INFRASTRUCTURE Dialogues

LISTENING, REFLECTING AND ACTING

Seeking Lessons from our

Infrastructure Sector Performances

17 October 2012

A comprehensive study identifying critical challenges and issues in implementing government's planned three-year, R800 billion infrastructure development programme has been released.

The 164 page study, commissioned by the Department of Performance Monitoring and Evaluation (DPME) in the Presidency and the Development Bank of Southern Africa (DBSA), formed the basis of discussion by public and private sector representatives at the 20th in the series of Infrastructure Dialogues.

The Dialogue preceded a special Presidential Infrastructure Investment Conference in Sandton where President Zuma announced that the infrastructure development programme could involve investment of as much as R4 trillion over the next 15 years.

Entitled *The State of South Africa's Economic Infrastructure: Opportunities and Challenges,* the study by independent experts covers rail, ports, roads, electricity, water and telecommunications infrastructure (see State of South Africa's Economic Infrastructure Report 2012).

Convened by the DBSA, DPME, the South African Cities' Network and the National Business Initiative, the Dialogue was led by:

- Marina Mayer, the recently-appointed Executive Director for the Economic Development Department in the City of Johannesburg, who presented an analysis of the study. Ms Mayer edited the study while working as a lead economist at the DBSA; and
- Thabo Mokwena, Director of the Centre for Public Enterprises at the University of Witwatersrand, and Colin Coleman, head of the South African office of Goldman Sachs and a member of the NBI board, who acted as respondents.

Issues raised by presenters and in discussions between them and other Dialogue participants included:

- Institutional and governance challenges identified by the study on the state of economic infrastructure, and the critical importance of ensuring that social and economic growth from the infrastructure development programme is inclusive;
- New infrastructure funding challenges arising from the continued international recession and the downgrading of South Africa's credit rating;
- The need to define the type of state South Africa is; and the nature of a Developmental State and how it can be underpinned through a social compact;
- The relationship between the public and private sectors;
- The role of local government; and
- Prioritising infrastructure investment and defining who should benefit.

Institutional and governance challenges

Analysis of six economic infrastructure sectors contained in *The State of South Africa's Economic Infrastructure: Opportunities and Challenge,* shows that shifting the economy away from resource extraction dependency is difficult. It is imperative that the new infrastructure development programme must be implemented in such a way that it transforms the economy and shifts it onto an inclusive growth path. Not only new infrastructure is needed; large-scale backlogs accumulated over the past 18 years have made it essential to rehabilitate existing infrastructure.

Marina Mayer, who presented the study on The State of South Africa's Economic Infrastructure: Opportunities and Challenges.

A key constraint to infrastructure development and rehabilitation is that the institutional framework for infrastructure delivery is fragmented across the different spheres of government, causing contradictions and bottlenecks. Even if policy contradictions and institutional fragmentation are addressed, actual project implementation will require considerable capacity to prioritise, prepare, unblock and finance initiatives.

The report identifies seven key issues government needs to address:

Policy

Policy certainty is critical in order to mobilise investment. However, government has no policy to guide integrated infrastructure planning. Pricing policy gaps exist in such key sectors as rail, roads and water, and government has failed to implement policy on ports and communications.

Market Structure, Regulation and Pricing

Monopolies in the public and private sectors, and an oligopoly in mobile telecommunications, has resulted in high prices and inadequate supply. Regulation is often ineffective or absent.

Financing Mechanisms

These are Inadequate in such sectors as roads, commuter rail and water, and inappropriate in some other sectors. There are inadequate levels of public-public-partnerships, and financing mechanisms for operations and maintenance are weak.

Institutional Frameworks

Coordination across government institutions, and cooperation within the public sector and with the private sector, is weak. There is also a dominance of monopolies, even in cases where competition is possible.

Capacity Constraints

Skills shortages are now part of South Africa's economic landscape. Developing technical skills for economic infrastructure is a long-term endeavor. In the short-term such skills could be assembled from public-public -partnerships and global labour markets. Financial constraints to create capacity are an immediate priority.

Thabo Mokwena, Director of the Centre for Public Enterprises at the University of Witwatersrand, who acted as a respondent.

