



Discussion Papers

4th Meeting of the OECD Network on the Governance of State-Owned Enterprises in Southern Africa

“Towards a regional consensus”

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CONCEPT NOTE

COMPANY GUIDANCE ON ANTI-CORRUPTION AND ETHICS FOR STATE-OWNED ENTERPRISES

Background Paper for Theme 2

4th Meeting of the OECD Network on the Governance of SOEs in Southern Africa

Background

Corruption raises both moral and political concerns; it undermines good governance, sustainable economic development and distorts competition. To attract investment and facilitate economic growth, it is essential that countries address the problem of bribery in business transactions and take steps to promote responsible business conduct. SADC economies are increasingly examining the issue of corruption and ethics in state-owned enterprises (SOEs), especially given that corruption and lack of transparency and accountability in business transactions remain high on the list of investment risks in Africa. Most African economies, including those of the Southern African Development Community (SADC), have taken steps to enact laws on bribery and corruption, in addition to amending codes to meet the requirements of international conventions that they have ratified or acceded to with a view to improving standards of corporate integrity and accountability. Moreover, there is an increased awareness of the importance of responsible business conduct, as a means to promote sustainable business practices. Three distinct issues can be considered in this context, these include the fight against corruption, corporate ethics and responsible business conduct.

The fight against corruption is of paramount importance to improving the corporate performance of SOEs. SOEs can be both passive and active actors when it comes to corruption. Commercial SOEs may be under pressure to bribe for business, especially where such practices are commonplace among private competitors and in certain industries. Like private companies, SOEs can also be victims of abuse and fraud by their own employees. SOEs officials can also be bribed by private companies to obtain lucrative contracts and other abusive business practices. SOEs may also be prone to corruption through privatisation or public procurement processes.

Corporate ethics goes to the core of the internal governance of the company and has an important role in promoting effective governance starting from the board of directors and executive management, to the conduct of employees and relations with stakeholders. Beyond the rights and responsibilities of individual actors, ethics also encompasses responsible business conduct. International standards tell us that corporate responsibility (also known as responsible business conduct) should be anchored in corporate governance. SOEs and their owners have an interest in being perceived as “good corporate citizens,” in broad range of areas that concern their business practices encompassing employment social, environmental, philanthropic and other areas.

It is proposed that the Network undertake a project to further explore the corruption challenges and good governance practices which seek to curb corruption, and reinforce corporate ethics and responsible business conduct in SOEs in the region. This concept notes outlines the main issues that could be tackled by the Network; other existing regional and international standards that it can draw from; and, considers various options for the project coverage and scope.

The main issues

Addressing the issue of anti-corruption, ethics and responsible business conduct is multidimensional and it necessarily starts with good governance practices at the level of the SOEs-themselves. This includes:

- stakeholder consultations to identify the corruption risks and opportunities;
- independent boards of directors with relevant committees, including ethics committees;
- company-specific codes and policies on company ethics consistent with national anti-corruption frameworks;
- transparent responsible business conduct practices and reporting;
- open and competitive recruitment, public procurement and privatisation practices;
- whistle blower facilitation and other channels for reporting misconduct; and,
- transparent and accountable reporting, disclosure and compliance practices consistent with national laws and regulations.

Drawing from other regional and international standards

Existing national, regional and international instruments, guidance and best practices cover anti-corruption and ethics extensively, although they do not deal exclusively or expressly with SOEs. These include:

International instruments dealing with anti-corruption, corporate ethics and responsible business conduct

- The UN Convention Against Corruption (UNCAC) and its accompanying documents including the Anti-Corruption Toolkit. The UNCAC is a global instrument that seeks to prevent corruption and includes model preventive policies that are directed at both the public and private sectors. It deals with both the “active” and “passive” sides of corruption. This has served to support Parties in the development of anti-corruption policies and institutions, including preventative anti-corruption frameworks.¹ It covers both transnational and domestic bribery.
- OECD Convention on Combating Bribery of Foreign Public Officials (OECD Convention) and its accompanying Good Practice Guidance on International Controls, Ethics and Compliance. The OECD Convention is a legally binding international instrument that aims at combating bribery in international business transactions.² The Convention focuses on the “supply-side” of bribery of public foreign officials. The Good Practice Guidance is addressed to companies for establishing and ensuring the effectiveness of controls, ethics and compliance programmes or measures for preventing and detecting foreign bribery in international business transactions. The focus is on transnational bribery of foreign officials, and it does not include provisions on domestic bribery.

¹ The UNCAC is in force in 144 countries.

