ECONOMIC TRANSFORMATION

ANC

POLICY DISCUSSION PAPER ON STATE OWNED ENTITIES AND DEVELOPMENT FINANCE INSTITUTIONS

January 2012

1. INTRODUCTION

The ANC's 4th National Policy Conference is being held during a year which also marks the people's glorious movement celebrating its 100 years of existence. The centenary of the ANC is indeed a special period which also represents the beginning of a new era and the end of another.

The centenary celebrations present an opportunity for the ANC to assess the impact of its policies in terms of the transformation of South African society from colonial rule and domination of a special type. This form of oppression was characterised by the land disposition of indigenous people as well as their total exclusion from all forms of economic freedoms and participation otherwise.

It is against this background that the discussion document focuses on the progress made towards the attainment of the total liberation of our people and the creation of a non-racial, non-sexist, democratic and prosperous South Africa as envisioned by the founding leaders of our glorious movement fifty-six years ago in the Freedom Charter.

The policy discussion process cannot proceed without remembering the one hundred years of collective conviction, commitment and resolve of the founding fathers and mothers of our movement to bring all fellow South Africans closer to the main strategic objectives of our National Democratic Revolution.

The year 2012 epitomises the story of countless sacrifices and immeasurable contributions made by heroes and heroines of our struggle; it is indeed a story of lifetime sacrifices, commitment, humility and discipline. It is a proud moment that is inextricably linked to the history of our struggle for freedom, non-racialism and democracy. A moral and revolutionary duty is thus imposed upon those of us who have been privileged to serve at this historical moment and we are charged with the weighty task of preserving its culture, values and traditions.

The 53rd National Conference of the ANC must, therefore, emerge with policies and programmes that will ensure the relevance of the movement in the minds and hearts of the people of South Africa as well as those of the continent over the next one hundred years. Such policies must continue to serve as a source of inspiration to our people to realise total economic and political emancipation of black people in general and Africans in particular.

As we approach the end of the second decade of the ANC democratic government, we must be conscious of the fact that despite all of the achievements made thus far; we are still faced with the huge responsibility of accomplishing unfulfilled tasks for the majority of the millions of South Africans. The seeds planted by the long walk to freedom can only sprout within an environment that is truly conducive to that of a united, non-racial, non-sexist, democratic and prosperous society. This is representative of a society in which all citizens will be measured by their humanity without attributing material regard to their race, gender and/or social status.

The 1994 democratic breakthrough provided the ANC as a liberation movement with the opportunity to pursue economic policies, which holds inclusive growth, development and wealth distribution at its core in order to bridge the inexorable gap between the rich and the poor within our country.

It has thus been identified that within this context, there exists a definite need to amplify the role of Development Finance Institutions (DFIs) and State-owned Enterprises (SOEs) as instruments for significantly advancing the levels of economic transformation within South Africa.

2. THE SCOPE OF POLICY PAPER

The National Executive Committee has developed a framework for all policy papers. The policy papers must be guided and focus largely on the following questions:

i. What are the existing ANC policies?
ii. What decisions have been taken?
iii. Has the policy been implemented?
iv. If not, does the problem lie within the policy or the implementation thereof or is it perhaps a combination of these two factors?
v. How are the new proposals aligned to that of those advocated by the National Development Plan and the New Growth Path?
vi. What is the ANC's strategy with respect to the manner in which it responds to this situation?
vii. Does the conference need to adopt any new policies in this area?

The scope of this policy paper covers all publicly-owned commercial entities and/or SOEs & DFIs; parastatals in all spheres of government; national, provincial and municipal entities as well as other state institutions that operate in any other commercial manner not covered by the aforementioned. The discussion paper shall, however, nuance largely on those entities that are commercially inclined in nature.

Considering that there is an absence of a common comprehensive policy framework that guides SOEs and DFIs. This discussion document, amongst other factors, seeks to address policy gaps and, thereby suggest new policy interventions that have the ability to shape and guide the role and architecture of SOE and DFIs. It is, therefore, important that the policy conference and the upcoming 53rd National conference considers new policy proposals articulated within this discussion paper.

The discussion document seeks to provide strategic direction for economic transformation by taking into account the role of SOEs and DFIs as drivers and agents of economic restructuring to advance the objectives required by the successful creation of a developmental state, as was directed by the 52nd National Conference Polokwane Conference resolutions.

Secondly, the policy paper assesses current policies with a view of enforcing optimum alignment and co-ordination of mandates and operations of SOEs as well as DFIs to the broader objectives of a developmental state. The broader aim must be to restructure the economy in order to create decent job opportunities, improve the current disparities with respect to income distribution levels, enhance the quality of service delivery and address social justice concerns, in an all-encompassing manner.

Thirdly, the policy paper explores viable ways and means to strengthen Public-Public-Partnership amongst and within the major state owned enterprises and Development Finance Institutions such as the DBSA, the IDC, pension fund institutions, ESKOM, PRASA, Transnet and others.

Fourthly, SOEs and DFIs are not created to maximise profits or incur losses, rather their existence is for the purpose of driving the development agenda. The dual mandate of SOEs and DFIs is to achieve a balance between the required level of self-funding and undertaking developmental projects that the private sector would ordinarily not. These policies must ensure that the SOEs and DFIs which are tasked with costly development mandates are strategically positioned to generate the revenues sufficient to cover the costs associated with executing their respective, but interrelated, mandates.

Fifth, the policy perspective must assess and interrogate the link between country savings levels and the funding of development. Emphasis will need to placed on mobilising national savings (such as pension funds) in order to support the strategic and long-term investment programmes. The development link between the quantity that a country saves and the manner in which it invests these savings is a critical success factor across all developmental states; as is evidenced by the East-Asian experience.