Backlogs, Rehabilitation and New Infrastructure

Capacity for planning within and across sectors is weak. Capacity is currently being developed through partnership between the infrastructure line-departments, the National Planning Commission, the DBSA and DPME. Performance indicators for infrastructure must be developed.

Infrastructure and the New Growth Path

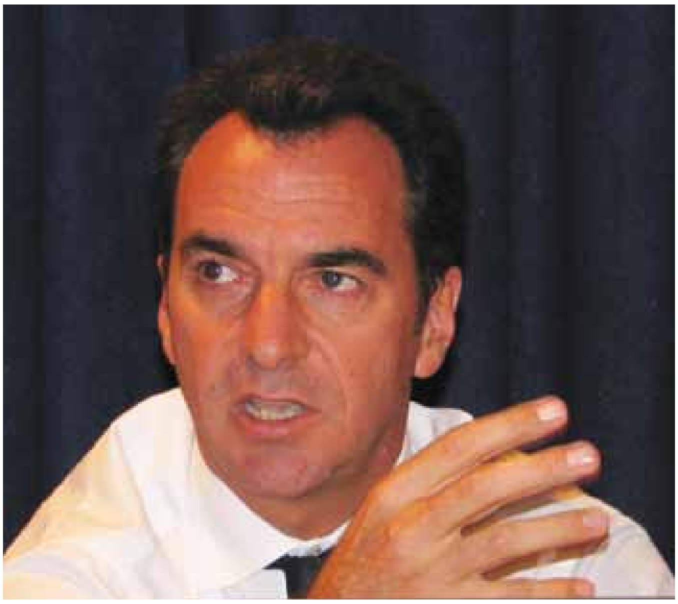
Current infrastructure was created to meet the objectives of apartheid based on a resource-based economy and exclusion of the majority of South Africans. New infrastructure investment must aim to reverse this legacy through diversification away from a resource base and with the inclusion of all South Africans.

New Funding Challenges

The persistent international economic recession and the downgrading of South Africa's credit rating in the wake of strikes in the mining and transportation industries weighed heavily on discussion, but with widely differing views on their impact and South Africa's ability to deal with it.

Responding to the presentation of the study on South Africa's economic infrastructure, an academic economist said the downgrading will restrict borrowing on world markets. He went as far as saying that "government will not be able to fund" an infrastructure programme involving investment of as much as R800 billion. Government has created "a whole hype" around the infrastructure programme, but, he asked, "where are we going to get this money?"

Another aspect of funding, noted the economist, is that many proposed infrastructure projects are technology-driven. He questioned whether the country has the capacity to develop technology. It will probably need to import technology or acquire intellectual property rights to enable local technology development, but at great cost.



Colin Coleman, head of the South African office of Goldman Sachs and a member of the NBI board and a dialogue respondent.

Developing this theme, a representative of a private financial institution said miners' strikes have raised the spectre of wage inflation, which will put pressure on interest rates. The recent transport strike has added to overall bottlenecking of infrastructure. Lower mining production and exports will put pressure on the Rand. The downgrading of South Africa's credit rating will add to the cost of capital and machinery.

However, he believed the R800 billion allocated for infrastructure investment over three years "is a relatively small number". The country, he said, has "the administrative and management capacity to be able to execute the project." South Africa is "a modern economy with loads and loads of highly talented people and we have it well within our means to deliver on that programme on time and on budget."

"However, this requires a modern state machinery. We cannot afford to have a machinery that is disorganised, that has ministries fighting each other rather than a centrally planned, coordinated government led by a cabinet with a president who gets things done."

"That is the bottom line. If we are coordinated and productive and efficient, and use the tools at our disposal, we can get things done. If we do not do that we only have ourselves the blame."

Defining the nature of the South African state

The state's role in development and implementation of the infrastructure programme came under close examination, with participants approaching the issue from a number of perspectives.

Debate was sparked by an economist who said South Africa needs to reassess the economic model on which the infrastructure development programme is based and whether it will deliver the expected results. This links to the notion of the Developmental State, he explained. The Asian Tigers are often cited as examples of successful developmental states, though they did not have this concept in mind when they set out to develop their economies. The concept was defined later by Western economists who studied the success of the Asian Tigers.