² The Convention is implemented by 38 countries, including South Africa as party to this Convention.

- OECD Guidelines for Multinational Enterprises. The OECD Guidelines require adhering governments to provide an open and transparent environment for international investment and to encourage the positive contribution multi-national enterprises can make to economic and social progress. It includes chapters on human rights, employment and industrial relations, environment, combating bribery, bribe solicitation and extortion; and consumer interest, among other topics. The Guidelines address both the rights and obligations of State and businesses.
- UN Guiding Principles on Business and Human Rights. In three pillars, the principles cover the State's duty to protect human rights in terms of providing a blueprint for companies on how to know and show that they are respecting human rights; it addresses the corporate responsibility to respect human rights, in terms of clarity of expectations and consistency of rule for business in relation to human rights; and access to remedy for victims of human rights abuse, for example where people are harmed by business activities, there is both adequate accountability and effective redress (judicial and non-judicial).

Regional instruments dealing with anti-corruption, corporate ethics and responsible business conduct:

- African Union Convention on Preventing and Combating Corruption (AUC). The AUC is a legally binding anti-corruption convention that addresses both public and private corruption. It provides for prevention, criminalisation, regional cooperation and mutual legal assistance as well as the recovery of assets.³ It covers both transnational and domestic bribery.
- The Southern Africa Development Community (SADC) Protocol Against Corruption and its Implementation Mechanism. The SADC Protocol provides both preventative and enforcement mechanisms at the national level to promote cooperation in the fight against corruption at the national level.⁴ It also seeks to harmonise anti-corruption national legislation in the region. The preventative measures include the development of a code of conduct for public officials, transparency and the establishment of anti-corruption agencies. It is also in line with the OECD Convention, in terms of criminalising the bribing of foreign public officials.
- The African Unions Africa Peer Review Mechanism (APRM). The APRM aims to harmonise anti-corruption laws within Africa through multilateral legal instruments. It is a voluntary instrument acceded to by member states of the African Union as a self-monitoring mechanism for Parties to the APRM.⁵

National codes, acts or guidelines dealing with anti-corruption, corporate ethics and responsible business conduct in SOEs

Based on these international or regional commitments, most countries in the region are amending existing legislation or adopting new legislation on corruption, money laundering and public procurement; in addition to enacting company laws or guidance that relate to responsible business conduct. In particular, some national codes, acts or guidelines address these issues at the company level, and even may include specific recommendations that concern SOEs. These include, but are not limited to:

³ The AUC is in force in 31 countries.

⁴ It has been ratified by 9 SADC member states.

⁵ The APRM currently has membership of 29 countries of the AU.

- Draft Southern African Guidelines on the Governance of SOEs
- King Code of Corporate Governance (South Africa)
- The 2011 Companies Act (South Africa)
- Malawi Code II: Code of Best Practice for Corporate Governance in Malawi, Sector Guidelines for Parastatal Organisations and State-Owned Enterprises
- Code of Corporate Governance for Mauritius: Guidance Notes for State-Owned Enterprises.
- Corporate Governance Framework for State Enterprises and Parastatals (Zimbabwe)
- The Social and Ethics Committee Handbook, Ethics Institute of South Africa

As demonstrated, although a number of international and regional commitments exist aimed at combatting corruption, corporate ethics and responsible business conduct, few deal with the company-level, let alone specifically addressing the practices of state-owned companies.

Proposed Scope and Coverage

This note has suggested a few areas where specific policies addressing anti-corruption, corporate ethics and responsible business conduct by SOEs and their owners are of importance. It has also provided a brief overview of international and regional commitments in this area.

Network participants are invited to undertake an initial discussion of potential future work to develop a specific project on this topic. The following action is suggested for the Southern Africa SOE Network:

- The Network can serve as a platform for sharing the experiences of governments with addressing anti-corruption, ethics and responsible business conduct in SOEs, including in the context of any initiatives that also address private sector companies. An initial deliverable could be a two-part stocktaking study of business integrity and anti-bribery legislation, policies and practices among Southern African economies, specifically covering SOEs, especially where practices differ from private enterprises; and drawing from case examples. The second part would cover company ethics and responsible business conduct practices across SADC economies.⁶
- It is proposed, based on the stocktaking study, that the project eventually leads to a set of recommendations on anti-corruption, corporate ethics and responsible business conduct in SOEs, from which company guidance or a template corporate code of ethics can be

