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Connecting the dots

JP Landman | Independent Political and Economic Analyst

Steve Jobs famously said that one can only connect the dots backwards. We have been connecting the dots on government's economic policy since 2018. The dots tell us what has been done, not what will be done nor what has been promised. They help us to distinguish between daily headlines and longer-term trends. (I apologise in advance that this read is longer than usual – there are just too many dots!)

Supportive macroeconomic framework

A stable macroeconomic framework is one of the five key pillars of growth. (See, for example, the report from the International Growth Commission on which Trevor Manuel also served). This simply means sustainable fiscal policies (reasonable deficits and debt) and sound monetary policy (curbing inflation).

Monetary policy

An independent reserve bank is crucial for stable, non-political inflation targeting and control. The South African Reserve Bank's (SARB's) independence came under severe attack. At the African National Congress's (ANC's) Nasrec conference in December 2017, a resolution was adopted to nationalise SARB. Eighteen months later, in June 2019, then-Secretary General Ace Magashule pushed the envelope and called for 'quantity (sic) easing' and a change in the mandate of SARB. Ex-president Jacob Zuma joined the fray and tweeted that a change in mandate was ANC policy and if not implemented, government could be recalled. The Public Protector published a report on changing the mandate of SARB. Julius Malema and the Economic Freedom Fighters (EFF) tried to make political capital about nationalising the Bank. Connect all these dots and they suggest a total onslaught on SARB.

However, 48 hours after Magashule's June 2019 statement, the ANC Top 6 issued a statement affirming the mandate of the Bank, confirming the role of the Minister of Finance in setting inflation targets and stating clearly that nothing would change. Magashule, part of the Top 6, had to swallow his words.

The statement also dealt with the ownership issue, saying: 'It is our desire for the SARB to be publicly owned. However, we recognise that it will come at a cost, which given our current economic and fiscal situation, is simply not prudent.' The noise around SARB died down - even the EFF went quiet - and SARB's independence and stature have since only grown.

Connect all these dots and June 2019 was the month that the tide turned on SARB.

Fiscal policy

The first dot on the fiscal policy page was made in February 2019, before Covid-19, when the President made a commitment in the State of the Nation Address (SONA) '... not to spend our way out of our economic troubles'. That was three months before the general election and a spending splurge was predicted by the chattering classes. In the event, spending in that year was only 0,3% above the ceiling set by the National Treasury.

The commitment to fiscal discipline was severely tested over the following three years with the Covid-19 pandemic, load-shedding, massive Eskom and other state-owned enterprise (SOE) bailouts and the destabilising effect of the July 2021 unrest.

Given these pressures, what do the dots suggest on that fiscal commitment?

In the 2020/2021 financial year, government broke the three-year wage agreement on civil servants' increases. Consider the politics: Cosatu unions had helped Cyril Ramaphosa become President. It's no small matter to break a negotiated agreement with your supporters. On top of that, in 2021 it was followed by civil service increases considerably below inflation. We will see what happens this year, but for two years increases were held tight.

Another dot is that extra spending due to Covid-19 and emergency relief was substantially (not fully, since debt was taken on as well) financed by cutting other expenditure – the (in)famous re-prioritisation of expenditure. There is not a department or agency that has not seen its budget cut. The economy shrank by 6,4% in 2020 when Covid-19 first hit. Government spending to off-set the impact of Covid-19 was about 5,5% of gross domestic product (GDP) – well within the rule of thumb that expansionary spending can be equal to the contraction. That dot confirms no splurging. (Government aimed to spend 10% of GDP, but that did not materialise as the bank guarantee scheme did not take off as planned).

In my view, these decisions were no mean achievement given the context. Of course, the favourable terms of trade from commodities helped the fiscal position. But it came after the tough decisions were taken. No wonder then that Moody's changed its outlook this April from 'negative' to 'stable'.

