient outcomes is thus not simply private sector participation, but the designing of projects to ensure competition and market-driven outcomes.

To illustrate the importance of this, Hausmann gave the examples of Jordan, Chile, and Colombia, all of which have experienced shortages in the supply of electricity. All three countries decided to resolve the problem through private sector investment. Jordan, in trying to make projects bankable, signed power purchase agreements with private providers. After 10 years of this policy, they were left with enormous over-capacity, extremely expensive electricity, and an insolvent state-owned energy utility. By contrast, Chile and Colombia created electricity markets with real-time pricing, a centralised dispatcher, and a competitive generation market. They realised enormous gains in efficiency and dramatic price reductions as a result. Hausmann's lesson is that market design is key. If you design the project right, which is always more likely if you bring market signals and real competition in, you can get the right investments that deliver optimal outcomes.

Fully implementing the Eskom roadmap could dramatically improve SA's power supply

Experience in South Africa and globally has demonstrated that relying on a small group of central planners in a national utility or in the state is an exceedingly poor way of approaching the challenge of insufficient energy supply. By contrast, well governed market arrangements will induce large-scale, growth-enhancing power sector investments, because investors will be exposed to normal market risks that they can manage or hedge against.

The role of the state remains critical, but its nature must change. The emphasis should shift to providing the necessary network and other natural monopoly infrastructure to enable the development of a power market. The state also has a critical oversight role to ensure that the power market is effectively structured and that no participant develops opportunities to exercise market power or to manipulate prices.

Given that the electricity system must be in balance in real time, it is necessary to implement a multi-market model to enable buyers and sellers of power to adjust their positions as they approach real-time dispatch. The system must be efficiently balanced. It is therefore critical that an independent state-owned transmission and system operator is unbundled from Eskom and is permitted and enabled to set up multi-market platforms with the aim of achieving the rapid and efficient roll out of large-scale investment in the power sector.

This is in fact the programme set out in the government's Roadmap for Eskom in a Reformed Electricity Supply Industry. According to this official 2019 document, the new transmission entity "will stimulate a competitive market and promote the use of diverse sources of energy". Its two key roles will be:

- Systems operator: managing supply and demand balances in real time through a range of least-cost options.
- Market operator: contracting with various suppliers and distributors.

Accordingly, the entity will, amongst others, be required to:

- Provide access to the grid on a non-discriminatory basis to Eskom generation and independent power producers (IPPs).
- Dispatch electricity from the existing asset base of generators, following clear least-cost principles and penalising generating entities that do not perform as contractually agreed.
- Make available necessary reserves for reliable operation and in line with the proposed energy mix.
- Provide full transparency about the performance of the power system to all market participants and the public.

According to Eskom Chief Executive Officer André de Ruyter, the functional separation of Eskom into three separate units has been achieved and the transmission entity has now been legally established, although it still requires a transmission license to be granted by the DMRE before it can begin operating. It is imperative for South Africa's future that, rather than representing a merely cosmetic change, the fundamental reforms envisaged within the Eskom roadmap are implemented vigorously, to the letter.

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This box benefitted from inputs provided by Grové Steyn, Managing Director of Meridian Economics and member of the Presidential Economic Advisory Council. CDE acknowledges and is thankful for his valuable assistance.

Accelerating South Africa's infrastructure programme

The greatest imperative to emerge from the workshop is the urgent need to move from talking, tweaking, and building goodwill to real action. To achieve that, both the private sector and government must identify a few areas where big-impact initiatives can be quickly implemented.

> **We need four to five big projects that are appealing to private investors and we need to get them going now."**
> Cas Coovadia

Cas Coovadia, Chief Executive Officer of Business Unity South Africa (BUSA), put it succinctly: "We cannot get stuck in a state of consultation paralysis. Government leadership must urgently decide which projects to put on the table.

"We need three to four big projects that are appealing to private investors and we need to get them going now."

Maree supported this view: "Many of the projects discussed in this workshop will take years to emerge. What we need is a few projects now to showcase and get off the ground. I have been an investment envoy for a while now and spoken to many foreign investors, and I can confirm that they want to see projects that generate returns. Once they see that working, they will be much more ready to look at South Africa as a potential investment destination."

The following changes must happen to ensure that the private sector and government can work together on a set of meaningful infrastructure projects: The state needs to speed up and sharpen the development of national planning, organising and delivery structures to identify projects of national significance. This should lead to a focus on three or four significant projects, which must then lead to the issuing of requests for proposals, so that the private sector can respond.