⁶ This would draw from a recent (2012) study covering 20 economies conducted by the OECD-AFDB Joint Initiative to Support Business Integrity and Anti-Bribery Efforts in Africa, in addition to existing continental, national and regional research examining anti-corruption and corporate ethics issues among participating economies.

developed. The recommendations and guidance would be the shared property of the Network and would be agreed up on through a regional process.⁷

- On the basis of the stocktaking, the Network would convene a regional Taskforce of 3-4 countries and additional experts in the field, to spearhead the drafting of recommendations and company guidance. The Taskforce would meet in the region to debate the proposed text.
- On the basis of a stocktaking report, recommendations and company guidance/template code of ethics the Network can serve as a platform for consultation among practitioners, activists and relevant authorities, including SOEs, to ensure coherence and relevance.

The timeline for such an activity would span 2014 through 2015. In 2014 an initial stocktaking study could be undertaken. In 2015, a process to develop regional recommendations and company guidance/template code of ethics could be pursued.

⁷ The Network would also cooperate with existing initiatives in this area including the OECD-AFDB Joint Initiative to Support Business Integrity and Anti-Bribery Efforts in Africa and the United Nations Economic Commission for Africa.

Discussion Paper

THE GOVERNANCE OF SOES IN INFRASTRUCTURE PROVISION

Background Paper for Theme 3

4th Meeting of the OECD Network on the Governance of SOEs in Southern Africa

Adequate infrastructure is crucial for national as well as regional competitiveness, as it provides essential inputs to downstream private sector activities, and is critical for regional integration, trade, and attracting FDI. Yet Africa faces a vast financing gap if it is to reach the level of infrastructure needed for attaining the Millennium Development Goals. According to Africa Infrastructure Country Diagnostic (AICD) estimates, Africa's total financing needs for new physical infrastructure and operations and maintenance amounted to US\$93 billion a year in 2008, with only US\$45 billion financed. The majority of this infrastructure investment came from African governments (US\$30 billion), a long way ahead of the private sector (US\$9.4 billion) and of Official Development Assistance (ODA).¹ Moreover as infrastructure ODA has substantially increased over the past few years, the budget constraints currently weighing on OECD countries make further increases unlikely in the near future. African countries therefore face two pressing priorities in terms of infrastructure funding and development: attracting more private sector infrastructure investment in order to fill this 'financing gap'; and ensuring that the public sector investment already taking place (mostly through State-Owned Enterprises) is as efficient as possible in terms of providing end-users with cost-effective and high-quality services.

Among SADC economies, SOEs play a very important role in the development of infrastructure. State-owned financial institutions can be responsible for financing and/or underwriting infrastructure projects, and SOEs are also players in the provision of infrastructure services – as monopolistic utility providers, as clients or bidders for infrastructure procurement, or as the public sector counterpart in PPP projects. Both as investors in new infrastructure capacity, and as actors of liberalisation processes that are aimed at attracting private investors, SOEs are therefore a critical component of infrastructure development in Africa. There are therefore two central stakes for SOE involvement in infrastructure, which are detailed below:

- **Guaranteeing SOE efficiency** in the provision of infrastructure services; and
- Ensuring that SOEs play a **constructive role in opening infrastructure sub-sectors to private participation.**

1. SOE efficiency in the provision of infrastructure services

SOE efficiency varies across SADC countries. In Botswana although certain public enterprises have recorded losses (such as Botswana Power Corporation), according to the 2011 Budget the majority perform satisfactorily from a financial standpoint: the total dividend paid to Government by SOEs in 2010/11 amounted to USD 14.7 million, led by Botswana Telecommunications Corporation.² By contrast in Tanzania, SOE inefficiency weighs heavily on the Government budget: verification of the performance of 170 privatized SOEs in 2012 reveals that 41 of these were making profits and 66 making losses.³ Some such losses may of course be 'deliberate', rather than a reflection of inefficiency alone: in many countries basic utilities such as water or electricity are intentionally under-priced in the interest of end-user affordability, which naturally deprives SOEs of commercial revenues and leads them to depend on Government subsidies (see Box 2 below). Nonetheless in many cases, financial and operational mismanagement do appear to be behind a large share of losses made – for example forcing the

Tanzanian Government to bail out six SOEs in 2008/09, at a cost of USD 36 million. Inefficiently-run SOEs can impose an unsustainable drain on public finances; financial balance aside, ineffective SOE management can also result in poor infrastructure maintenance, service quality and network coverage. Therefore while SOEs can be an effective vehicle for infrastructure investment, this requires a clear long-term strategic intent as well as sound financial and operational management.