All this must be seen against the very different pattern of dots of Zuma's attacks on the Treasury in 2016 and 2017. Remember 'weekend special' Des van Rooyen in 2016, the dismissal of Pravin Gordhan and Mcebisi Jonas in 2017, the overwhelming evidence of state capture...? In South Africa we now take stable macro policy for granted because we have it. But it did not happen by itself.

Structural reform

Beyond macro policy, the single most important pattern of economic policy dots concerns government's commitment to structural reform.

The first big dot came in August 2019 when Tito Mboweni published the Treasury paper on structural reform. It was met by general howling and condemnation, even from some in business. Six months later, in February 2020, the President quietly declared in SONA that the Treasury paper 'is now cabinet policy'. By October 2020, there was a dedicated unit in the Presidency working solely on promoting structural reform. The Economic Recovery and Reconstruction Plan largely reflects the Treasury paper – and is now generally accepted government policy. All departments defer to it. Structural reform has become the key economic policy of the Ramaphosa administration.

The biggest reform is playing out in the so-called network industries: spectrum/telecommunications, transport and electricity. Digital migration and the concomitant spectrum release has been completed after 10 years of delay. (In the first eight years the delay was due to political ineptitude; in the last two years it was due to private sector resistance.) It is now done and dusted. The auction netted R14,4 billion for the Treasury. If that is not a bright dot, I do not know what is.

Dots outside government are investments by Google and a Facebook consortium in undersea cables linking South Africa to the wider world, more than doubling all current capacity. Inside the country, MTN, Vodacom and Remgro subsidiaries are all extending fibre connections beyond the usual areas into poorer communities at affordable prices. A total of R2,5 billion has been put in the budget for the South African Connect project, which aims to bring broadband access to all South Africans, prioritising rural and under-serviced areas.

Next came railways and harbours. Two years ago, the policy on railways and harbours was still one of state-run monopolies. Change started slowly, then accelerated. First, regulating functions in both railways and ports were separated from operations. Next, infrastructure was separated from operations to determine proper charges. That opened the door for private operators to enter railway and port operations. The physical separation took about 18 months. Then, in April 2021, the President announced that a new pier would be built in the Durban harbour by the private sector in a R100 billion project.

Since then, Transnet has issued requests for proposals for a new manganese terminal at Ngqura in partnership with the Coega Development Corporation, as well as one for a liquefied-natural-gas terminal in Richards Bay. In April 2022, Transnet Freight also opened bids for slots on the container corridor between Durban and City Deep in Gauteng. (There is an entirely predictable tussle on terms and conditions; see the paragraph below 'Have a heart'). Work is also being done to upgrade the railway line from Tshwane to Gqeberha to facilitate vehicle exports that currently go by road and through the congested Durban. It is a R7 billion project.

Energy reform

The biggest reform of all is taking place in electricity. Not just the biggest, but also the most important, since load-shedding is by far the largest constraint on the economy. Fixing electricity is more important than crime, education, corruption and every other ill inflicted on South African society. In the past two years, I have written seven times about the big reforms in electricity and will not repeat it. Here I want to focus on load-shedding and overcoming that.

The supply shortage causing load shedding is 4 000 MW to 6 000 MW. How much of that will be covered by current procurement? Connect the dots and note the trend:

- In **April 2018**, 27 independent power producer (IPP) contracts from Bid Window 4 that were suspended by Brian Molefe in 2016, were signed. South Africa's renewable programme could restart. The last 500 MW from that bid window is now being connected to the grid. Currently, 93 completed projects have added 6 855 MW to the grid. Imagine load-shedding if we did not have that!
- In **August 2020**, the emergency or 'risk mitigation' programme was launched, 1 200 MW was awarded to the now infamous Karpowership. Thankfully, that deal appears to be stuck, but 800 MW given to other operators are in construction and will be connected to the grid.
- From **October 2020**, municipalities were allowed to procure their own power. In June 2021, Johannesburg Metro opened bids for 220 MW from solar and gas. In February 2022, Cape Town opened a bid for 300 MW. Eight other municipalities are working on it but have not opened bids yet.
- In **April 2021**, Bid Window 5 for 2 600 MW renewable power was opened and the 25 successful bidders were announced in October 2021. Financial closure is at the end of April 2022. The 2 600 MW can be connected to the grid by 2023/2024.
- In **June 2021**, the President lifted the threshold below which a licence is not needed from 1 MW to 100 MW. Several private companies have signed agreements to procure power from renewable producers. Examples include Amazon in Cape Town (which gets 10 MW solar power from the Northern Cape), South African Breweries (which signed an agreement with a black women empowerment group for electricity from gas generated from the biomass of a dairy farm), and BMW (which already gets a small quantity of power from a biomass plant). A total of 58 projects are currently being pursued by 12 companies for 4 500 MW. The big ones are the mining companies. Anglo signed an agreement to switch to 100% renewable power by 2030; Sasol is pursuing 900 MW. Eskom has made land available for renewable operators to put up plants below 100 MW on Eskom land. This list goes on, but this paragraph illustrates the galvanising effect of the President's 100 MW announcement. This is where the real action and innovation in power generation is. Eventually, most dots will be here.
- During the weekend of **23 April 2022**, news broke that the unit in the Presidency dedicated to help implementing structural reform has succeeded in getting some restraints removed that hinder projects for below 100 MW. This is new territory for everybody, and as the various players move along, more reforms will follow.
- In **April 2022**, Bid Window 6 was opened for another 2 600 MW renewable power. The closing date for bids is 11 August 2022. This can be connected to the grid by 2025.
- Note that all the money for this new power generation comes from the private sector.

The dots above add up to more than 11 500 MW that will be connected to the grid by 2025. It excludes the 1 200 MW from Karpowership. Compare that to the 4 000 to 6 000 MW deficit. As sure as I am writing this, more bid windows will open this year and next. I am listing only the dots that are already on the page. Of course, 1 MW of renewable power is not the same as 1 MW of base load, but still, the gap is being narrowed considerably.

Load-shedding will not be a permanent feature of our future. Mistakes have been made and delays occurred, but the trend is absolutely clear.

Infrastructure

A key element of economic recovery is more infrastructure. Readers will know I have been cautious on this issue, simply because so many ducks have to be put in a row. It now looks as if I may have to shift my stance – the ducks are lining up.

The first is the budget. Infrastructure spending by government entities increased by a healthy 22% in 2021/2022, enough to overtake the numbers recorded in the two years before Covid-19. Investment spend is set to increase a further 15% over the next three years. Transport and logistics (roads, railways, and small harbours) get the biggest chunk, and water and sanitation the second biggest. (By the way, a very competent and experienced civil servant, Sean Phillips, was appointed Director-General of the Department of Water and Sanitation in December.) The third biggest chunk goes to energy to expand power-generation capacity. Noticeable big projects include Phase 2 of the Lesotho Highlands Water Project to supply Gauteng (R32 billion) and the project on renewable energy and water saving in government buildings (R55 billion). The latter will be done by the private sector with its capital on a build, operate and transfer basis.

The second is an innovation, the Infrastructure Fund, which blends public and private money to facilitate infrastructure investment. After a three-year struggle, it at last became operational in 2021. This year, the Treasury put R4,2 billion into the fund, with another R13,3 billion to follow over the next two years. Over 10 years, the Treasury will contribute R100 billion. (One wonders if some of the money from the spectrum auction will go there…?)

Seven projects adding up to R21 billion have been approved by the fund, which will contribute R2,6 billion of the money, with the balance coming from the private sector and development institutions. It shows the leveraging impact that the fund can have. The seven projects include social housing and student housing projects and two water projects (the Olifantspoort and Ebenezer Water Supply Scheme and the Mokolo-Crocodile River Water Scheme, both in Limpopo).

A third duck getting into the row is the deliberate effort to build skills. Last year, government admitted that it simply does not have the capacity to run infrastructure programmes. A dedicated unit, Infrastructure South Africa, was established to build a pipeline of projects – in the process building skills and capacity. The Treasury, through its technical advice service, is helping to build skills at both the Infrastructure Fund and at Infrastructure South Africa.

