Discussion Papers

3rd Meeting of the OECD Network on the Governance of State-Owned Enterprises in Southern Africa

Forging Ahead with Reforms

8-9 October 2012

(Ver 7.11.12)

Sponsored by the Development Bank of Southern Africa
With the financial support of the Norwegian Government
In partnership with SADC-DFRC, NEPAD-OECD Investment Initiative, and APRM

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TOWARDS A REGIONAL CONSENSUS: A NOTE ON DEVELOPING GOOD PRACTICES FOR SOE GOVERNANCE IN SOUTHERN AFRICA

Background Paper for Session 2
3rd Meeting of the OECD Network on the Governance of SOEs in Southern Africa

1. Background

Most Southern African countries have business sectors consisting largely of resource-based activities (including farming), small private companies and state owned enterprises (SOEs). Although the weight of SOEs in economic activity varies from country to country, state ownership can account for over 20 percent of the business sector and remains prominent across a number of key areas including infrastructure and utilities (e.g. air and rail transport, electricity, gas, and water supply, broadcasting, natural resource extraction, telecommunications), in addition to finance (e.g. banking and insurance). SOEs play a vital role not only in terms of the direct services they provide, but also because these sectors are so vital to the functioning and development of their overall economies given their linkages with other downstream activities. Although figures vary considerably by economy and sector, SOEs also account for a non-trivial contribution to employment. (Nellis, 2005)

It is, therefore, not surprising that many Southern African economies have placed SOEs at the centre of their national development strategies. This strategy is partially a response to unsuccessful privatisations that accompanied structural reforms programmes carried out through the 1990s. It is also a reflection of the growing trend to rely on SOEs to remedy market failures and remove obstacles to development (see also Network Discussion Paper on role of SOEs in supporting development). In parallel, Southern African governments are also pursuing important reforms aimed at promoting competition, boosting private sector development and improving international and regional trade and investment. Nevertheless, some distinct challenges (subject to varying degrees of pertinence depending on the national context) remain for improving SOE performance, as summarised in Table 1.

Table 1: Performance challenges in SOEs

Challenge	***Description***
Inadequate capitalisation	SOEs rely on debt and finance to fund basic operations, but this may not be enough to fund capital intensive projects especially rehabilitation and upgrading of infrastructure in the utilities and network industries
Below-cost pricing	Tariff structures may need to be revisited. Compensation may be required for non-commercial services
Remnants of poor investment decisions	Remnants of initial investment decisions in industrial and commercial SOEs; lack of ability to adjust to changing market conditions.
Collection deficiencies	SOEs have been underfinanced partly because they have not been able to collect on services (historically).
Inadequate reporting systems	Inadequate reporting and monitoring does not allow for transparency and accountability surrounding SOE cost structure. It further does not help expose where SOEs may be over or under financed, shield SOE from misuse of public budgets, corruption, etc.
Deficient boards of directors	SOEs' boards may require further professionalization and shielding from the political apparatus.
Other shortcomings	Encouraging and attracting talent in SOE boards and in SOE management. Upgrading or downsizing SOEs to ensure efficient functioning.

Source: Adapted from Nellis (2005).

Thus the need for a strong effort to ramp up the efficiency, competitiveness and commercial viability of existing SOEs is imperative. Improving the corporate governance of SOE is one of the ways to address these challenges in the Southern African region. Indeed, Southern African economies have been embarking on ambitious reform programmes aimed at:

- Improving the efficiency of SOE as compared with private activities to ensure that SOEs are not a drag on national and fiscal resources.

- Removing some of the privileges accorded to SOEs – whether *de jure* or *de facto* – by policy makers and regulators, with the aim of stimulating private commercial activities.

- Focusing on specific sectors with an element of natural monopoly where SOEs dominate (e.g. utilities and other network industries), with the aim of boosting the productivity of downstream economic activities.

- Controlling corruption and other illicit activities and avoiding the use of SOE a conduit for "rent seeking" practices.

In order to assist the process of SOE governance reform the remainder of this note describes the relevance of regional guidelines for the corporate governance of SOEs drawing on examples from the Southern African region (Sections 2) and other country/regional practices (Section 3). The note also describes how such a process could be designed in the context of the SOE Network for Southern Africa (Section 4).

2. Regional Guidelines for SOE Governance in Southern Africa

Developing a regional consensus on SOE reform priorities is one way to set a benchmark for good practice in SOE governance. A regional benchmark can help governments assess and improve the way they exercise ownership of the enterprises they own, which often constitute a significant share of the economy. Guidelines are intended to be aspirational. As such they become a helpful tool for national governments from which to draw and adapt national practices.