The functioning and efficiency of SOEs in infrastructure can be enhanced in several ways, as investigated in the following sub-sections:

- Functional separation of infrastructure sub-sectors can help to identify in which areas profits or losses are made, and can therefore shed light on what operations the SOE is best-suited to shoulder, as opposed to the functions that would be best left to private actors;
- The framework for governance of infrastructure sectors (including independent infrastructure regulators, competition authorities, and also the independence of SOE boards) can strongly influence the quality of SOE operations; and
- A strong regulatory framework for bidding and procurement is essential for efficient SOE delivery of infrastructure services.

1.1 Functional separation of infrastructure sub-sectors

Functional separation of infrastructure sub-sectors can support efforts to increase SOE efficiency, as it helps verify which segments record profits and which make losses. For those segments that are considered, following thorough evaluation, to be run efficiently, this separation can help SOEs to better focus their staff and resources on delivering higher value-for-money and quality infrastructure services to the general population. Functional separation and the associated efficiency gains can also better prepare SOEs for potential competition once infrastructure sectors are liberalised, and can pave the way for privatisation in functions deemed better-suited for private sector provision. For Governments seeking to privatise an infrastructure SOE, improving the latter's efficiency and corporate governance also reduces the need for large-scale restructuring and can therefore make the prospect of taking the SOE over more attractive for potential private investors.

1.2 Framework for regulatory oversight and governance of infrastructure sectors

Sector-specific regulators are crucial both for infrastructure sectors where the SOE runs as monopoly, and where the sector is open to competition. Ensuring that the needs of end-users are met and keeping infrastructure markets competitive (if they have been liberalised) requires careful regulation and oversight. Regulators have been set up in many SADC countries, although their independence varies from country to country (and even within different infrastructure sub-sectors of the same country). In Mauritius for instance, the ICT sector is more independently regulated than the electricity sector. The recently amended ICT Act gives greater power to the ICT Regulator, the ICTA, to proactively intervene in prices (particularly as regards operators holding significant market power). By contrast, the Central Electricity Board (CEB), the primary body responsible for regulation of the electricity sector, is a wholly government-owned SOE which reports to the Ministry of Energy and Public Utilities. The CEB is also the monopoly actor in energy transmission and distribution (under a single-buyer model). Although self-regulation may be an efficient option in the case of natural monopolies and where single providers will inevitably emerge, this is seldom the nature of electricity markets (where there is generally room for competition in generation but also in distribution and transmission – facilitated for instance through a wholesale market or smart-grid infrastructure). In the case of the CEB, legislation was passed in 2005 to

provide for the creation of an independent Utility Regulatory Agency which would take over the CEB's regulatory role; while this would reduce the risks of conflict of interest, the agency has yet to be set up.⁴

The independence of both energy regulators and SOE boards is an important dimension of increasing SOE effectiveness in infrastructure provision. Regulators are often also involved in tariff-setting, which has implications both for end-users and for fiscal sustainability (as adequately-set tariffs can generate government revenues, while tariffs that are artificially low may force governments to heavily subsidise the SOE). Independence can be further reinforced by: allowing the regulator to generate revenues from its activities, rather than depending on budget allocations from line ministries; establishing the regulator via law rather than by decrees, which are more easily revoked; and appointing top management with fixed-term positions that are independent of the electoral cycle. Independence from political pressure can also be ensured for the regulator's board, the commissions associated with the regulator, and any other agencies responsible for enforcing a level playing field (such as the competition authority – see below). Likewise the independence and sound governance of SOE boards themselves, as well as SOE management more generally, is essential to efficiently meet end-user needs in infrastructure service provision.

Dedicated entities have been set up to oversee the procurement process in many SADC countries. In Botswana for example the PPADB (Public Procurement and Asset Disposal Board) is involved with SOE governance processes in its daily operations, as is PEEPA (the Public Enterprises Evaluation and Privatisation Agency). In Tanzania the PPRA (Public Procurement Regulatory Authority) is entrusted with monitoring procurement, while the Consolidated Holding Corporation (CHC) evaluates the performance of all privatised entities on behalf of the Government. Meanwhile in Mauritius the Public Procurement Act 2006/7 restructured the Central Tender Board into the Central Procurement Board, and set up two oversight institutions designed to bring more clarity and procedural fairness to the process: the Public Procurement Office (PPO, the policymaking and oversight institution) and the Independent Review Panel (IRP, which hears appeals from aggrieved bidders). However the fact that IRP decisions are not binding has resulted in their non-implementation by some of the targeted public entities; in order to effectively improve the management of procurement by SOEs, it is important that such bodies have the legal clout to enforce their decisions.

