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Investment – pulling it all together November 2024

25

Turning South Africa into 1 big construction site is the expressed ideal of ministers from the ANC and the DA. What is the state of play, and what are the prospects?

2 sectors: public and private

2023 GDP IN CURRENT PRICES:

ABOUT R7 TRILLION

TOTAL INVESTMENT IN 2023:

R1 TRILLION, i.e. 15% of GDP

In 2023 total investment in the country amounted to just over R1 trillion. Total GDP was just over R7 trillion, which means investment came to 15% of GDP.

It is below the 25% National Development Plan's ambition but still an enormous number. It comes to R114 million per hour, every hour of each of the 365 days of the year!

(Just for fun, some context on numbers we use so glibly: If one counts at a speed of 1 digit every second, it will take 5 seconds to get to 5 and 10 seconds to get to 10, and so on. To get to 1 million will take 11.5 days; 1 billion 31.7 years; and 1 trillion 31 709 years! To get to R114 million will take 3.6 years.)

Traditionally, fixed investment in South Africa comprised about two-thirds from the private sector and one-third from the public sector. In recent years, the public sector share has declined, and the private sector share has increased. By 2023, the numbers came to 71% and 29%, respectively. The private sector is becoming ever more important.

A new UNU-WIDER working paper by Prof Philippe Burger from the University of the Free State found that a 1 percentage point increase in the private-investment-to-GDP ratio can increase economic growth by 0.675% per annum. That is a spectacular dividend. He also found that an increase in both government and public corporation investment to GDP did not translate into higher growth. It does not mean that public sector investment is unimportant or can be dispensed with; it simply means that the efficiency of public spending must improve. It resonates with common sense: Medupi and Kusile are prime examples of

inefficient spending, as are the numerous reports of exorbitant prices often paid by the public sector, like R1 million for a borehole or millions of rands to tar a stretch of road. The efficiency of spending matters.

All the more so, because public-sector investment fulfils an important social role and often acts as a catalyst for private-sector investment. Both public and private sector investment are indispensable to the economy.

Public sector

A total of R943.8 billion is budgeted for public-sector infrastructure spending over the 3 years from 2024 to 2027. It increased above the inflation rate and defies the often-stated truism that capital expenditure is the first to be cut when budget austerity occurs. The increase reflects political priorities.

Who spends the money?

State-owned enterprises (SOEs) are the biggest players (40%), followed by municipalities (23%), provinces (20%), national departments and their agencies (16%), and public-private partnerships (PPPs) (2%). One can expect the SOE share to decline over the coming years and PPPs to increase. Medupi and Kusile are nearing completion, and both Eskom and Transnet will rely more on private capital for further projects.

Though public investment is increasing, the R943.8 billion is still only equal to about 4% of the expected GDP for the 3 years. Using more private-sector money is indispensable if we want to increase public investment.

Quality

Of course, these numbers tell us nothing about the quality of spending. There is corruption, poor planning and budgeting and faulty execution. Much of the corruption in the public sector is committed by private companies, as revealed in the Zondo Reports and monies subsequently reclaimed from private companies.

Construction mafias also influence the quality of spending and sometimes block this completely. Government officials are talking about R63 billion in projects that have been blocked. (Using our earlier calculations, it will take nearly 2 000 years to count to that number!) Let's watch this space over the next while and see how it develops.

Public-private partnerships

Although PPPs form only about 2% of the R943 billion budgeted for infrastructure, they punch above their weight when it comes to delivering good-quality outcomes. Toll roads are a good example - we all know the difference between driving on a toll road and driving on a provincial road.

The range of PPPs is now being expanded to include projects like the redevelopment of 1 Military Hospital in Tshwane and Tygerberg Hospital in the Western Cape, as well as the upgrade of 6 border posts between South Africa and its neighbours.

A small but unique PPP was concluded earlier this year between the Mpumalanga Tourism and Parks Agency and the British Aspinall Foundation to redevelop the Loskop Dam Nature Reserve. The partnership will upgrade infrastructure like roads, fences, staff accommodation and field ranger facilities. The agreement will run for 25 years and unlock R120 million in investment. The ambition is to expand the 23 500 ha reserve to 100 000 ha by incorporating community- and privately-owned land. That will make it bigger than Pilanesberg.

