

**QUESTIONS RAISED BY THE PORTFOLIO COMMITTEE ON TRADE
AND INDUSTRY: INDUSTRIAL POLICY ACTION PLAN
3RD MARCH 2010**

ANSWERS SUBMITTED BY BUSA

Introduction

The questions raised by members of the committee have been clustered into themes to facilitate answering.

Integration and co-ordination

1. BUSA mentions that there is a need for an integrated approach within government. One of the ways to deal with this is to ensure wide awareness of the IPAP. Government has a responsibility for this, but BUSA also has a duty in this regard. How can BUSA work in step with Government to raise awareness?

BUSA is committed to working with Government and other stakeholders to support successful implementation of IPAP2. To this end BUSA will publicise the document widely within its constituency and will encourage its affiliates to do the same.

2. Please elaborate on the apparent lack of common ground between National Treasury and **the dti** on the preferential procurement proposals.

Implementation of many of the proposals in respect of preferential procurement contained in IPAP2 requires legislative amendment or at least a change in approach to tender requirements. It is understood that the National Treasury considers at least some of the proposals to be unconstitutional and thus they are unable to engage with anyone on how to implement them. Although it is BUSA's assumption that a document as important as IPAP2 would not have been released without ensuring constitutional validity, it has encouraged affected affiliates to take up the issue individually. One of BUSA's affiliates has obtained a legal opinion on the "point matching" proposal, which in Treasury's view is unconstitutional, which expresses a contrary view. It is proposed that this matter be addressed in cabinet as a matter of urgency so that joint progress can be made in the first quarter as planned in the action plan.

Promotion of SMME's and co-operatives

3. Current policies towards SMME's have failed to narrow inequality within the South African Society. What strategies can BUSA recommend to narrow the inequality gap especially in respect to SMMEs and co-operatives?

It is recognised that South Africa's Gini Coefficient remains amongst the highest in the world, this is concerning because inequality has a negative impact on poverty reduction. Effective steps to achieve progressive growth (growth whilst simultaneously reducing inequality) that have been successful in other countries are

investment in education for all to increase efficiency and growth; reduction of health inequalities; creation of income, employment and incentive-based fiscal transfers to alleviate poverty in the short run, and public investment in rural infrastructure. These initiatives are mainly implemented during economic growth periods as more resources become available.

Creation of economic opportunities is one of the most sustainable strategies for eliminating both poverty and reducing unemployment in South Africa. The challenge so far is that the levels of support might not be adequate to assist micro industries graduate from the “informal” economy into the mainstream economy. BUSA believes that SMME development must be aligned to the overall education and skills planning.

A low level of performance by some segments in this sector reflects years of under-performance in education and skills area which ultimately means that there is limited scope for this sector to grow. It is proposed that practical business training has to be provided to the SMME’s & Co-Operatives, such training should include financial management and market readiness training.

Cost of doing business

4. BUSA refers to the cost of doing business and this is understood to refer to infrastructure costs. What other factors contribute to the cost of doing business?

It is correct to say the cost of infrastructure is a factor in the cost of doing business but there are a number of other factors that contribute to the uncompetitively high cost of doing business.

Government has acknowledged that the regulatory environment “unnecessarily hampers the development of business”. In order to reduce the regulatory burden on business, especially SMME’s government undertook to introduce a system of Regulatory Impact Assessment (RIA). This was based on the understanding that certain laws and regulations can have negative unintended consequences.

The first challenge arises as the result of the lack of integration between the three spheres of government. It is often found that there is no uniformity in municipal by-laws and rules, licensing regimes and other provincial and national government policies. Secondly, the myriad of such regulations and laws mean that compliance costs for companies are significantly higher than would have been in a more streamlined environment. The situation is amplified by administrative inefficiencies that are not uncommon in many government departments (at all three spheres). Often these inefficiencies result in delays in getting licensing and permissions. In respect of SMMEs the situation often forces them to operate outside the formal economy.

Further, there is a significant number of SMME’s who operate in peri-urban areas, where access to necessary physical and telecommunications infrastructure remains a challenge. It is worth investigating the possibility of creating a flexible regulatory framework for this group, to ensure that a balance is struck between SMME development and other local government imperatives.

BUSA has repeatedly called for the implementation of the RIA process to assess the impact of regulation on business especially SMME's. While it is understood that progress has been made in implementing the RIA system, for such a system to be successful it needs to include input from business. The outcome of regulatory impact assessments should form part of the public record in respect of new legislation. The RIA process should be used on all legislation at national, provincial and local level to eliminate duplication amongst the different spheres of government.

5. How does BUSA think that duplication of regulatory measures can be addressed, particularly through monitoring so that decisions affecting business can be expedited? SMMEs should also benefit from this.