Competition Authorities also have a role to play in regulating SOE activities in infrastructure. It is crucial that competition authorities possess enough resources and skilled staff to suitably monitor and enforce competition regulations in different infrastructure sectors. This can help improve SOE efficiency, and is also a crucial condition for achieving successful liberalisation and attracting private investors to infrastructure sectors. In the case of privatisation or unbundling of vertically integrated SOEs, the competition authority notably has a role in: levelling the playing field between SOEs and private actors (by denouncing abuse of dominant market position by the SOE, but also disproportionate subsidisation by Government); and ensuring that the process is adequately carried out (and that private bidders are not, for instance, offered market exclusivity clauses). Competition authorities require adequate political support and independence to exercise effectively, in particular when they must challenge vested interests in infrastructure markets – such as state-owned firms that fall under the regulatory authority of other parts of government. Clear roles and responsibilities shouldered by both the sector regulator and the competition authority therefore need to be defined. Competition authorities must especially have sufficient independence vis-à-vis government to denounce anti-competitive practices in infrastructure SOEs, where these arise. Evidence of political intervention in competition cases can otherwise considerably erode the authority and credibility of the authority.

1.3 Regulatory framework for bidding and procurement in infrastructure

Public authorities must regularly make crucial choices concerning the mode of infrastructure delivery. Governments need to choose between public and private provision, including by considering various options for private procurement (such as public-private partnerships, PPPs). Public procurement gives SOEs an especially prominent role, as it keeps the control and management of the infrastructure assets in Government (or SOE) hands and essentially outsources certain operational or maintenance functions to private actors with the requisite technical experience. Nonetheless SOEs can also be central in the design of private procurement. In setting up bids for infrastructure procurement, governments therefore have to define how the SOE fits into the picture. While on the one hand SOEs can play a relatively passive role as recipients of procurement and as users of the procured infrastructure service, on the other hand SOEs can also be active bidders for the procurement contract. In such cases, alongside opening infrastructure markets so as to increase competition, sources of capital, and transfer of technological know-how, governments may want to develop the SOE's ability to compete in those markets themselves. Resolving this challenge often involves a mix of partially opening the market and keeping a share of it for the SOE. In South Africa's energy market for example, only 50% of the planned new generation capacity was covered by outside tendering, and the remaining 50% was reserved to the state-owned Eskom.

Both public and private procurement require strong bidding and tender evaluation procedures. The dedicated entities for overseeing public and private procurement that have been set up in many SADC countries (see 1.2 above) have an important role to play in this regard. In cases where SOEs directly bid for infrastructure procurement contracts, any preferential treatment that may be given to the SOE during tendering should be justified by public interest motivations, rigorously defined and clearly explained to all bidders. In such situations care must be taken to ensure that bidding criteria do not restrict market entry, hamper competition, or limit the innovation potential (and associated cost reductions) that tenders can bring. Whether or not the SOE acts as a bidder or rather as a mere client of the procured infrastructure service, bid design should also minimise opportunities for bid rigging. Standard procurement models can help in this regard. Over 2012 Mauritius is for example developing Framework Arrangements and Contracts which will allow public bodies, including SOEs, to procure from one or more suppliers on a fixed-rate basis, or from many suppliers through mini-competition. This should enable public bodies and SOEs to choose from different models of framework arrangements that provide the possibility for longer contract periods, but without necessarily locking the procurement entity or SOE into a long-term arrangement with a pre-selected number of suppliers. Such frameworks also simplify the administrative process, reduce the resource intensity of bid and contract preparation, and can moreover improve the efficiency of SOE management and service provision.

2. The role of SOEs in opening infrastructure sectors to private participation

Government approaches to SOE participation in infrastructure vary across SADC countries, and this can provide varying signals to private investors. As Box 1 below illustrates, some governments view SOEs as highly complementary with the private sector in infrastructure provision; others have engaged more resources into privatisation and divestiture attempts; and yet other countries have oscillated between the two positions, with a preference for keeping control of strategically important companies. In this variable context, the sections below analyse different ways in which SOEs can play a constructive role in opening infrastructure sectors to private participation: as infrastructure planners, service providers and partners with the private sector (whether it be through 'single-buyer' provision or PPPs); and even as financiers of public and private infrastructure projects.