Lastly, the policy perspective should assess the manner in which a developmental state through the efficient utilisation of the strength of SOEs and DFIs, support and direct private sector investments to productive sectors of the economy to stimulate manufacturing as well as the promotion of entrepreneurship development programmes that will enhance the levels of deracialisation in existence. This will also seek to facilitate the creation of new firms and industries (black industrialist in nature) as opposed to tender-dependent economic transformation.

Broadly, the question we are expected to answer in the Policy Conference is: "what role should SOEs and DFIs play to underpin the role of the state in directing national economic development through the mobilisation of domestic and foreign capital and other social capital formation initiatives or partnerships to achieve our stated goals?" The aforementioned question must be considered within the context of the current global economic environment, which is characterised by volatile, turbulent and uncertain global financial markets accompanied by a weak demand in the export of goods and service due to the many economic recessions currently in force.

The key objective of this policy discussion paper is to ensure that state-owned commercial entities operate as powerful instruments of economic transformation and remain firmly within the control of the state in order to have the capacity that is capable of responding effectively and efficiently to the developmental agenda of the ANC government.

1. DEFINITIONS AND CATEGORISATION

The area of state owned entities is awash with acronyms and abbreviations, which often lead to definitional confusion. For clarity, the following definitions form the basis of the discussions contained within this document.

It is recognised that State-owned entities (SOEs) is an umbrella term for all the entities in which government holds partial or full ownership.

In defining SOEs we distinguish between commercial SOEs and non-commercial SOEs. A commercial SOE is a state-owned company, a state-owned enterprise, a publicly-owned corporation or a government business enterprise that is created by a government to undertake commercial activities on behalf of the owner, the government.

A non-commercial SOE is an entity that is created and owned by the government to undertake certain functions of government with the purpose of improving service delivery to the citizens. Typically, these are government agencies or state entities established to pursue non-financial objectives. In some instances these entities may pursue some commercial activities. These entities are largely involved in delivering public goods and services. It is, however, important to point out that commercial SOEs ultimately also have as their goal that of improving service delivery achieved via the objectives of developing state capacity levels and in turn, economic development in the long-term.

We provide below a simple but useful categorisation of SOEs:

- **Constitutional Institutions** (listed in Schedule 1 of the PFMA), for example the Municipal Demarcation Board or the Commission for Gender Equality;
- **Public entities** including *Statutory Corporations* (listed in Schedule 3A of the PFMA), which includes *service delivery entities*, *stewardship bodies*, *regulators* and *advisory bodies*, for example, museums, the National

Energy Regulatory and the Human Sciences Research Council; as well as statutory corporations such as Rand Water and the South African Bureau of Standards; PRASA etc

- **Government Business Enterprises or GBEs,** which include *State Owned Companies* (SOCs) in which the state is the sole shareholder, for example Transnet and ESKOM; *State Interest Companies* in which the state owns a partial share, for example, Telkom; and the *Development Finance Institutions* – for example the Development Bank of Southern Africa or the Industrial Development Corporation. These are listed under Schedule 2 to the PFMA.

Public Sphere Institutions, which includes institutions of higher learning or other tertiary institutions

It should be noted that this document focuses on Public Entities and largely on Government Business Enterprises or GBEs. Policy outcomes should endeavour to create a firm framework for SOEs as well as an effective process to review the rationale and role of existent entities.

2. BRIEF ANC POLICY REVIEW ON SOE AND DFI

The ANC policy on SOEs and DFIs is primarily informed by the 52nd Conference Resolutions and the ETC policy paper presented to the conference. The NEC has, subsequently, taken specific decisions on SOEs and DFIs including the establishment of an NEC subcommittee to drive the implementation of these identified policy measures. The NEC Lekgotla of July 2011, also further dedicated substantial deliberations on SOEs and DFIs. The Lekgotla outlined a clear programme and tasks with regard to the implementation of the policy on SOEs and DFIs.

In essence, the current ANC policies on SOEs and DFIs have been implemented in a systematic and dedicated manner. It is, however, important to note that the current policies are not adequate in terms of being able to optimally drive the strategic opportunities presented by SOEs and DFIs in South Africa.

The new policy proposals on SOEs and DFIs will broadly seek to advance the key objectives articulated by the ANC policy on economic transformation. The policy proposals will strive to advance the ANC policies contained within the New Growth Path. The proposed National Development Plan is expected to be informed and influenced by ANC policies; therefore the policy conference pronouncements on SOEs and DFIs will shape and guide all other initiatives within this sector.

4.1 What are the existing ANC policies?

The Polokwane conference provided a clear policy directive with regard to the roles of both SOEs and DFIs. On SOEs the Polokwane Conference resolved;

- that the ANC and its government must build the capacity of the state in order to pursue the objectives of a developmental state and to ensure that whilst SOEs and DFIs remain financially viable and profitable; their primary responsibility is to support and lead in strategic government-led developmental objectives within the realm of a clearly defined public mandate of pursuing an overarching industrialisation programme.

On DFIs the Polokwane conference resolved that:

- there is a need to ensure that these institutions as well as non-financial institutions are accessible to the majority of South Africans and are able to effectively channel financial and institutional capacity towards a variety of economic transformation objectives, including industrial diversification and development, small business ANC co-operatives, small-scale agricultural initiatives, micro-enterprise development, local and regional economic development as well as the empowerment of youth and women.

Therefore, the overall objective and mandate of SOE's and DFI's is to advance the socio-economic and political agenda of the developmental state, to promote social cohesion, the creation of decent jobs as well as skills and training development, in addition to other socio-economic needs.