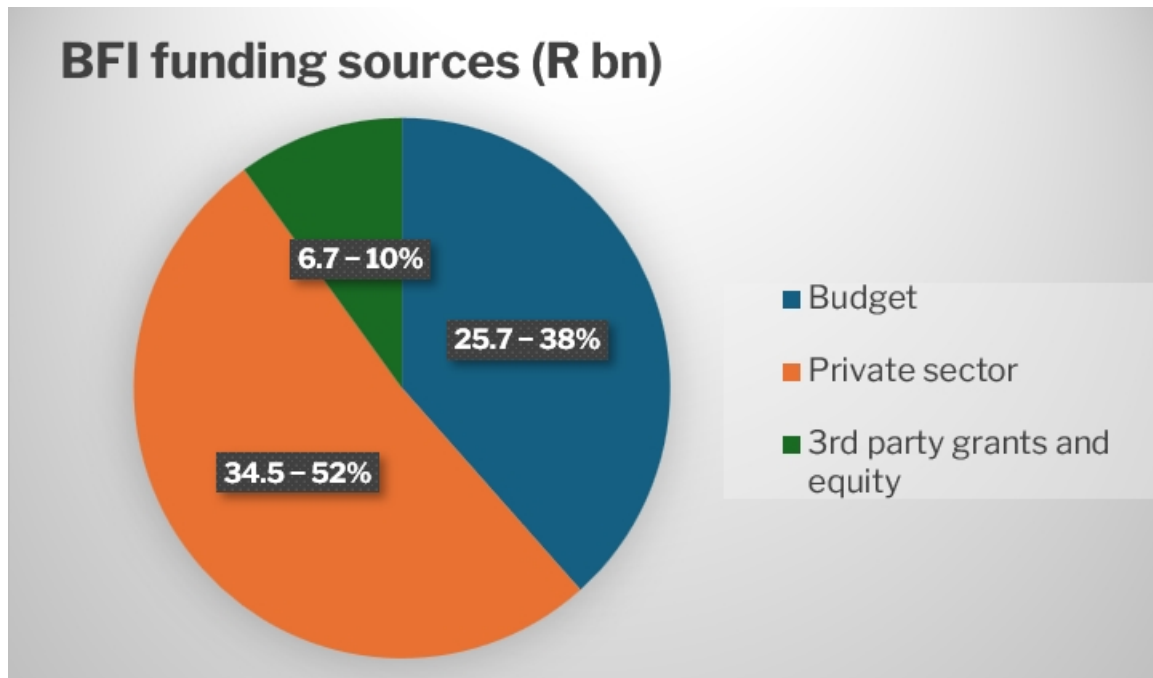
Budget Facility for Infrastructure (BFI)

A step to ensure better quality spending was taken back in 2016 when the Treasury created the Budget Facility for Infrastructure (BFI). It requires public sector projects to do rigorous planning and technical preparatory work before they will be considered for budget finance.

Up to now, the BFI has operated by way of an annual bid window, when public institutions could bid to have their projects included in the budget. The seventh bid window was run this year. In October, the Minister of Finance announced that the bid windows will now be run on a continuous basis to evaluate projects rather than just once a year. That should throw the quality net a bit more widely.

Apart from quality control, the BFI also increases access to funding by hooking up public projects with private funding where appropriate.

Some 14 projects totalling R66.9 billion are financed through the BFI, an increase of 7% from last year. (Again, these increases are telling in the context of budget austerity.) About 38% or R25.7 billion comes from the budget, 52% or R34.5 billion from the private sector and 10% or R6.7 billion from third-party grants and equity. Examples of projects include social housing (some 14 000 units), 5 water and sanitation schemes, the revamping of 6 border posts, and student housing projects on 4 different campuses involving some 10 000 units.



Infrastructure Fund and Infrastructure SA

An important step change occurred in 2018 when President Ramaphosa took office. He launched the Infrastructure Fund with the intention of blending public and private funds and increasing the pot of money available for infrastructure. The fund became operational in 2020. (Things take time in the public sector).

