SONA – BUT CAN WE IMPLEMENT? 16 Feb 2022

As far as the economy goes, last week's State of the Nation address (SONA) dealt primarily with structural reform in sectors like electricity, spectrum, transport and infrastructure. But even the sceptics who supported the announcement asked: it's all very well, but will it be implemented?

The easiest way to answer that question is to look back at the track record of implementation on critical economic issues. As the president himself said "The state of the nation is linked inextricably to the state of the economy".

Reviving the economy is firstly a policy choice

There is broad agreement that, without dramatic intervention, the South African economy has a growth ceiling of about 1,5% to 2,0% per year. That is about the same rate as population growth. There is no hope of dealing with the country's triple curse of PUI (poverty, unemployment, and inequality) if this doesn't change.

So, what dramatic intervention could bring revival? Two possibilities are being debated vigorously.

The first, let's call it 'easy money', is to stimulate demand by running bigger budget deficits, financed by printing money, with the central bank buying government bonds. This view states that addressing people's direst needs through more government spending will in itself promote growth. The US, UK, Japan, and others have indeed chosen this route and it has helped them – except for the small matter of inflation. This view also ignores South Africa's current account balance constraint.

The second option, let's call it 'the hard way', is to address the fundamental factors creating the growth ceiling. Stimulating demand while there's no reliable electricity supply, trains that cannot move goods, and exports that cannot leave the harbours will not help growth. It will only stoke inflation, which will hurt the poor and middle classes most. What is really needed is higher productivity in electricity, our harbours and so on. That is brought about by deep structural reform.

This SONA confirmed unequivocally what has been clear since early 2019: government has chosen the route of structural reform. So the policy choice has been made. Can government now implement the required reform? Let's consider their recent track record on the most important issue in the economy: electricity.

Reviving growth - electricity

Electricity reform started in **2018**, seven weeks after Ramaphosa took power, when 27 independent power producer (IPP) contracts were signed. These contracts had been suspended by Brian Molefe then at Eskom, causing South Africa's very successful renewable energy programme to simply crash. The signing didn't happen without opposition. Parties with vested interests were livid, blockading Tshwane more than once and going all the way to the Appeal Court to stop government, happily to no avail.

Later in 2018 a draft of the Integrated Resource Plan (IRP) was published for comment and consultation, as is required by law. In **2019,** the final version was promulgated. It opened the door decisively for renewables, storage and gas.

Also in **2019**, the president announced that Eskom would be split up, ending a century-old vertically integrated model built by Hendrik van der Bijl and his successors. As with the IPP contracts, there was vociferous opposition from various interest groups, and the sceptics harrumphed that it would never happen. Three years later not only has the separation taken place, and a free-standing transmission company will be legally constituted by the end of 2022.

In SONA, the president said draft legislation to create a legal framework for such a competitive market would soon be published. It was published the next morning. Among other things, it provides for a free-standing transmission company, as mentioned above. The Eskom break-up paves the way for a competitive electricity market in South Africa, a truly radical reform. The 2019 announcements are coming to fruition.

2020 was the year of Covid-19. Even so, in October regulations were promulgated allowing municipalities to procure their own power from any source. Johannesburg Metro was first out of the starting blocks with a tender for 220 MW. Currently, eight municipalities are in the process of procuring a total of 1 400 MW.

In **March 2021**, bid window five for 2 600 MW from renewables was opened. Contracts were allocated to 27 successful bidders at the end of October.

In **June 2021**, the president announced that the licensing exemption for power generation would be lifted from 1 MW to 100 MW. Regulations giving effect to that change were published in August. Currently, an estimated 4 000 MW of projects are being pursued by various players under the new regulations. The number is likely an under-estimate as it comes from only one sector (mining) whilst we know of many other companies and private households turning to renewables.

Together with 500 MW from the tail-end of bid window 4 and 800 MW from the risk mitigation programme, this means that 9 300 MW is in the process of being added to the grid. For context, the capacity shortage Eskom wants eliminated to avoid load shedding is 6 000 MW.

In **2022**, three further bid windows will open: bid window 6 for 2 600 MW of renewable generation (end March); a small window for 513 MW of battery storage (April) and bid window 7 for 3 000 MW of gas six months later. That will add a further 5 600 MW.

The only blot on this track record is the Karpowership deal. The allegations of corruption and the inappropriate 20-year contract means it will be a blessing if this falls through.

Understandably, any conversation about electricity in South Africa is completely dominated by load-shedding and the Karpowership deal. It creates the perception that nothing is happening. Yet, under the noise and dust, a revolutionary change is playing out.

Three other sectors

Private sector participation in **railways and harbours** has long been a goal. Some pre-conditions had to be met: separate operations from the regulatory role in both railways and harbours, determine who carries what risk, who must do the maintenance, and so on. Some of these changes have been made and others are in progress. In SONA, the president set target dates for private sector participation: April for rail (Gauteng/Durban line) and October for two harbours (Durban and Ngqura).