Investors and the government need to negotiate, in specific terms, how risks and returns are to be allocated for these projects to ensure a sustainable financing model for public goods. Financing includes repayment either through user charges or taxes. Both are under pressure. A stable political commitment regarding how these assets are to be financed is essential, which includes protecting investors from corruption and theft. In return, the private sector must deliver sound value propositions on time and reliably over the life of any project.

The private sector and the government need a more focussed, action-oriented programme that can rise above the current complexities, conflicts of interest and constraints within the state. To get there:

The private sector should:

- As Savage put it, improve on their track record of telling government "what they really, really want". Investors and organised business must explain clearly what the basic challenges are that block private sector investment and point out what must be done immediately to fix that.
- Get clearer and more unified in communicating with government. Private sector leaders and organisations need to clarify their exact message to the government about private investment in infrastructure and make sure this is heard 'loud and clear'. If more effective policing and dealing with construction mafias is a prerequisite for investment, say that. If a clear revenue stream is a prerequisite for investment, then clarify that and spell out the implications for what is possible for the private sector to finance.
- Emphasise that policy reform is absolutely vital for accelerated infrastructure delivery. This will not require secondments to the state. Bold and speedy reform will create the environment in which private sector investment and capacity will be mobilized. The private sector is not communicating this strongly in the context of the infrastructure programme. It needs to be clearer and more consistent on demanding policy reform to enable much more infrastructure investment. The 100 MW decision is an important first step to improving our country's electricity supply, but it should not be the end of that process or make

the government lose sight of the many other policy reforms urgently needed. The Eskom roadmap policy document shows the way forward, now it must be implemented as speedily and effectively as possible. Meanwhile, dealing with the investment environment for the mining sector will drive investment in exploration; resolving uncertainties around property rights will lead to more investment in the agricultural sector; making a decision on e-tolls in Gauteng will create certainty for investors in roads; similarly allowing third party access to rail would lead to private sector investment in locomotives and wagons.
- Decide exactly what they want to achieve by seconding people to help government with infrastructure. Seconding people to 'help the government' sounds like a good idea to strengthen capacity. However, this is not straightforward and could be the wrong focus of private resources and energy.
- Speak out more forcefully about the negative impact of multiple objectives that make projects very difficult, if not impossible, to implement successfully. That includes localisation requirements, which will increase costs and impose unnecessary delays.
- Demand action with respect to 'construction mafias' and make sure this is understood as a law and order challenge. Involving communities in infrastructure projects is in no way a solution to this problem, and is, in fact, likely to exacerbate the issue.

Government should:
- Implement policy reforms with much greater speed, especially in sectors where reforms can lead to greater private sector investment organically without the need for government-developed projects.
- Push through with greater urgency the regulatory changes that would allow effective cooperation between the private sector and government, especially in the form of PPPs. It is hard to understand why this has to take as long as is anticipated. Surely it could be fast-tracked.
- Avoid over-regulation. We need to get the balance right, something we have yet been able to achieve. As Savage put it, "We regulate for risks we do not have, while we are not regulating effectively for ones we have, like corruption."
- Distinguish clearly between user-funded and taxpayer-funded projects and prioritise the three to four significant projects vital to improve the conditions for faster economic growth, which can be launched now, without imposing substantial new strains on the taxpayer. Leadership is required from the top to cut through the complexity of the government architecture around infrastructure development, and to move priority projects along.
- Be realistic regarding weak state capacity. Do not plan as if essential state capacity already exists. The current approach is mired in a vast bureaucracy, with overlapping responsibilities and an absence of clear priorities. Somebody needs to take charge, be the accountable executive and work within the realities that we currently face.
- Properly understand the trade-offs between multiple goals and decide what the most important goal is. In deciding that, government leaders need to appreciate the massive benefits that higher growth and better, cheaper services can generate for everyone (i.e., many communities) in the country.
- Urgently deal with construction mafias and other threats to law and order in a way that allays the concerns of investors. If a unit to tackle this issue has been established, then investors need clarity on leadership, funding, targets for delivery, approach, where it is being deployed, whether successes have been achieved,

> **"It is a bad idea to involve the private sector as a way of gaming public accounting. It is therefore important to draw a distinction between projects that pay for themselves and projects that will require taxpayer assistance."**
>
> Prof Ricardo Hausmann

and so on. As Maree pointed out, providing more security could significantly enhance the value that a lot of existing infrastructure could generate.