4.2 What decisions have been taken?

In furthering the 52nd National Conference resolutions on SOEs and DFIs:

The NEC established a dedicated subcommittee to drive and implement ANC policy. Further to the NEC establishment of the SOE and DFI subcommittees, the NEC Lekgotla in 2011 adopted additional resolutions that will seek to ensure the advancement of the Polokwane resolutions. A programme of action with clear deliverables for SOEs and DFIs was adopted at the NEC Lekgotla.

Evidently, DFIs and SOEs are at the core of realising the objectives of a Developmental State. However, the absence of a common framework defining the developmental goals of government and subsequently, SOE's undermines the economic impact of our capital expenditure. This discussion document among other policy decisions seeks to address the above limitation.

4.3 Key Milestones in implementing the Policy on SOEs and DFIs

The following are some of the key milestones and interventions undertaken by ANC and government, as practical measures to implement the ANC policy. This programmes and interventions sought to further advance the economic transformation policy, which include the directives on SOEs and DFIs.

Creation of the State Mining Company

Significant progress can be reported on establishment of a state-owned mining company. The ANC has also established a research unit to investigate nationalisation of the mines. The report and recommendations has been tabled for processing and discussions as part of the ETC DIS discussion document.

Post Bank Act has been passed by parliament to speed the transformation of the Post Office to carry out commercial transactions or activities like all major banks in South Africa and improve financial access for rural and poor communities.

DFI Review Commission: The government concluded a review of the DFIs and adopted a programme for the rationalisation of DFIs. The review also produced proposals on how to ensure the effectiveness and efficiency of the DFIs.

The New Growth Path: The New Growth Path as adopted by the NEC and the ANC led government, contains specific roles of these institutions. The New Growth Path consistent with the Conference resolutions position these commercial entities as key players in driving economic growth.

National Development Plan: The proposed National Development Plan also provides a diagnosis of the state of SOEs and DFIs and further makes proposals for effectiveness of these institutions.

Presidential Review Commission on SOEs: The ANC government has initiated a comprehensive review of SOEs. To take the process forward, the President has appointed and established a Presidential Review Commission (PRC). The commission will make policy proposals on the means by which we can strategically position SOEs in line with ANC policies. The PRC has played an important role in developing this discussion document.

Industrial Policy Action Plan 2 (IPAP2): The Industrial programme as adopted by the ANC government also outlines the strategic role to be played by SOEs and DFIs and is consistent with ANC policy.

National Skills Strategy: The National Skills Strategy requires SOEs and DFIs to play a key role in building the essential, and much needed, economic skills.

Provincial and Departmental Reviews: Several provincial governments as well as national departments have also commenced processes of reviewing provincial SOEs and sectoral department-specific SOEs. These initiatives are aimed at strengthening the role of these commercial entities and ensuring overall alignment with key ANC policies. However there is a clear need to ensure co-ordination and alignment with the Presidential Review Commission. Directives from the PICC will be most significant in this regard in terms of enhancing co-ordination, thereby improving implementation and execution capacity levels
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5. BRIEF HISTORICAL BACKGROUND OF SOEs

The economic and financial crisis throughout the globe in the past three years has, once again, demonstrated that capitalism is indeed at cross roads and that the state cannot be an uninterested party nor can its role be confined to that of a mere regulator. Various state capitalism initiatives, across the globe within the emerging markets sphere, have given credence to the postulation of such a system being a viable alternative to the traditional notion of liberal capitalism.

Global growth is being driven by the robust levels of demand from emerging economies. This is even more plausible when viewed from the angle of the current geographic locations of portfolio and FDI flows, which are flowing to as well as emanating from BRICS and other key emerging financial centres. Central features of robust economic growth in China, India, Russia and Brazil is the role played by SOEs and DFIs.

South Africa is now a member of BRICS; it is both an opportunity and a challenge. It is a challenge because membership alone will not necessarily translate into automatic positive growth and development and necessitates the urgent reorganisation of the state and its capacity. Secondly, we need to transform SOEs into real economic drivers and, in turn, for these institutions to become key agents of economic development; thus not merely being confined to the economic growth domain.

In the past Africa was considered to be a destination for grants and aid and it has now become an attractive destination for trade and investment. Furthermore, Africa was previously exclusively perceived as a commodities extraction platform; however, there now exists real economic growth drivers.

Historically SOEs existed to drive specific national agendas

The previous government's drive was to enhance the self sufficiency of South Africa and this required the development of in-house capabilities to manage several strategic economic growth drivers. However several of these industries have continued to be managed as SOEs in an economic and political climate in a manner very different to that of the apartheid era. There are currently about 576 SOEs, which includes subsidiaries, in the Republic generating about 8% of GDP.

SOEs were historically created by governments to support strategies for economic development and promote public interests, however over time the definition and reference of these institutions have gradually evolved and, as such, some inherent tension between the interests of the public and those of enterprises has developed. The existent level of tension is more conspicuous particularly when there exists a climate in which the socio-political objectives of government are not clearly defined or articulated. This is even more pronounced because of the fact that short-term commercial objectives are solely driven by capital market returns that supersede developmental objectives.

The period between 1948 and1994

The first SOE to be created was the South African Railways and Harbours Administration (SAR&H) in the late 1800s.

The services of SAR&H were later rolled back to government to form the Ministry of Transport, Ports and Telecommunications. From this period, government created more public companies, parastatals. Parastatals were given exclusive franchises and operated in strategic industries. The larger companies included the following:

- ESKOM – Established in the 1920s, ESKOM's operations were focused on electrical power production and distribution.

- ISCOR – Also established in the 1920s, ISCOR was created to secure iron and steel production.