Comprehensive application of the RIA system should eliminate future duplications. Current duplications should be addressed as part of the improved implementation of the RIA system. BUSA would be willing to provide details of current duplications being faced. Timeframes for decisions in terms of legislation should be introduced as an integral part of any legislation which has an impact on a company's ability to establish and operate a business. Performance reporting of all departments should include this aspect.

The application of different requirements in provinces and municipalities could also be addressed through comprehensive application of the RIA system. The accounting officer of each national department, provincial and local government should be required to declare that legislation is aligned with other existing legislation and that the requirements do not duplicate requirements of other legislation. BUSA therefore agrees that performance monitoring could play an important role in reducing the cost of doing business.

6. In respect of the regulatory burden is the problem the actual regulatory regime of the implementation thereof?

In general implementation of legislation is the greatest contributor to the regulatory burden. In many cases lack of resources results in delays in decision making and in some cases also results in poor decisions, which ultimately force companies to seek redress in the high court or to abandon the project all of which increases the cost.

Development finance

7. The IPAP largely focusses on support for big business. In the aggressive pursuit of employment there must also be a focus on support for SMMEs. What specific suggestions does BUSA have as to how Development Financing can be applied to support SMMEs.

Currently there are various development finance institutions whose mandate includes supporting SMME development, namely Umsobomvu, Khula, SEDA, the National Empowerment Fund. Several provincial governments have also introduced agencies to support SMME development, for instance the Gauteng Enterprise Propeller, and Ithala Bank in KZN. Whilst BUSA has not commissioned research in this area, anecdotal evidence suggests that administrative inefficiencies are the primary reason

for low uptake by the SMME sector. Further, the funding application process is often described as overly complicated and is not generally user friendly especially for the micro business person. DFI's performance in the micro enterprises lags that of independent financing institutions like the Women's Development Bank, which on average disburses more than 50 000 loans to micro businesses especially those in rural areas. It could be useful to review models in organisations such as WDB to assist government in developing a new approach to SMME financing.

Further, there is a case to streamline the application process for funding across all sectors. The proposal is that a single application (whether paper based or online) could be simultaneously submitted to all SMME focused DFI's. This will significantly reduce the administrative burden and ensure quick response time for the businesses.

The current structure of DFI application process creates a perverse incentive that discourages SMME funding in general. The loan application process is the same whether the amount is R10 000 or R1 Million. Thus the DFI has to invest the same effort for two completely different programmes. The perverse incentive arises because DFI are measured by the total number of funding disbursed, regardless of the number of receiving businesses. Based on the current performance measurement system it is much more expedient for the DFI to disburse a single R1 Million loan than a hundred R10 000 loans. BUSA proposes that a system is investigated to streamline the application process and to ensure that the perverse outcome from DFI's is minimised.

8. BUSA mentioned that IDC is risk averse and operates like a commercial bank. Can BUSA provide clarity on how the IDC should operate, especially given the background of a self-funding IDC, which funds projects off its own balance sheet without capitalisation from the state?

The banking association and National Treasury are currently engaged in discussions as to how this challenge can be addressed.

9. BUSA mentioned that industrial incentives may exclude sectors that are not specifically listed. BUSA must specify which sectors which are excluded should be included in the incentive scheme?

The Action plan lists the following sectors:

- Metal fabrication, capital equipment and transport equipment
- Green and energy saving industries
- Agro processing
- Automotives, components and medium and heavy commercial vehicles
- Downstream metals beneficiation
- Plastics, pharmaceuticals and chemicals
- Clothing, textiles, leather and footwear
- Biofuels
- Forestry, paper and pulp and furniture
- Cultural industries; craft and film
- Tourism
- Business process Services

Advanced manufacturing.

In turn within each sector specific projects are listed. It is proposed that the action plan clarify whether development financial support is only available to those projects and sectors listed or whether access to incentives is available to any projects where the project will contribute to achievement of the overall objectives of industrial policy. As the list provided is clearly not an exhaustive list of the sectors in the economy. It is important that this be clarified.

10. How can provincial agencies support business through the industrial financing?

Provincial and national agencies should work in alignment. For industrial policy interventions to work it is necessary to achieve a critical mass of companies contributing to the objectives of the policy. It is therefore important for provincial agencies to complement the support provided by national agencies rather than engage in separate non aligned activities.

Developmental trade policies

11. The major problems arising from importation of low quality and underpriced goods are well understood and reflected in the IPAP. How can we address these problems?

There are two broadly separate problems to be addressed. The issue of underpricing can be addressed by having a sound information management system where data on the cost price of goods is collected and maintained. This allows customs fraud relating to under invoicing to be more easily identified. This is one of the measures which has been agreed by stakeholders in Nedlac and on which some progress on implementation has been made.