- Take private sector concerns seriously. Private actors are driven by the need for revenue streams and greater certainty. This must be fully grasped by government if genuine collaboration is to take place.

Concluding remarks

Covid-19 has made everything more challenging, but it also means that the need for action is more urgent than ever. Kickstarting an infrastructure programme on a large enough scale could have a positive impact on South Africa's growth prospects. To maximise that impact, we should ensure that we implement reforms and prioritise initiatives that will lead to significantly greater economic activity – and soon.

The Minister of Finance Enoch Godongwana's recent Medium-Term Budget Policy Statement talked about "62 infrastructure projects that have been gazetted, and an additional 55 new projects from various sectors valued at around R595 billion". He pointed out that these projects have a funding gap of around R441 billion that he wants the private sector to fill.

We should start with three to four catalytic projects. If the government wants the private sector to step in, it needs to focus on projects that will allow for returns on investment and that signal a very different approach by the state to partnership with the private sector. We need to move from talk to action. The private sector needs to be crystal clear regarding what they require to invest, and in what kind of projects. Secondees need to work with government officials towards those goals. CDE's impression of the conversations that are going on now is that there is too much emphasis on, and excitement about, the fact that the two parties are talking and committed to working together, and too little emphasis on exactly what needs to happen. That is the short-term urgent necessity.

> **"We do not currently have the capacity to do large numbers of meaningful projects that are extensively regulated and seek to achieve multiple goals."**
>
> Ann Bernstein

As Bernstein put it at the end of the workshop, "All parties need to become more realistic. We do not currently have the capacity to do large numbers of meaningful projects that are extensively regulated and seek to achieve multiple goals. What we can do is get a few, private sector-driven initiatives off the ground that will make an impact on critical constraints to faster growth. Business and government should be talking about these three to four projects as a matter of urgency".

Policy and regulatory reforms that unleash more private sector investment without requiring the design and development of new projects by the government bureaucracy should be seen as the fastest, cheapest way to obtain results. The reforms in electricity generation show what can be done. The decision by the President in this regard represents the removal of unnecessary regulatory blockages to private sector investment. Further private sector investment in electricity could be unleashed by other regulatory changes in the sector, such as the unbundling of Eskom and the creation of an independent transmission entity that can function as a market operator and manage a trading platform for electricity, as envisaged by the Eskom roadmap.

"A focus on policy and regulatory reforms would unleash new investment and makes no (or limited) demands on public funds."

CDE Report

Similarly, the government needs urgently to allow third-party access to rail operations – as it has promised to do – which would then unleash private sector investment in locomotives and wagons. Transnet may be deliberately dragging its feet on this; if so, leadership is required to initiate the reforms that will unlock new investment.

Transnet, meanwhile, is in the process of enabling massive private sector investment in the ports. This means that the PPP reform process that is being led by the National Treasury needs to be expedited so that these investments can take place in the very near future.

In roads, there are big projects that SANRAL could develop, but nothing can happen until the e-tolls quagmire has been sorted out – another policy decision that has been delayed for far too long – and SANRAL's balance sheet can be restored to normal.

Other reforms that would lead to new investments include releasing broadband spectrum, addressing municipal bottlenecks in the way of the rapid deployment of digital infrastructure, and addressing the constraints to investment in mining and agriculture as a matter of real urgency.

Providing more effective policing or, more practically, tightening security around critical installations, could ensure the value of a lot of the infrastructure we already have.

In social infrastructure projects like student accommodation, and in the complex space of water projects, there has to be a much stronger emphasis on government involvement and finance, and on getting the PPP framework exactly right. Water projects also necessarily involve municipalities, which creates massive challenges and barriers to progress. The best way to proceed in this space in the short to medium term is to focus on the big bankable projects that have a chance of drawing in private sector funding in the near future.

There needs to be greater clarity of thinking and communication to make progress. There are no shortcuts, much as we want them. Infrastructure is not a silver bullet for the country's ills, but there are two urgent and, we believe, achievable priorities for action. The first is to make the policy reforms and decisions that will enable private sector investment at significant scale without the state having to build the capacity to design world-class, bankable projects. For example, implement the president's 2020 commitment and immediately open access by 3rd party operators to the national rail infrastructure. The second is to identify three to four large projects that require new and effective partnerships to get off the ground with real urgency. Both these actions could signal determination and change in how South Africa is doing things, attract local and foreign investors and start to contribute significantly to faster long-term economic growth.

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