- FOSKOR – was created to mine and process phosphate minerals for use in fertilizers and other applications.

- SASOL – A major producer of coal for use in the company's perfected Fischer-Tropsch method for making synthetic fuels. The motivation for the establishment of SASOL was a petroleum embargo imposed on South Africa during apartheid.

- SOEKOR – The Southern Oil Exploration Corporation was never successful in locating crude oil in South Africa.

- The Postal Service - In addition to its major function of providing postal services within the republic, the postal service operated a subsidiary Parastatal providing local telephone services. The company is now known as Telkom.

- SABC – The South African Broadcasting Centre allowed for programming to be broadcast in Afrikaans, English and other local languages. The SABC was used by the government as the voice of Apartheid and played a key role in the spreading of propaganda during the Apartheid years.

- ARMSCOR – was responsible for the management of all research and development of arms, ammunition, military vehicles and military machines.

- SAA – South African Airways was established in 1934. The company's major function was to fly mail between the major cities of South Africa.

FOSKOR, SASOL and SOEKOR were started by the Industrial Development Corporation (IDC), which was established in 1940 and given a mandate to build domestic industries that would have the capacity to supply goods that would later become unavailable from foreign sources, as a result of World War II and thereafter due to apartheid sanctions. The apartheid government owned several stakes in private companies and in the 1980s it was estimated that the Republic of South Africa owned and controlled more than 40% of the country's physical capital.

In the 1980s, the National Party diverted from its goal of import-substitution development and focused on achieving economic development through export-led policy mechanisms. Perhaps the most significant export SOE was ARMSCOR. Through its exports division, Nimrod, it sold an estimated $300m worth of arms in the 1980s. Toward the end of the 1980s as the rule of the National Party government was drawing to a close, it was announced that some SOEs were to be privatised. The following were some of the reasons given:

- Losses incurred by state enterprises had to be perpetually covered by government revenues.

- Capital expansionary projects of SOEs were being funded by limited state credit resources.
- The funds that would be provided by privatisation became an attractive option to a government whose funds were depleted owing to sanctions imposed against it for its apartheid policies.
- The poor efficiency exhibited by parastatals brought unwanted criticism against the government, exacerbated by the existence of the oppressive policies of the past.

In 1989, ISCOR was the first SOE to be listed on the JSE and more than 200 000 south Africans bought stock in the company for an estimated total of R3 billion. Privatisation had a number of drawbacks, a major one being foreign buyers being allowed to own and control critical South African industries.

The proliferation of the SOE's was part of the objective to promote economic development which was aimed at promotion of the industrialisation strategy premised on the export-economy and import-substitution. Subsumed in this strategy was the notion of economic self-sufficiency. The SOE sector was formerly used by government to empower Afrikaner enterprises in mining, agriculture, finance, manufacturing and commerce

It is also necessary to mention that the state and the SOE sectors became significant employers, especially in the mid-1970s when the investment climate deteriorated as a result of the sanctions imposed against the apartheid regime. The 1976 Soweto uprising and internal political instability hit investor confidence levels. This resulted in high levels of disinvestment and the industrial sector shedding a large number of jobs. In the late 1980s, it is indicated that the industrial sector could only generate 28 000 jobs as compared to 448 000 in the 1960s.

In the 1960s, the GDP growth rate was approximately 5.7 percent and it then declined to 3.4 percent in the 1970s. The political instability in existence was a large factor in contributing to the economic weaknesses experienced by the country. By the 1980s the GDP growth rate declined to 1.5 percent; indicative of the direness of the situation at that time. In spite of this economic reality, the government defied the logic of fiscal prudence as spending by the government had only increased as a result government incurred a huge public debt and a bloated state sector was increasingly became too expensive to can maintain.

POST 1994

Initially, the African National Congress, was strongly opposed to the selling of state assets and was of the opinion that privatisation was merely a strategy implemented to deny the new government control over the economic resources of South Africa and to keep the businesses within white hands.

In 1994, however, the Government of National Unity identified a need for the privatisation of some SOEs. It was decided that a few smaller state enterprises like Aventura and Arivia.kom would be completely privatised and others like TELKOM and SAA would sell a portion of their ownership share to private interests. The key reason for government's change of heart was its inheritance of a near bankrupt government, and funds were desperately needed to revitalise the economy. Telkom was privatised on September 30, 1991 when it was registered under the South African Companies Act, but remained wholly state-owned until 1997 when government sold 30% of its shares in the company to Thintana Communications. This effectively marked the beginning of the liberalisation process of the local telecommunications market.

As previously mentioned, in 1994 the South African government adopted a Reconstruction and Development Programme (RDP) with the aim of rebuilding and developing the country by:

- meeting basic needs;
- developing the country's work force; and thereby
- Broadly and inclusively building the economy.

When the RDP was implemented it was supported by macro-economic strategy, which outlined the government's aims for growth, employment and redistribution.
The state's major objectives through its RDP programme were to:

- Encourage economic growth through increased competition and rooting out monopolistic behaviour;
- Create wider ownership through empowerment principles;
- Mobilise private sector capital investment;
- Reduce state debt; and
- Enhance the capacity and competitiveness of all SOEs.

Despite there being many long term goals, the State's immediate need was for high quality infrastructure and services to be made available to historically disadvantaged groups at a low cost. In 1999, the government announced that the restructuring of the four biggest SOEs, Telkom, Eskom, Transnet and Denel, would be prioritised. At the time these four companies controlled 90% of the assets of the top 30 South African SOEs.