Box 1: Differing long-term government approaches to SOE participation in infrastructure

Across SADC countries, SOEs play a dominant role in infrastructure provision. The long-term government vision concerning this role however differs across countries:

Zambia has engaged in an **extensive privatisation programme** since the early nineties, and over 260 SOEs have been privatized since. There are essentially two categories of SOEs in Zambia today: those incorporated under the Companies Act; and “statutory corporations” which are established by particular statutes. Only a few SOEs remain, in the energy, building, finance and insurance services. Attempts were also made to increase SOE autonomy from government in decision-making terms: following the 1993 Public Service Reform Programme (PSRP), all Boards of Statutory institutions and SOEs were restructured to include higher numbers of independent non-state actors.

Botswana does not envisage full-out privatisation of all SOEs in coming years. Rather, the 2011/2012 Budget states that the **SOE sector is central to the country’s high growth strategy**, and that SOEs can function in a complementary manner to private firms (by presenting benchmarks for the private sector and providing services cost-effectively in markets that may not be attractive to private actors). Likewise, although the 2008 Botswana Excellence strategy notes the importance of privatisation, in practice it mostly makes plans for optimising SOE efficiency. There has been little private investment in infrastructure, with the exception of the telecommunications domain.

Mauritius controls the provision of almost all key utility services (including for electricity, water, waste water, postal services, and television broadcasting) either directly or through SOE companies. While the importance of increasing private participation in infrastructure is recognized, there is a **dominant focus on improving SOE efficiency and financial autonomy**. The 2010 report on Facing the Eurozone Crisis stresses the importance of SOEs operating on a commercial basis and requires that SOEs finance their own operating costs rather than depending on budgetary transfers. The report plans to make government funding conditional on SOEs providing a minimum real return of 5% on invested capital.

South Africa passed a Protocol on Corporate Governance in the Public Sector in 2002. By means of Shareholder Compacts with SOEs, Government thereby requires that **SOEs contribute to improving competitiveness and reducing the cost of doing business** in South Africa. The SOE mandate includes: providing infrastructure capacity ahead of demand; improving operational efficiency; providing essential infrastructure required to safeguard security of supply to the economy; and pricing competitively so as to earn a return on funds invested. On this basis several companies have developed turn-around strategies focused on re-engineered business, more strategic balance sheet management, and better corporate governance and risk management. While the state may capitalise SOEs in the start-up phase, in later stages SOEs are expected to be financially sound in order to mobilize their own resources in national and international capital markets.

Tanzania has oscillated between strong policy enthusiasm for private investment in infrastructure (as demonstrated by recent enabling legislation for PPPs and procurement), and the tendency to maintain strategic SOEs in government hands. Five major Tanzanian utilities had a form of private participation by 2003: Tanzania Electricity Supply Company; Tanzania Harbours Authority; Dar-es-Salaam Water & Sewerage Company; Tanzania Telecommunications Company; and Air Tanzania. However following their privatisation attempts, most of these companies were re-possessed by Government on the grounds that they required subsidies due to the nature of the services offered, as they were not specifically expected to generate profit. Likewise although by 2011 34 public bodies were in stages of privatisation, considerable delays had arisen in the process. In addition to these delays limiting SOEs in their strategic plans and increasing wear and tear of assets, the **ambivalent government position on SOE participation in infrastructure** sends conflicting signals to private investors potentially interested in the sector.

2.1 SOEs as infrastructure managers, providers and partners with the private sector

As infrastructure providers, SOEs can complement private sector provision. In many situations, large companies such as SOEs may have a comparative advantage in access to finance, as they can finance projects on their balance sheet. Due to their considerable prior experience in the specificities of the infrastructure market in which they have operated, SOEs can also provide valuable and informed inputs in the preparation of bids and their technical requirements. The partnership with private actors, can in turn allow SOEs to benefit from private capital and transfers of managerial and technical know-how. **Public-Private Partnerships (PPPs)** can for example be a useful mechanism to attract private participation in infrastructure – especially in African countries where infrastructure deployment cannot rely on public resources alone. Well-designed PPPs can also optimally allocate risks and costs between the public and the private sectors. As an alternative to the PPP route, many African, Asian and Eastern European countries have also chosen to shift from a fully vertically integrated monopoly to a **‘single-buyer-model’** (especially in the water and energy sectors). In the energy sector for example, independent power producers (IPPs) contract with the national utility SOE. This increases overall power generation capacity while maintaining a unified tariff rate, and enables governments to keep strategically important transmission and distribution functions in state hands.