To strengthen planning, budgeting and execution abilities, Infrastructure SA was created to work alongside the Infrastructure Fund on all projects of more than R1 billion. It is a one-stop shop for large infrastructure projects with a team of professionals to help unlock projects. In this year's budget, R600 million was allocated to Infrastructure SA for technical and professional skills to prepare, manage and execute projects. Grand plans require grand skills. Infrastructure SA is now the co-ordinating point for infrastructure projects.

Currently, there are 31 projects under preparation by Infrastructure SA, among them schools in the Northern Cape and Eastern Cape and 4 hospitals in Mpumalanga and the Free State.

Water and sanitation

Water is an evermore present worry for many South Africans. I've therefore included some detail below on what is happening in that area.

With regard to bulk supply, the government has prioritised 11 projects across 7 provinces totalling about R139 billion (included in the above numbers for the public sector). Some examples:

- The biggest single project at R42 billion is the Lesotho Highlands phase 2 project, for delivering water to Gauteng (Completion date 2028).
- KZN will benefit from 3 different projects totalling about R46 billion, which will bring much-needed relief to the province, particularly the South Coast (completion dates 2027 to 2032).
- An interesting one is the Olifants River project in Limpopo, a joint effort between Glencore, Amplats and the government. It will involve 400 km of pipelines and provide 250 million litres per

day - equal to about one-third of Cape Town's usage. Ten local and international banks are involved in the financing (completion date 2030).

However, water is not just about bulk supply. Municipalities distribute it, and that is where there is many a slip between the reservoir and the tap.

Leaks and non-revenue water

Following the template developed for renewable energy, the government has set up the Water Partnership Office (WPO) in the Development Bank to help municipalities raise private sector finance to fix their creaking water systems.

'The WPO has begun to mobilise private sector financing for water projects in eThekweni, Mangaung, Buffalo City, Nelson Mandela Bay and Tshwane for the replacement of leaking municipal water distribution pipes, which are resulting in high levels of non-revenue water', says Johann Lubbe, Head of the Water Office. However, he warns: 'But it takes time. It's not something that happens overnight. For the larger projects it takes 12 to 18 months to structure the project properly. You also don't want to rush through something and put it out to the market, and then the private sector shoots it full of holes.'

Bringing private and public sectors together should instil some discipline and proper management in local water administration and ensure better quality. Last week, Treasury agreed to withhold municipalities' equitable share (their transfers from the budget) where they owe money to water boards. This will ruffle a few feathers. It is also a feather in the cap of the Department of Water, which lobbied Treasury for this decision. (Now imagine if the same arrangement can be made for municipalities not paying their electricity bills.)

Private sector

Private sector investment in the economy runs at about 10% of GDP, below the NDP target of 15%. Thus, both the public and private sectors fall short of their NDP targets (public 4% to 10% and private 10% to 15%).

In 2023, 6 of the 9 economic sectors measured by SARB data invested less than they did in 2019 (measured in constant rands). First, Covid (2020) and then load-shedding (2021/2022) knocked the stuffing out of the economy and investment.

The three sectors that invested more are Agriculture, ICT (information, computer and telecommunications equipment) and transport, storage and communication. Agriculture led the pack with 33% more investment. Clearly, the noise around expropriation is not deterring the farmers from investing.

Even the biggest sector in the economy, namely finance, insurance, real estate and business services (they are grouped together), invested 11% less in 2023 than in 2019. Over the years, this sector has replaced mining as the biggest sector in South Africa. Financial institutions now play the societal role that big mining companies once played.

Mining itself invested 2,2% less in 2023 than in 2019. In fact, it invested 9% less than ten years earlier in 2014. The country is really undergoing a big change from mining to other sectors. Perhaps gas discoveries will turn that around, but so far, the mining decline is both persistent and substantial.

The construction sector, critical to turning the country into a big construction site, invested 3,5% less in 2023 than in 2019. A bigger pipeline in both the public and private sectors is needed to propel this sector.

Energy

Like mining was a hundred years ago, energy is now the investment frontier in South Africa. It is not showing up in the official numbers yet, but it is happening. I count it all as part of 'private sector', because even the public procurement projects in electricity (bid windows) are all built with private capital, although with a public sector guarantee.

(The guarantee arrangement must change but is not a topic for this note.)