"We are preoccupied with labelling and branding ourselves upfront as a developmental state and we put ourselves in a corner in which we must emulate the Asian Tigers," said the participant. "But our conditions and environment are completely different, so we need to ponder what type of state South Africa is. Is it a social democratic state, or a classical capitalist state? It is important to come to terms with this because we can continue fooling ourselves. We need to define ourselves and have the conviction and courage to act accordingly in rolling out the infrastructure programme."

Another participant was more forthright. "South Africa cannot afford an inefficient, uncoordinated, consumptive developmental state," he said. "What we need is an effective, productive developmental state. There is nothing worse than bottlenecks, corruption, inefficient state monopolies, and costs and services that are high, with a lot of talk about putting infrastructure in place and having endless tenders."

A Developmental State underpinned by a social compact

Discussion on a Developmental State prompted debate around the issue of a "social compact" in which key stakeholders agree on a joint approach towards economic development. Much of this focused on the relationship between the public and private sectors.

In successful developmental states, noted a representative of a development finance institution, the public and private sectors work as a consortium. The problem in South Africa is that the two sectors do not work together. What South Africa needs to do is to build on the fact that it has a national development plan. The country must now:

- Use the national development plan as a tool to coordinate stakeholders.
- Develop a common understanding of the roles and responsibilities of the three tiers of government and of the private sector in rolling out a national programme.
- Assess what tools the stakeholders have, or need to have, in order to fulfil their roles and responsibilities and build capacity where required.
- Ensure that the private sector and the state are working on the same programmes. "This is where the social compact comes into play," he said. "We can't have a situation where the private sector goes overseas and bad mouths the South African government to the point that the people they are talking to don't want to invest because the government is so terrible. The issue is how do you build a consortium in which the public and private sectors work together."

> ***"We are preoccupied with labelling and branding ourselves upfront as a developmental state and we put ourselves in a corner in which we must emulate the Asian Tigers."***
>
> Participant.

One possible way in which to achieve this, suggested another development finance institution representative, is to focus on smaller projects. "Perhaps we are trying to emulate South Korea by taking on huge projects, but maybe we should undertake smaller projects in order to develop a model for a social compact." An example, he said, is cooperation between the public and private sectors to integrate mine workers into human settlements. This could help to "put aside mutual suspicions" through "working for the greater good".

Responding to the suggestion, the commercial banker said small projects could lay the basis for public-private cooperation but that an effective social compact can only be built through agreement on an overall set of objectives. Without this, he said, "we won't tackle the big projects and the world will pass us by".

Relationships between the public and private sectors

While the need for close cooperation between the public and private sectors was emphasised, a number of participants expressed frustration over the continuing adversarial relationship between the sectors.

Debate was prompted by an economist who noted accusations by certain government representatives that the private sector is "unpatriotic" because it is not investing the considerable amounts of money at its disposal. For example, it has invested in telecommunications because it sees benefits in doing so, but has not invested elsewhere, the economist claimed. Does the private sector have the appetite for investment, or is it content to be a beneficiary of infrastructure investment?

A development finance institution representative described the relationship as a "zero sum game played between the public and private sectors on the grounds of mutual suspicion: 'you are sitting on wads of cash but are not investing it in the economy', but 'you are not creating the enabling environment in which we can invest our wads of cash'."
A representative of a commercial financial institution strongly challenged the perception of an "unpatriotic" private sector that is resisting investment.

The private sector is keen to invest but faces an indecisive government. As an example, he cited the government's Renewable Energy Independent Power Producers' Procurement Programme. Government was scheduled to finalise agreements with the first private developers by June but has still not done so, he said.

"The private sector puts immense effort into tendering and then seeing government not approve and implement those projects, with subsequent waste of time and effort, with funding from banks having to be rolled over, and subsequent logjamming of the system."

Wearing the Infrastructure Dialogue's hard hat gift to speakers were (from left) Colin Coleman, head of the South African office of Goldman Sachs, Marina Mayer, Executive Director for the Economic Development Department in the City of Johannesburg, and Ravi Naidoo, Group Executive of the Development Planning Division of the Development Bank of Southern Africa.