In 1996 the government introduced the Growth, Employment and Redistribution (GEAR) framework. The GEAR policy underscored privatisation as a strategic imperative in turning around a weak economy that resulted from the apartheid era. At the time that the ANC government came into power, it inherited a near-bankrupt state and was simultaneously confronted with ambitious expectations from the previously disenfranchised, which was compounded by an investment strike within the business community.

The fundamental question was whether the RDP was the appropriate policy approach to deal with the existing economic challenges, as its solution lay largely in substantial investment in the economy. It is against this background that GEAR emerged and its proponents contended that it was a strategic intervention in pursuit of the developmental goals of the state as contained in the RDP. However, GEAR was viewed by others as a policy that deviated from the RDP which proposed a rational balance of socio-economic imperatives. GEAR underscored the implementation of the public sector asset restructuring programme, including guidelines for the governance, regulation and financing of public corporations; beginning with the sale of non-strategic assets and the creation of public-private partnerships in transport and telecommunication sectors. Subsumed in the GEAR strategy was the privatisation of the SOEs, which was highly contested.

In 1995, the Department of Public Enterprises (DPE) developed a discussion paper on the restructuring of state assets. The concept of *privatisation* was replaced with that of *restructuring*.

Presently, the DPE is government's shareholder
representative for a select group of entities. DPE is tasked with overseeing the companies in its portfolio. The SOEs that currently fall under the DPE are Alexkor, Broadband, Infraco, Eskom, PBMR, SAA, SAX, SAFCOL, Denel and Transnet.
Other policy Ministries play the government shareholder role with regard to other significant entities.

Figure 1: *Summary history of SOEs*

The history of SOEs is important for understanding the reasons for their formation and some of the failures and achievements. The formation of state owned entities began in the late 19th century to pursue economic development

Political Environment	Rational	Examples
1880-1910 Period of economic self sufficiency . Monopoly concessions were granted to private citizens.	Sovereignty and economic self-sufficiency of the Afrikaner	South African Railways
1910-1940s Period of high unemployment. Saw the establishment of a number of key state-owned corporations	Strategic industries Job creation	Eskom, ISCOR and IDC (also SAR, Post Office
1948-1970s The Government used state instruments to improve the living standards of a few in the economy and society. After 1960, with growing isolation, there was an emphasis on self-sufficient	Upliftment Strategic industries Self-sufficiency	Aventura, SABC, SASOL Science Council, Land Bank
1976-mid-1980s The Soweto Uprising and conflict in Angola gave impetus to the development of the state security establishment. Also the Government created entities to circumvent sanctions. In the mid-1980s the Government followed a trend of fostering the private sector and privatising some key state industries.	Avoid Parliamentary scrutiny Busting sanctions Privatisation	Central Energy Fund Denel, Armscor MOSSGAS, SBDC (ISCOR and SASOL)
Late 1980s - early 1990s: Political change became inevitable. Government sought to use the instruments of state to 'win the hearts and minds' of the new voters	Working around the existing structures of government	IDT (also used Eskom and Telkom)
1994 -the present New government focused on poverty alleviation, developing a competitive economy, and improving the functioning of government. Strong emphasis on creating independent bodies to carry out new functions. Also a tendency to move functions out of government so as to 'create something new' or effect 'transformation'.	Regulatory functions autonomous of gov. Running away from government Continued privatisation	NER, Nuclear Regulator, Competition Commission, SA National Parks, Museums, Water boards, Theatres, etc.

Below is a high-level outline of some of the post 1994 restructuring initiatives.

It is important to note that though the political and economic climate has changed several of the above-mentioned industries continue to be managed as SOEs.

Given these challenges, the ANC 4th National Policy Conference must address the following questions as directed by the National Executive Committee in November of 2011.

6. CHALLENGES AND CONSTRAINTS OF CURRENT GOVERNMENT POLICY

Because of the complexity of often conflicting objectives and multiplicity of legislations and policy frameworks of different departments at different spheres of government and their entities, a clear strategy is often difficult to craft for an individual SOE, and even more complex for a portfolio of SOEs and DFIs. The difficulties of implementing an overarching strategy are acknowledged in the context of decentralised and multiple policy frameworks, legislations and oversight approaches as is the case at the moment.

A short to long term action plan is required to transform the SOE and DFIs sector as a matter of urgency. The plan should seek to embed an overarching strategy for state owned commercial entities in South Africa that effectively respond to the developmental state agenda; create an enabling environment which amongst others seeks to create a universal policy framework and legislation; and develop state capacity to effectively monitor and evaluate state owned commercial entities at all spheres of government and to promote and strongly drive collaboration amongst all government stakeholders.

The following are some of the major policy challenges in the SOE and DFI sector in South Africa.

6.1 Lack of a clear agenda for SOEs & DFIs;

The launching pad for a clear agenda for SOEs and DFIs is firstly, the understanding of the definition, nature, and character of these institutions in South Africa as well as their location within the broader structure and scheme of the public and the private sector at all spheres of government. Secondly, a coherent understanding of the South African economic and development policies in the short, medium and long-term as well as their strategic implications for SOEs is crucial. Finally, through the utilisation of an understanding of South Africa's strategic sectors and assets as leverage to achieve the agenda for SOEs and DFIs is of critical importance.

6.2 Poor alignment with government of policies

There is overwhelming evidence around the poor alignment of SOEs to government policies and agenda in the short to long-term. SOEs themselves attest to their inability to comprehend and deliver on evolving government expectations, particularly “short-term” expectations.

6.3 SOEs & DFIs are challenged with trying to strike a balance between the interests of the public and the enterprise itself

There is a natural conflict between the commercial interests of these entities and the states developmental interests. Several high profile examples are illustrative of the existent dichotomy between public interests and the SOEs commercial interests. On the whole, South African SOEs seem to have mixed results when assessed against the competing but equally prioritised objectives of economic and socio political objectives.