The question of the quality of goods presents a different challenge in that in order to restrict the import of substandard goods a national standard is required against which the goods can be measured. IPAP2 includes a number of products for which the development of standards should be prioritised. Once the national standard has been developed customs inspections need to be carried out on the goods in question to ensure that they comply with the national standard.

Infrastructure provision

12. Funding is recognised as a major challenge for infrastructure provision. Does BUSA have thoughts on privatisation and other ways in which the private sector could support investment in infrastructure? Comments on PPPs and selling off of assets.

There are a number of ways for the private sector to contribute to the financing of public infrastructure without transferring responsibility for rendering the service to the private sector.

These include Private Public Partnerships, whole or partial sale of existing assets, investment in market instruments like bonds.

In the case of private public partnerships, BUSA has identified a range of challenges to full exploitation of the amount set aside by Government for such partnerships. A summary of BUSA's views on this matter is attached as Annexure 1.

Business wants to work with government to overcome the problems which constrain the unfolding of a far more vigorous PPP market, which could alleviate the pressure for funding from the fiscus.

Sale of existing assets in tariff funded services can help to overcome the current funding backlog that exists in investment requirements in most major infrastructure services. The attractiveness of the sale of infrastructure assets to private sector investors will depend on the conditions of sale and the risks inherent in the situation. For example the sale of 30 % of Kusile, which has not yet been commissioned is a bigger risk for an investor than the sale of 30% of an operational power station where the operational performance is known.

Freight infrastructure offers different possibilities in that in order to move freight from road to rail, which has to be a national objective, infrastructure elements that lend themselves to private sector investment are branch lines as well as specialised rolling stock.

The issue of bonds for specific infrastructure requirements has been successfully used by Transnet and Sanral.

In considering ways of funding infrastructure, the extensive debt backlog and technical and non technical losses from the system must be brought under control to ease the demand for additional funding.

Global competitiveness

13. Given the current level of competitiveness of the South African economy, what are the areas where BUSA believes new competitive industries could be developed and what support is required from government?

There are a number of areas where new competitive industries could be established. Examples are essential oils based on wide biodiversity, extension of value chains to higher value added products in a number of sectors and subsectors. In new start up industries it is important for government to play a role in areas like research and development as was the case for essential oils. Support for private sector investment is also important once the viability of a new value chain has been established.

Consultation

14. On the issues of consultation, BUSA mentioned that further consultations are required. The understanding is that BUSA is part of NEDLAC. Is BUSA suggesting that NEDLAC consultations are inadequate?

There is no suggestion that Nedlac consultations are inadequate but the IPAP has not yet been tabled there for consultation.

The section dealing with developmental trade policies was the only part tabled for consideration prior to finalisation.

BUSA understands from its sectoral affiliates that there was very limited consultation at sectoral level and where consultation did occur it was not considered adequate.

BUSA Position Paper on Public Private Partnerships (PPPs): problem areas requiring attention and possible solutions

1. **Institutionalised political will / support / commitment**

PPPs can make a significant contribution to government's delivery on the country's infrastructure needs inclusive of the maintenance of infrastructure because PPPs combine the resources of government with those of the private sector in a unique way. However, the full potential role which PPPs can play will only be realised if there is a real, tangible and ongoing commitment to and support for PPPs from the side of government from the President down to all the Ministers/ Ministries and Departments (from the DGs down to other officials at all levels) – and the same applies to provinces and municipalities.

Since PPPs are by their very nature not only costly to get off the ground, but very long term projects, consistent support and commitment are fundamental implying that the commitment has to be institutionalised in order to transcend the individual, thereby avoiding a situation where projects are shelved or delayed as a result of new incumbents in particular positions (who might in any event lack the necessary institutional memory). The alternative is a waste of scarce resources to the detriment of the country and all its people.

Action required / recommendation: The President should be requested to provide the required leadership to support and institutionalize PPPs as an inherent and important part of the fabric of the South African economy

1.1. **Project sponsor**

An inherent part of an institutionalised political commitment will be uninterrupted and ongoing support in the relevant line department involved in a particular PPP. Amongst others this support will have to be reflected in a project sponsor at Director-General level who must remain involved and committed throughout the life of the project; and a line department champion / the Project Officer who has direct and open access to the DG and the Minister; and is authorised to make decisions; and is bound by the decisions.

2. **Regulatory and feasibility studies and deal flow**

The regulatory and feasibility studies which have to be undertaken in the case of PPPs do not apply to projects undertaken by departments outside the PPP regime and consequently introduce an additional burden / time consuming extra step when opting for the PPP route. Also, the decision whether to go the PPP route will depend on the department's available capital and operating budgets. This begs some questions regarding the value of regulatory and feasibility studies and also regarding the monies which departments can source outside their normal budgets such as from the Development Bank of Southern Africa (DBSA).