"The private sector puts immense effort into tendering and then seeing government not approve and implement those projects, with subsequent waste of time and effort."

Participant.

He questioned why government recently rejected a bid by a Korean company to invest in Telkom, and why government has not invited the private sector to take a minority stake in a state-owned entity, such as Eskom. "China has sold stakes in state enterprises to the private sector without relinquishing control. Capital is available for programmes that are driven by growth, but why are we so ideologically bound that we don't think the private sector can invest in Telkom or in Eskom. Why is that such a terrible idea?"

He urged government to look to the private sector to help in implementation of the infrastructure investment programme, "but government itself should do a whole lot of things on its own and be very ruthless, brutal, quick and fast about implementing it. We absolutely need to up the game and have a modern government administration, and get on with it".

A representative of a business association said the public and private sectors seem to be living on two different planets “and never the twain shall meet”. The infrastructure programme was announced 10 months ago and nothing seems to have happened since then, she said. Things need to start happening. Companies need to keep their order books full, otherwise they will go elsewhere to find work and, increasingly, it seems those opportunities will not be in South Africa but in other parts of the world.

Allied to this, she said, is the issue of localisation, a key component of the infrastructure investment programme which aims to stimulate local manufacturing and job creation in order to alleviate unemployment and poverty.

Companies will only expand manufacturing capacity if they have a marked to ensure economies-of-scale and an acceptable return on investment. This is dependent on government creating favourable conditions for investment and an enabling regulatory environment. However, she said, “we dangle localisation like a piece of string and get a lot of people to jump at it” but without putting in place effective policy to create the necessary conditions for investment.

“Localisation,” added the commercial banker, “has to be done in such a way that it doesn’t layer-in extra costs and affect business competitiveness.”

The role of local government

The role of local government in the infrastructure development programme emerged as a problematic issue.
A participant said the study on economic infrastructure noted that much of the infrastructure development will take place at local government level, but that development will be driven by national institutions. What role is local government expected to play, she asked.

The former head of a local government association responded that municipalities are hobbled by their limited powers of taxation. They are restricted to generating finances from sales of electricity and water, but are expected to fund numerous amenities and services. “Taxation is a real issue,” he said.

> ***“Salaries take up as much as 75% of many municipal budgets, leaving limited scope for development projects. How do you put in place capital projects when all your money goes into wages?”***
>
> Participant.

A representative of a metropolitan government responded that the quality of municipal service delivery is declining. This is aggravated by the fact that poverty is deepening despite the social grants system. “There are 3 million new poor people between 1994 and now,” she said. Unemployment has also doubled over this period. Salaries take up as much as 75% of many municipal budgets, leaving limited scope for development projects. “How do you put in place capital projects when all your money goes into wages,” she asked.

She said another participant’s description of the public service as an “employment agency” should be taken seriously. The participant had said that budget allocations for social spending in such areas as health and education are among the best in the world, but the outputs are among the worst, aggravated by the fact that public sector salaries make up a large proportion of budgets. “We must ask the question: do we have a public service that is an employment agency with insufficient productivity measures and then doesn’t deliver bang for the buck. We cannot as a country afford this,” said the participant.

Prioritising infrastructure investment

A participant questioned how decisions will be made on who should benefit from new infrastructure. As an example of what he regarded as previous questionable decision-making, he said government invested heavily in the Gautrain, which benefited a relatively small number of people, but has neglected to invest in the Moloto Corridor east of Pretoria, which is used by many more people and is in urgent need of investment to develop a safe and efficient transportation route.

This prompted a provincial government development planner to question whether a province such as Gauteng, which contributes 35% of national GDP, should receive more investment in infrastructure than other areas and regions because of its role as the country's economic driving force. Opposing the idea, an economist said the country needs to invest in such a way that there will be more equitable, balanced development throughout the country.

Procurement

Procurement needs to be integrated and mechanisms developed to avoid corruption. Procurement should be based on quality and not on price to avoid having to rebuild infrastructure, as has happened in such areas as housing. Delays in awarding tenders need to be avoided.

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