6.4 Disjointed good governance and performance management

Finally, the PRC in its preliminary report indicates that South Africa has 590 SOEs including their subsidiaries. This presents a remarkable opportunity that will assist the ANC in its research and policy formulation process.

“What gets measured gets done. If you can’t measure it, you can’t manage it.”

Although most SOEs understand the socio-political objectives of the government, there appears to be an element of self policing by the manner in which these objectives are managed, executed and reported.

On the surface it would seem as if SOEs are meeting commercial objectives as they are growing, from a financial perspective (in terms of turnover and profit levels). However these measures are narrow and do not take into account the monopolistic position of most SOEs as well as wider GDP –related measures which would provide a better view of performance

The socio-political objectives of government are not clearly articulated and commonly understood by SOEs and as a result, a perception exists in some areas that socio-political objectives encumber the achievement of commercial objectives. For this reason it is necessary for the shareholder to provide leadership and guidance on what should be done (by all stakeholders of SOEs), to maintain a healthy balance between socio-political and economic objectives as well as ensure that such processes can monitored and evaluated.

6.5 Enabling environment

- There is an absence of a "single-window" view of SOEs and DFIs;
- Some institutions are established for a specific purpose in terms of statute requirements and they subsequently change and become something else during the process;
- There has been a proliferation of SOEs and DFIs at various spheres of government. Almost 55% of the SOEs were established after 1997 (according to research recently conducted by the HSRC for the PRC);
- There are serious issues of non-compliance with the current legislative aspects governing SOEs as contained in the PFMA and Municipal acts such as the Municipal Finance Management Act and the Municipal Systems Act
- Conflict, duplication and confusion is evident within the legislative sphere, which leads to a lack of consistency as well as a lack of coherence
- Government as the owner and shareholder does not have a structured and obligatory process through which they periodically review the

relevance and significance of the SOEs ensuring in the process that there exists adequate levels of clarity and a harmonisation of mandates.

6.6 Viable and effective SOEs and DFIs

The performance of SOEs is dependent on a number of factors. Key amongst these factors is the clarity of the agenda, particularly as determined by its owners, in this case the state or the government. The conduciveness of the environment within which SOEs operate and the internal capacities and capabilities of SOEs are representative of additional factors that affect the performance of SOEs and DFIs. A further crucial element is funding adequacy as well as the owners' readiness to support further socio-economic objectives, as is necessitated by the developmental state agenda.

6.7 Capacity for effective ownership

Challenges are observed with regards to the capacity of the state to provide effective oversight on the entities which they own. The capacity challenge is further compounded by a lack of sound governance by the Boards appointed by the shareholder oversight ministries. The executive and management capacity of SOEs also requires continuous enhancement to promote optimal delivery.

7. POLICY PROPOSALS

7.1 Governance and Ownership

The challenges of the political mandate and expectations of shareholders have in the past years led to a serious misunderstanding between the political authority and the Boards of these institutions. In some instances the conflict is as a result of the Public Finance Management Act and now the New Companies Act which determines how these organisations should work to comply with their respective pieces of legislation.

The following actions are required to improve governance and ownership:

a) The ANC should clearly define mandates and set measurable objectives for each SOE/DFI and create a common framework in shareholder management. This will enable an effective monitoring and evaluation framework.

b) Oversight and coordination are required to ensure that SOE/DFI efforts are optimally aligned with the state's development agenda. Two main mechanisms are required namely the preparation of an overarching SOE and DFI policy as well as the necessary legislation, which would address governance issues such as defining and standardizing the relationship between the executive authority (the shareholder) and SOEs and DFIs across government. Co-ordination, as well as subsequent implementation, of the DFI and SOE mandate at an institutional level requires that shareholder departments are well co-ordinated.

c) The NEC has mandated the establishment of a DFI Council as a means to strengthen coordination.

d) The Presidential Infrastructure Coordinating Committee (PICC) also has an important role to play in ensuring that key strategic projects are suitably identified and led by the relevant SOEs and DFIs.

e) Where necessary, the government should separate policy departments from overseeing SOEs and DFIs to mitigate the potential conflict of interest between the policy department's focus on developing an industry for the benefit of the consumer from the needs of their enterprise.

f) There must be an adequate level of consolidation of shareholder oversight of SOEs and DFIs into as few as possible specialised oversight Departments or agencies so as to optimise portfolio synergies across SOEs and create a national centre of excellence in shareholder management.

g) ANC must develop a governance model for DFIs and SOEs with respect to Boards of directors and their roles must ensure enhancement and protection of shareholder (government) interest as well as support state activism. The shareholder interest must be protected to drive the objectives of the developmental state. Simply stated, their institutional design and framework should ensure the necessary level of conduciveness towards implementing the state's developmental objectives.

h) Boards of DFIs and SOEs require competencies and public sector ethos to affect the identified developmental mandates efficiently. The roles, functions, membership and relationships (especially to the shareholder), therefore, require enhancement. The operational authority of the Board must have the capacity to give effect to policy directives of the shareholder and the Board must subsequently be accountable to the state.