Proper due diligence to avoid losses of public money is essential when structuring the role of SOEs and private actors in infrastructure provision. In many cases inefficiencies in the partnership between public and private sectors for infrastructure projects can be attributed to a poorly defined regulatory framework, under-capacity for public and private procurement, weak risk management, insufficient upstream infrastructure project preparation, underestimated contingent liabilities falling on the public partner, and poor public-private communication. Clear regulations for PPPs, together with a pipeline of PPP projects and provisions for managing these projects in a transparent and accountable way, are for instance essential. It is also of crucial importance that public authorities be well-equipped to assess infrastructure needs and to negotiate sound infrastructure contracts on an equal basis with their private counterparts. Indeed both PPPs and the single-buyer model pose considerable risks in terms of taxpayer and end-user costs if contracts are poorly designed and managed:

- The **single-buyer model** has in some cases weakened payment discipline and imposed large contingent liabilities on governments, as government is expected to step in if the ‘single-buyer’ cannot honour its obligations to independent producers.⁵ There is also a risk that the monopoly distributor passes an unusually high share of energy purchase costs through to its buyers (as the Tanzanian example in Box 2 illustrates). The design of clear procurement rules (for example standard power purchasing agreements in the energy sector) is therefore essential to protect consumer interests when using the single-buyer model.
- Meanwhile considerable upstream preparation is required for **designing PPP contracts** that share risks adequately between public and private actors, and that are fiscally sustainable (for this an affordability test, which assesses the impact of a PPP project on public finances, should be computed). Poor fiscal, risk and performance evaluation prior to engaging in infrastructure PPPs could otherwise endanger the creditworthiness of public utilities, thereby increasing the cost of debt for developers wishing to partner with them in PPPs.

Box 2: Electricity pricing in Tanzania

In Tanzania, the state-owned utility company TANESCO has passed through an unusually high fraction of purchase costs to consumers, causing electricity tariffs to rise by 70% between 2008 and 2012. In response the energy sector regulatory agency (EWURA) is now developing its own methodology for tariff calculation,

which should subject TANESCO's choice of tariff to greater scrutiny.

Prior to 2008: underpriced and inequitable electricity tariffs. Until late 2007 TANESCO maintained underpriced electricity tariffs, making it heavily dependent on Government subsidies and impeding any improvements in capacity or service quality. Cost of service in 2006 exceeded its revenues by 40%. This low price of electricity had no socially desirable effect in terms of broadening the access of poorer citizens to electricity: electricity access remained geographically constrained to areas inhabited by richer segments of the population. Backed with extensive public funding, these low tariffs therefore acted mostly as a regressive subsidy for the rich rather than facilitating access for the poor.

2008-2012: a cumulative 70% increase in tariffs secured by TANESCO. In 2007 TANESCO applied to EWURA for a 40% tariff increase starting in January 2008. As a result TANESCO's tariffs have risen considerably (by an estimated 70% since 2008) and electricity prices now far outstrip those of neighbouring countries. However these increases have not been accompanied by significant improvements in service delivery.

2012: new structure for tariff-setting considered in light of social unrest. In mid-January 2012 TANESCO once again requested a tariff increase (of 155%) on the grounds that operational costs had risen due to its efforts to address power shortages⁶. EWURA and the Government rejected this demand but agree to a lower tariff increase (of 40.29%). This has sparked considerable frustration among consumers and producers, particularly given TANESCO's performance record. As a result EWURA is currently developing its own methodology for tariff-setting in distribution, generation and transmission. Transparency of information and costs so as to establish the true cost of service is a key issue in developing this methodology.

Source: Subsidiary legislation to the PPP Act 2010 (Supplement No.17). Government Gazette No.22 Vol.92, 3 June 2011.

Accurate assessment of the SOE's performance and capacity for infrastructure deployment vis-à-vis the private sector is also crucial. A wide set of important procedures and principles (such as cost-benefit analysis, or review of alternative modes of delivery and of their impact across the full system of infrastructure provision) exist to help ensure that the choice of delivery will correspond to the most cost-effective option that provides the most value-for-money for tax-payers and end-users. The choice among different forms of public, private, and hybrid provision of infrastructure services should be based on: assessing the comparative advantage of each actor in providing the service (including by calculating a Public Sector Comparator, which estimates the hypothetical risk-adjusted cost if a project were to be wholly financed, owned and implemented by government and the relevant SOE); designing a compensation mechanism for the public or private infrastructure provider, based on performance and accounted for in a transparent manner; and monitoring performance of both the SOE and of private or PPP alternatives on a regular basis. These evaluations require that information on the SOE's commercial activities and performance be easily available, which can be facilitated through: frequent reporting requirements; independent monitoring of the SOE; and benchmarking SOEs against internationally recognised accounting standards.