Generation

Six bid windows have been run to date, resulting in agreements for 8 000 MW of new generation capacity

(all renewable) for a total investment of R270 billion. Bid Window 7 for 5 000 MW is currently in the market. Investors are clearly keen: Bids for 8 526 MW have been received; a final decision on the winning bids should be made by the end of November. Also in the market is a bid window for another 615 MW of battery storage and 2 000 MW of gas-to-power. These projects are estimated to involve R180 billion investment between 2026 and 2029.

6 bid windows completed	Now in market	Private companies
<ul style="list-style-type: none">• 8000 MW• R270 billion	<ul style="list-style-type: none">• BW 7: 5000 MW• 615 MW batt, 2000 MW gas• Est R180 billion	<ul style="list-style-type: none">• 22 500 of own power in pipeline• Est R390 billion

However, the bigger action is outside the bid windows. An important shift away from public procurement has occurred since President Ramaphosa opened up the market in 2022. A whole new energy system is now being developed, all of it with private capital (without government guarantees).

More and more companies are making their own arrangements on power: some are building their own facilities, some are concluding power purchase agreements with renewable facilities, some deal with energy traders who buy and sell power, some contract with energy aggregators who buy power from different generators and sell it to a range of customers, and so on.

Private power is no longer about load-shedding. It is now about the ever-rising cost of Eskom tariffs; having a green footprint to limit carbon taxes; and environmental, social and governance (ESG) considerations. The game has changed profoundly since 2022.

According to Operation Vulindlela data, 22 500 MW of private sector projects are currently in the pipeline, with an estimated investment of R390 billion. Even if we assume that not all of it will come to fruition, it is still a healthy dose of investment.

An often-forgotten fact is that even with recent postponements granted to some Eskom power stations, 8 of the 14 Eskom coal-fired power stations are going to close down over the next decade. Simply replacing that capacity will require significant investment.

Transmission

As is generally known, the transmission grid is a constraint and needs to be upgraded. The numbers required vary between R200 billion and R390 billion, depending on the time frames used by the forecaster.

The National Transmission Company of SA (NCTSA) has R112 billion earmarked over the next 5 years to build transmission capacity. To unlock further funds, the government has authorised the Independent Power Producers Office (IPP Office) to run a pilot programme to procure SA's first independent transmission project. It will be a build-operate-and-transfer project running over 25 years. A new credit guarantee vehicle, developed with the World Bank's help, will support the project so that private investors have some guarantee, but the government is not on the hook for 100% of the project.

By 2028	By 2034
<ul style="list-style-type: none">• 31 projects• 16 000 MW connected	<ul style="list-style-type: none">• 30 projects• 40 000 MW connected

NCTSA projects that 56 000 MW of new generation capacity will be integrated into the grid over the 10 years between 2025 and 2034. The 31 projects currently under construction will connect 16 000 MW of capacity by 2028. A further 30 projects will enable 40 000 MW by 2034. That 56 000 MW can indeed be reached.

The overall trend on energy is clear: over the next 5 to 6 years, R1.5 trillion is needed for the energy

transition, and in the 10 years after that, a further R3 trillion. That will surely take energy beyond mining and the finance, insurance & real estate sector as the biggest investment sector in the country.

So what?

- The trick in making SA 1 big construction site requires that investment in both the public and private sectors must increase from 4% to 10% of GDP to 10% and 15%, respectively.
- One of the consequences of state capture is that SOEs, once perceived as the engine of public investment, have suffered a severe decline. This necessitates the use of more private funds for public infrastructure.
- Since 2018, the political climate on public-private partnerships and using private capital in the public space has changed significantly. There is a greater willingness to blend public and private money for infrastructure.
- For this blend, one needs a pipeline of credible projects. The institutional architecture to plan and execute the projects is getting stronger and the pipelines are getting bigger.
- More stringent project requirements and the use of more private capital will simultaneously improve the quality of spend and increase the pot of money.
- Using private money will also maximise the public sector's role. It is really a no-brainer.
- Ironically, load shedding and water shedding are driving these changes ever more forcefully.
- As for the private sector, all confidence metrics have improved since the formation of the Government of National Unity; and confidence is the foundation of private sector investment.
- Of course, all this may become unstuck due to global events (eg Ukraine, Middle East, Trump) but that is beyond our control. Let's focus on what we can control.