Should the **spectrum** auction indeed proceed on 8 March, as the president confidently stated, we could compile a similar track record on spectrum release. Like so many things under Zuma, migration languished for 10 years, and South Africa missed the 2016 deadline. It was only seriously tackled after 2018 when the relevant minister was replaced, the court fight between him and the regulator stopped, and the matter was attended to as a political priority. The critical pre-condition for release is migration from analogue to digital broadcasting. Last February, the president stated that migration will be completed by March 2022. It has proceeded on schedule and will indeed be completed by end March. Only Telkom and the courts can stop spectrum release (Telkom’s application will be heard in April.) There has been more progress in the past four years than in the 10 years before that.

Again, it is however no plain sailing. Vested interests oppose, courts interdict, regulators stumble – but vision, political will and staying power still triumph. We will know on 8 March.

A similar story seems to be unfolding in **infrastructure**. Regular readers will know I have been cautious about infrastructure, but things seem to be coming together. The president first announced an infrastructure fund in 2018; it took three years to drive it through the bureaucracy and get it established. (The president's frustration has been palpable.) Covid-19 also reduced the money available for the fund. Still, it is now operational. SONA contained detail on infrastructure projects with clear money commitments from both the public and private sectors. We will assess this track record too a year's time, but momentum seems to be building.

What we can learn about implementation so far

The changes in the four sectors discussed above are quite radical for South African. Traditionally these sectors have been monopolised by the state. That is now changing and could not have happened without political vision, overcoming opposition, building support, harnessing technical skills and staying the course through setbacks and mistakes. It bodes very well for the implementation of SONA pronouncements.

This track record blows out of the water the notions that Ramaphosa 'just sits on his hands', 'does nothing', that 'he's afraid of his ministers', 'only appoints task teams', and 'kicks the can down the road'. If he did only those things we would be where we are now.

Reviving investment and employment

The expansion of electricity generation outlined above implies enormous investment. New plants cost money. A back-of-the-cigarette-box calculation points to investment of more than R190 billion over the next three years and more thereafter. All the investment will come from the private sector, with about half from foreign investors. It will shift the dial not just on investment numbers, but also employment. South Africa will be a most peculiar place if that kind of investment does not create jobs.

Furthermore, award-winning economist Elna Moolman has calculated that load-shedding has cost South Africa 1% growth a year for the last three years. That is a lot for an economy with a growth ceiling of 1,5% to 2,0%. If that constraint is lifted, the effect will be substantial, also on jobs. More investment and more jobs must mean more demand, which means more growth. Add spectrum, railways and harbours, infrastructure, and the IMF is not far out with its view that 3% growth is attainable through reforms.

Structural reform: a 25-year view

The last time South Africa experienced serious structural reform was between 1990 and the early 2000s. Sectors like agriculture, road, rail and air transport, radio and television broadcasting, as well as telecommunications were all turned on their head. Trade tariffs, budgets and tax administration were also subject to drastic reform. Not surprisingly, South Africa's productivity numbers show a concomitant rise for that period.

For four years the economy grew by more than 5% per year and created more than 500 000 jobs per year – that is two million jobs in four years. So much for jobless growth… The numbers speak for themselves. Imagine for a moment if we had carried on creating 500 000 jobs a year… Granted, there was also a commodity super-cycle, but electricity was abundant, trains took exports to the harbours, and the harbours shipped them out. Now there is again a commodity boom, and we struggle to get growth going.

Back in the middle 2000s the Mbeki administration appreciated that more needed to be done and Trevor Manuel appointed an international and South African panel of experts to advise. They made common sense recommendations that are still relevant today. However, the recommendations died an early death when Mbeki was removed at Polokwane, Manuel left Treasury, and the Zuma era started. The 2010 World Cup boosted growth, bringing some reprieve, but by 2014 the game was over. Since then, we have experienced declining investment, job creation and per capita incomes. We got poorer, aggravating the problem of PUI.

Now, electricity is the one sector in which serious structural reform has been undertaken. Announcements on spectrum, rail, harbours and infrastructure in this year's SONA herald a new era of such reform.

So what?

- South Africa needs drastic change to lift the growth rate above the 1,0% to 1,5% ceiling.
- The government has chosen 'the hard way' to make this happen by addressing fundamental factors holding back the economy through structural reform.
- A timeline of reform in electricity shows government has indeed implemented plans and goals over four years despite opposition, setbacks and mistakes.
- Expansion of electricity generation implies investment of more than R190 billion over the next three years, which will mean more growth, more jobs and more demand.
- Spectrum, harbours and rail, and infrastructure are the next areas of focus. We will monitor the developments.