7.2 Investment Strategy

The ANC must develop policy guidelines for government establishment, maintenance, investment and disinvestment in SOEs and DFIs. The policy must be informed and guided by the following principles:

a) The identification of new sectors and sub-sectors for direct state ownership and for DFIs investments in the economy. The identification of sectors must be based on a comprehensively researched assessment of the different options available to achieve government's strategic developmental objectives. In identifying the sectors, the ANC government must develop and implement appropriate policy mechanisms and measures that ensures the existence of incentives for owning SOEs.

b) DFIs and SOEs have been provided with a dual mandate of achieving longer-term strategic economic objectives whilst simultaneously maintaining financial sustainability. This delicate balance needs to be appreciated and actively supported by the state to ensure that SOEs and DFIs are appropriately and adequately capitalised and resourced, in a broad sense (beyond that of mere physical capital) to deliver on their mandates.

c) Since DFIs are established to correct market failures and provide risk capital to strategic investment programmes, it is therefore necessary for the DFIs to naturally exhibit a higher level of risk tolerance and crowd in the private sector. DFIs are also expected to be self-sustaining. The options to ensure that DFIs are financially sustainable include ensuring they:

- Have a separate budget line from the fiscus to cover certain developmental costs
- Act as the “lead arranger” of strategic investment programmes of the developmental state (with regard to major infrastructure or industrial developments).
- Have privileged access to concessional funding, such as the Brazilian development bank BNDES, which is given a ring-fenced 40% of the Brazilian workers assistance fund payroll tax in order to re-invest in development.

d) The government must develop and adopt a policy regarding the strategic rationale for the establishment or consolidation of SOEs and DFIs in these areas:

- Water infrastructure
- Mineral resource sector, mining, beneficiating and steel
- ICT infrastructure
- Transport infrastructure
- Driving infrastructure integration in the continent.
- Agriculture and Food security
- Energy
- Financial sector

- SOEs and DFIs can be commercially rationalised so that leading SOEs and DFIs are mandated to lead sectors or functions where they have a distinctive capability, track record and/or any other distinguishing advantage.

    - The DBSA could assume the lead for all infrastructure investment including oversight on provincial DFI infrastructure programmes.

    - The IDC could do the same for all industrialisation investments

7.3 Partnerships

a. Public Private Partnerships (PPP) is fundamental; focus should be directed to the collaboration and alignment of government entities in capital infrastructure programmes. This model has proven to be very successful in developing countries such as China, India and Brazil.
b. South Africa is part of the BRICS family and, as such, it will be important for our SOEs and DFIs to lead and forge strategic and commercially-driven partnerships with experienced SOEs to direct infrastructure development opportunities within the continent.
c. SOES and DFIs should be required to collaborate through public-public partnerships that plan and implement identified strategic programmes of the developmental state. The joint efforts should first serve to satisfy the absolute need for increased long-term planning to guide the coordination, project selection and effective execution of investment programmes.

d. Strategic programmes and projects developed for roll-out by SOEs should then reserve a role for the relevant DFI to act as financial "lead arranger" to arrange financing of such programmes and the crowding in of funding from other identified sources. A DFI may, for instance, fund 10% of a large infrastructure project and be responsible for raising the remaining 90% from other development or private sector funders. The net result of such public-partnership is that the state will play a leading role in driving strategic programmes whilst mobilising national savings and the private sector.

e. Government as shareholder managers must build relationships with like-minded shareholder managers from around the world, with a particular emphasis on the BRICS Alliance, so as to enable knowledge sharing and international collaboration between SOEs and DFIs to achieve mutual strategic objectives. BRICS partners are of necessity in terms of seeking to advance their own national interests and hence the South African government must be well-coordinated with respect to its own SOEs and DFIs in these interactions.

7.4 Funding Options

Developmental States have tended to create a national savings-investment nexus, with savings channelled to critical economic development investments via DFIs and SOEs acting as intermediaries.

i. <u>State Funding</u>

Access to off-balance sheet and concessional funding is necessary. Government can provide equity, guarantees, transfers, tax exemptions or dividend retention.

Government should create a regulatory environment to allow DFIs to access pension funds.

Only the most efficient and effective DFIs and SOEs should be considered for such institutional arrangements so as to protect public resources.

ii. **<u>cost recovery in the market</u>**

The use of price recovery is when the SOE increases prices in order to recoup its costs in order to remain financially to can undertake new developmental projects. For example DFIs and SOEs should be involved in the identification, planning and funding of programmes and projects.

iii. **<u>Direct Capital Markets</u>**

Raising funds from the international developmental institutions should be the last resort. A developmental state should avoid funding that comes with conditions which may not be suitable to its strategy and national sovereignty; as was the case with the Structural Adjustment Programmes directed by the World Bank and IMF in the latter half of the twentieth century.

However, in circumstances where economies of scale and technologies demand this, the country may have little choice but to secure funding from external sources. Under these circumstances, a thorough assessment would, of course, be conducted in terms of the potential costs and benefits to the economy and the country, as a whole.

iv. **<u>Retirement funds & Insurance</u>**

As a matter of urgency, the State should regulate a substantial part of retirement and life assurance funds (public and private) in order for these funds to be invested in SOE and/or DFI financial instruments as well as additional strategic investment programmes.

These funds can be used to provide concessionary finance. SOEs and DFIs that benefit from such concessionary funding would be required to provide smooth (as opposed to the volatile returns retirement funds now receive), secure and development impact-related returns.

v. **<u>Creation of the National Competitiveness Fund</u>**

South Africa has adopted an aggressive mixed market economy approach; the major downside of this approach is that our trading partners are operating with rules that make it favourable for them to compete with us. For example China and India do not allow the export of steel and aluminium scrap metal. We are probably the only country in the world that allows this trade. It is recommended that the National Treasury should levy such exports and use the money for development of the affected industries.