Infrastructure South Africa's work also involves unblocking policy and regulatory obstacles to infrastructure development. An example is getting land rezoned by a municipality to build a school. Currently, it takes an inordinate amount of time. (The same problem exists in getting land rezoned for renewable-energy projects).

Connect the dots of political will, more money and building capacity, and infrastructure spending is likely to increase considerably.

Growth dividend

Treasury modelling suggests that these structural reforms should add about 1,7% to GDP growth. If we take our current growth ceiling as about 1,5%, it means that growth can go to 3,2%, which is double our population growth.

Have a heart

Allowing the private sector into the network industries and financing infrastructure is new territory for South Africa. We grew up with state monopolies in the network industries. The tradition is more than 100 years old. Converting to private sector participation requires new rules and practices. Developing them will necessarily take time. Who takes the risk? Who does the maintenance? What is a reasonable return? Over what period? These are the details that need to be thrashed out. Naturally it involves a process of negotiation and arm twisting between old monopolies and new private sector players.

On toll roads, we have developed successful partnership models. It happened through an intensive process of having all the parties in the same room, the engineers, bankers, operators, builders, lawyers and policy makers. The same will now be happening in energy, railways and harbours. It is not necessary to go hysterical when the process plays out and it seems like the parties are far apart.

The trend is clear: the genie is not going back into the bottle of state monopolies. We will learn how to have a 'mixed economy' in the network industries.

Employment stimulus

A separate page in the economic report book concerns short-term relief measures on unemployment.

In October 2020, the President set the goal of 800 000 public employment jobs. This must not be confused with civil service jobs. They are temporary jobs paying a stipend of R 3 500 per month. To date, 850 000 people have been employed in this programme, of which more than 500 000 have been employed in education as teachers' assistants, cleaners and janitors in schools. More than 80% are young people and 60% are female. The number is set to rise to one million this year. There is enough money in the budget to sustain the programme for three years. Will it solve the country's unemployment problem? No. Will it contribute to alleviating poverty and put some food on the poorest tables in South Africa? Yes.

The programme is now being expanded beyond government by using the capacity of non-governmental organisations (NGOs) and community organisations that work in areas such as urban agriculture, early-childhood development, public art and gender-based violence. It is expected that 50 000 jobs will be created that way.

Other dots include:

- the expansion of the employment subsidy, making it easier for smaller businesses to employ young people;
- the SAYouth.mobi platform for young work seekers, which now has more than 2,3 million young South Africans registered, of whom 600 000 have been placed in jobs;
- the revitalised National Youth Service, which will recruit its first cohort of 50 000 young people this year; a total of 10 000 unemployed technical and vocational educational and training (TVET) graduates who will be placed in workplaces, starting this month; and
- the Department of Home Affairs having hired 10 000 youngsters to digitise records.

These dots will not resolve South Africa's unemployment problem of nearly 12 million unemployed people. To lower unemployment substantially we need to increase the size of our economy. That is where the structural reform measures come in. But these employment measures provide young people with the work experience they need to take their first step into the labour market. They also bring much-needed relief while unemployment is rife.

So what?

- It was a former editor of The Economist, Bill Emmot, who said '… like all instant analysts, the journalist is constantly at the risk of over-interpreting the short term and under-rating the longer-term trends. What is needed is a longer view.' The dots help us to see the longer-term trends.
- More space is being made for the private sector in energy, railways, ports and infrastructure funding. The monopoly model that South Africa has grown up with for over 100 years is changing fundamentally.
- This is an important new trajectory for more investment and higher productivity.
- For six years, South Africa has suffered from declining per capita incomes. It turned around in 2021 (thanks to the low base Covid-19 created). More investment and higher productivity can lift growth by 1,7%, enough to put South Africa back on the path of rising per capita incomes. It is a tipping point.
- At the second investment conference in 2019, the President said: 'The man who moves a mountain begins by carrying away small stones.' That summarises his style. Over the past two years, the stones have systematically become bigger. The mountain will move.