2.2 SOEs as infrastructure financiers

Alongside the state-owned public utilities which run and invest in infrastructure projects, **state-owned financial institutions (especially Development Finance Institutions, DFIs) can function as strategic planners and financiers in the overall infrastructure network.** The DFI Development Bank of South Africa notes that, in successful emerging economies, state-owned DFIs have been at the centre of

integrated planning for infrastructure as integrators. 'Integrators' facilitate the integration of infrastructure development into broader economic development, by providing financing to integrate connection in the infrastructure delivery system, and by linking different initiatives, resources, stakeholders and decision makers in both public and private sectors. These agencies can therefore play both a financial and an overarching co-ordination role which commercial financial institutions cannot. They can complement government resources and market financing, by funding development projects and acting as facilitators of finance in line with national industrialization and economic development strategies. DFIs can also provide counter-cyclical funding to maintain infrastructure in times of economic downturn. Many African DFIs are however challenged by poor corporate governance, low capitalization, inadequate skilled manpower, and poor business models⁷; several countries – including Nigeria and South Africa – openly recognise these shortcomings and make reference to the Brazilian Development Bank, BNDES, as a model to follow. DBSA especially stresses the importance of aligning DFIs more tightly with broader national economic policy, of ensuring greater coordination between DFIs and other SOEs so that their investment activities are complementary, and of better enabling DFIs to serve as integrators, financiers, advisers, partners and implementers in infrastructure development.⁸

3. Going Forward

This note has briefly investigated the different roles played by State-Owned Enterprises in infrastructure development in Southern Africa. In addition to the possibility for State-owned financial institutions to finance or underwrite infrastructure projects, SOEs are pivotal players as direct providers of infrastructure services, as clients or bidders for infrastructure procurement, and as partners of the private sector in PPP infrastructure projects. Important risks and considerations in terms of guaranteeing SOE efficiency in the provision of infrastructure services, and ensuring that SOEs play a constructive role in opening infrastructure sub-sectors to private participation, have been outlined above. On this basis, the following long-term opportunities for the Southern African SOE Network present themselves:

- The Network can serve as a platform for sharing the experiences of SOEs in different infrastructure sub-sectors across Southern Africa (both as purchasers and bidders in infrastructure contracts), so as to address common challenges and identify practical solutions to issues of efficiency and end-user affordability.
- The Network can also provide a venue for infrastructure regulators to share their experiences across different countries and infrastructure sub-sectors, especially with respect to the challenges that they may face in regulating and interacting with SOEs.
- The Network can also serve as a unique forum for bringing together SOEs, policymakers, Development Finance Institutions and private actors in a common discussion. This can help all of these actors to gain a better understanding of their position in the institutional landscape of infrastructure development in their own countries, with room for regional bench-marking and comparisons. This can potentially help open avenues for tackling existing infrastructure bottlenecks at country-level in a more collaborative and coherent manner.
- The SOE Network could serve to build synergies with other regional platforms, including the SADC PPP Network (which groups together PPP practitioners from all SADC Member States). Network participants already or potentially associated with these regional platforms could bridge these regional efforts, by mutually informing of developments and emerging best-practices in these respective policy communities. SOE Network members could also potentially participate in associated trainings or events organised jointly by the OECD and SADC PPP Network.

So as to move forward on these opportunities in view of tangible deliverables, suggested next steps for action by the Network include the following:

- If there is sufficient interest, a workshop could be organised bringing together those actors which would like to take a “lead” in developing output for the infrastructure pillar of the Network. Participation would be voluntary, but could involve 4-5 countries, 3-4 SOEs and 1-2 DFIs, in addition to interested regional organisations. The workshop would serve as a means to begin developing a shared SADC position on the role SOEs play in infrastructure, how to improve their governance, implementation capacities and ability to engage in PPPs, or other types of arrangements which involve SOEs as partners.
- The workshop could propose a timeline for its operation; it could for instance decide to tackle different infrastructure sub-sectors (e.g. energy, water, transport, etc.).
- Following the workshop, the institutions which have taken a lead on the project will report back at the next annual meeting of the Network in the fourth quarter of 2014 on the shared position.

Sources

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⁶ Hussein Mulefu and John Barigye. “Raised Power tariff hit Uganda and Tanzania”. Great Lakes Voice, Friday, January 13th, 2012. Available at: <http://greatlakesvoice.com/?p=1945>

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