7.5 Comprehensive policy on SOEs and DFIs

The government must develop a comprehensive policy paper or a white paper on SOEs and DFIs that spells out the arrangement for SOEs in the medium to long-term. The white paper should seek to address the following amongst others:

- Set out clear ownership and shareholder management approaches
- Incorporate the high level strategic plan for commercial and strategic SOEs aligned to developmental state objectives.
- Confirm definition, classification of SOEs
- Identification of the priority and strategic sectors that the state will be involved in through SOEs as part of the state's strategic plan.
- Provide the precise details with regard to the management of all commercial and strategic entities required to support the fiscus under a well defined and centralised shareholding platform.
- The functional departments should retain non-commercial entities.
- The corporatized non-commercial entities that do not create value for departments and citizens, or are unlikely to do so by virtue of their models, should be carefully managed or rolled-back to departments
- Commercial entities that do not create value or are not likely to do so in the future should be carefully managed for rationalisation
- Articulate a clear framework for accounting and governance procedures
- Develop and communicate clear and balanced performance criteria

- Develop a consolidated framework for the remuneration of Boards as well as the management of SOEs
- Develop and encourage institutionalised collaboration between shareholder ministries and SOEs

7.6 Skills to improve capacity

The ANC government should prioritise and develop programmes to build and attract relevant and necessary skills to improve the capacity for implementation in SOEs and DFIs. A similar process should be considered for government in order for them to improve and enhance their shareholding capacity and the bold ownership stance. Secondly, skills development and training should form a part of the core business of SOEs.

8. High-level micro intervention considerations

DFIs and SOE's are not well coordinated at the central government level

Consolidation and centralisation of shareholder oversight of commercial SOEs and DFIs is required. This process may require to be phased to allow for the least possible disruption. At the initial phase, separate consolidation of commercial SOEs and DFIs respectively under two central shareholding management platforms should be considered. A further process shall require the rationalisation and streamlining of mandates.

Initial phase micro-intervention focus:
In this phase, the ETC should focus largely on SOEs involved with economic infrastructure – _Energy, Transport Logistics, Water and Communications_

Electricity

- Need to ensure long-term security of electricity supply at the lowest possible cost
- Completing capacity-building programmes at the lowest cost in time is critical
  - Ensuring adequate funding at the lowest cost is a challenge

- Changing incentives to operate in a more dynamic and competitive environment
- Urgent need to resolve the distribution impasse
  - REDS idea has introduced considerable uncertainty

Transport

Freight logistics

- Capacity is critical to support economic growth in mining, manufacturing
- There is an urgent need for large-scale investment, including opportunities for public-private partnerships
- The lack of a resolution in terms of policy certainty is hampering investment programmes.

Passenger rail

- Interrogate a viable business model
- Focus on expansion as well as efficient and reliable transporting of people
- Correct poor institutional linkages with urban transport systems

Water sector

- This sector is complex and fragmented and the following aspects require urgent resolve:
  - Key problem is poor regulation of water services – restructure and reform the water regulation environment
    - The law houses this function within the national department
    - There exists a severe lack of skills throughout the system
    - There is a need to rationalise and consolidate the various entities
    - Many municipalities are shirking from their responsibility to maintain good water quality
    - Bulk and raw water pricing is not sustainable
    - Attempts to create viable financing are challenged

Communications

- Develop a clear and consolidated strategy
- Need for more private players to lower the cost of services within this sector

- State capacity needs to be directed at state facilities as well as underserved areas.

9. SUMMARY

In summary, there's a need to do the following:

1. Implement cutting-edge monitoring and evaluation mechanisms
2. Develop state capacity to effectively monitor and evaluate SOEs
3. Implement a new act that regulates the new arrangement for SOEs
4. Conduct an SOE review every four to five years and produce a white paper on SOEs
5. Implement best practice guidelines for SOEs on governance, remuneration, and performance as well as in other relevant areas
6. Consider the establishment of an SOE remuneration tribunal similar to the Public Service Commission and the Independent Commission for Public Office Bearers
7. Produce a consolidated annual report on the performance of all SOEs.

These are some of the questions which will guide our discussions as we continue to seek relevant policy options:

1.1. How can ownership issues and governance models be fine-tuned to maximise output of desirable outcomes?

1.2. How can SOE and DFI mandates be aligned to our development imperatives?

1.3. How can SOE and DFI form part of a long-term developmental plan to ensure long-term success of the New Growth Path?

1.4. How can SOE and DFI be instruments of skills development and skills transfer?

1.5. How can the legislative framework be amended to leverage infrastructure development? Can SOEs be vested with powers to expropriate land with the intention of developing infrastructure without violating the Constitution of the Republic?

1.6. Is it desirable to pass one legislation to regulate all SOE and DFIs compared to each being regulated by its own Establishment Act?.

1.7. What are other legislative hurdles that should receive attention to leverage substantive economic development along the New Growth Path?

1.8. How can SOE and DFI mandates be focused to enhance inter-collaboration and cooperation, and avert fragmentation and duplication?

1.9. How can shareholder participation in SOE and DFI operations not be limited to financial assistance but include directing investment?

1.10. How can strategic, organisational, and technical capacities of the state be fortified to deepen its efficiency in meeting developmental imperatives?

1.11. How can government manifest strong political will to make strategic choices to broaden gainful employment of our people?

1.12. Should SOEs account to the shareholder ministry or the policy ministry, as the dual accountability tends to weaken government leverage over both SOEs and DFI's?

10 CONCLUSION

The discussion document provides a comprehensive analysis and considers critical issues primarily regarding the role of SOEs and DFIs in South Africa. The analysis studies and makes proposals with respect to the enabling environment, performance, viability, as well as the capacity of SOE's.

The paper also raises fundamental questions around the capacity of the [state] shareholder required for oversight governance and executive management.

The observations articulated compel the ANC to take urgent action in order to deal with challenges facing SOEs to allow these institutions to play an active role within the economy.