The budget overruns on some non-PPP projects where the rigorous processes of regulatory and feasibility studies were not followed, suggest that it might be prudent to introduce a threshold above which any project irrespective of whether pursued as a PPP or not, has to be preceded by a regulatory and feasibility study. This kind of discipline will ensure better value for money for the country in the long term, whilst also potentially contributing to PPP deal flow since the time element will not be a key determinant for a department opting for a non-PPP route.

At the same time it might be worthwhile to investigate the prudence of possibly introducing a lesser burden regarding feasibility studies for PPPs below a certain threshold. While a key benefit of a PPP is the robust feasibility that is then tested, the studies required should be proportional to the cost of the proposed project. Poorly conceived feasibilities result in poorly constructed projects resulting in unhappiness and conflict due to a mismatch in expectations between what the client department expects and what the Private Party thinks it has contracted to provide.

In addition it is suggested that the entrenchment of concept development / pre-feasibility studies / questions undertaken in-house by line departments might be a prudent path with a view to ensuring that no undefined projects are taken to the market / transaction advisor thereby avoiding any unnecessary costs / risks of “wasting” scarce resources on clearly non-viable or unnecessary projects.

Recommendation: regulatory and feasibility studies should be a requirement for all institutional (any entity listed in terms of a Schedule to the Constitution) capital projects and especially above a specified threshold.

3. **Deal flow**

The deal flow must be increased significantly to allow learning from experience at scale, thereby addressing some of the resource constraints. Amongst others it will help to address skills problems / constraints by growing skills in the public and private sector.

Despite its challenges to the current legislation and budgeting systems, an approach that would result in more projects clearing the minimum capital expenditure threshold and justifying the procurement costs) whilst reducing bid costs will be the clumping together of small(er) projects which are similar in nature (such as a PPP for 10 or 20 schools as opposed to one PPP per school, or one PPP for sewerage works for 10 or 20 small(er) municipalities as opposed to one PPP per sewerage work). This will also help address some of the capacity problems in the private sector.

4. **Capacity problems**

Whilst appreciating the reasons for the PPP Unit in National Treasury playing a dual role of government deal maker / advisor and regulator it is suggested

that these two roles should be split into completely different sections to reflect their differing roles. At the same time both sections need to be strengthened considerably to ensure that the advisory section does indeed play the role of pushing projects in the pipeline and the regulatory section not inadvertently being in a position of delaying / stopping projects due to the staff's divided attention between giving advice and regulating. This implies that the existing capacity problems have to be addressed.

Proposal: business wants to work with government in building the required capacity.

5. **Unsolicited bids**

Unsolicited bids under the PFMA holds considerable potential to address some of the infrastructure and maintenance backlogs in the country. However, there has to be a commitment from the side of government for any such bid to have a remote chance of going forward and since the preparation of bids require scarce resources and are expensive, it might be worthwhile to consider the possibility of allowing the bidding company to submit a pre-feasibility study, which can be done fairly quickly, with a view to testing the interests of government before a lot of possibly wasteful expenses are incurred in preparing a bid in which there would be no interest from the side of government. Once government indicates an interest, a more comprehensive feasibility study can be undertaken.

On the clear understanding that there has to be a balance between incentivising the private sector and securing value for money for the nation, it is further proposed that best practice from international experience be adopted by introducing an advantage / incentive for the originator of the project if it goes through to an open bid stage. This could be done by some tweaking of the procurement system in order to allow the originator of the unsolicited bid a specified percentage benefit during the formal bid stage.

6. **Standardised contracts**

Standardised contracts, including standardised sub-contracts for Design and Construct (D&C) and Operations, have been mooted as a way to contribute to addressing some of the problems around costs and timelines / turn around times; and may also help address the high bid costs (legal). Standardised contracts may not materially impact design and financial modeling costs. Standardised designs will to an (small) extent reduce design costs but will also reduce private sector innovation. Standardised contracts will to an extent, reduce legal costs. However, standardization will never provide a "one size fits all" package. The best way of reducing costs is to substantially improve the deal flow thereby getting the RSA market familiar with the process and requirements and also to have a draft agreement in the RFP that is closer to the market's commercial position at the time and client expectations that the client can afford. As a first step it might be worthwhile to specify certain core provisions (identified in consultation with the private sector) which may not be marked up.

It is further suggested that it might be prudent for government to deal with the current development of a toolkit through a structured process.

7. **Prioritisation of project pipeline**

There is currently no co-ordination with a view to fast tracking projects of national importance, for example a project to help address the education, or energy or health problems in the country as opposed to a departmental office block. It is suggested that the possible need for prioritisation some time in the future will be determined by the extent of the deal flow. Stated differently, prioritisation will only become necessary once the deal flow is such that the private sector is not able to take up all the bids on the table.