Guidelines can pronounce themselves on some of the key issues that are of interest and debate. For example, the institutional, legal and regulatory framework under which SOEs operate; where to place the ownership function within Government; the effectiveness of boards of directors and their role in ensuring that SOEs are shielded from undue political interference; the role of minority shareholders (both in terms of protection of their interests and also the positive impact that they can have on corporate governance practices); and balancing commercial and non-commercial objectives, while also encouraging a level playing field to encourage public-private competition.

Some of the priority areas identified in the Southern African region are described below:

- ***Effective ownership arrangements.*** Government are the cornerstone of implementing an SOE reform agenda in any context. In Africa, this challenge must be set against the broader issues of political governance, and requires particular attention to ensure that proposed reforms are achievable within current political and resource constraints and are matched to the cultural and legal environments. Among the existing participant countries, the stage of reform varies considerably. Some (such as **South Africa** and **Mozambique**) have relatively sophisticated arrangements that can provide pathways for other countries in the region. As an example, **Angola** is currently implementing an ownership model based on the **Mozambique** structure. Nevertheless, favouring a centralised ownership function versus a decentralised or dual structure have not yet been sufficiently tested in practice and may not suit all southern African economies.

- ***The role of boards of directors and board improving efficiency.*** There is a clear disconnect between policy makers on the one hand, and SOE directors (particularly government nominees drawn from the private sector) as to the respective roles that they can and should play, the challenges that they face and how they might better interact.

- ***The role of non-government shareholders.*** This is a high priority issue for the region not least because governments in the region are turning to private capital for funding (especially for big infrastructure projects). Private capital can be raised by selling shares to "strategic investors", floating minority shares of SOEs on stock markets (this may be less prelevant in some countries with less developed capital markets) and other arrangements where foreign expertise is sought including through public private partnerships and more traditional joint ventures (see also Discussion Paper on role of SOEs in Infrastructure). Thus a consideration of how to treat non-state investors, and improving the legal and regulatory environment in which they operate is of key importance. In many cases, non-government shareholders have sought protection of their interests through bespoke legislation and/or project agreements. These seek to address sovereign risk, but also more standard risks of commercial partnerships. Their experiences in negotiating such arrangements can also inform discussions on a more generic level about policy issues associated with investor protection and ensuring a level playing field between SOEs and the private sector.

Where challenges exist, guidelines are a useful tool to provide concrete suggestions with the ultimate aim of improving the performance of SOEs and promoting competitive, transparent and more efficient enterprises. Guidelines can be used by all interested parties concerned by State ownership. First and foremost by the State acting as an owner, but also for board members and CEOs of SOEs, state audit bodies, unions, parliamentarians or other stakeholders with an interest.

Until now, no Southern African regional benchmark for SOE governance has been developed. However a small number of national SOE corporate governance guidelines do exist. The trend has been to use national corporate governance codes and to adapt their implementation though specific guidelines that applies to SOEs. To the authors' knowledge SOE guidelines are currently into effect in **Mauritius** ("Guidance Notes for State-Owned Enterprises") and **Malawi** ("Sector Guidelines for Parastatal Organisations and State Owned Enterprises") (Box 1). **Zimbabwe** has also developed a corporate governance code for parastatals. The King III code is also applicable to some listed SOEs in **South Africa**.[1]

[1] **Botswana**, has modelled its Code of Corporate Governance around a similar framework as the King Reports; the Botswana Stock Exchange has been encouraged to adopt the Code as a listing requirement, including as pertains to listed SOEs.

Box 1. Existing national SOE codes or guidelines in the Southern Africa region

Malawi: 2011 Sector Guidelines for Parastatal Organisations and State Owned Enterprises

The sector guidelines were developed at the request of the National Corporate Governance Review Committee by the Institute of Directors in order to clarify how the Malawi National Code of Governance II would apply to the specific case of parastatals and SOEs. They provide specific definitions, guidelines, best practices and in some cases more stringent requirements for their implementation. Although tailor-made, the government drew from international good practices, including the *OECD SOE Guidelines*. Their aim is to facilitate systematic promotion and monitoring of compliance by the Department of Statutory Corporations, in cooperation with the Ministry of Finance's Public Enterprise Reform and Monitoring Unit.

Mauritius: 2006 Guidance Notes for State-Owned Enterprise

The Mauritius guidance for SOEs is derived from the national Code of Corporate Governance (based on *the OECD Principles for Corporate Governance*). It is a tool which aims to provide solutions to key issues concerning the distinct governance challenges faced by SOEs including accountability, monitoring board performance, risk management, internal control and audit, stakeholder communication, etc. SOEs are required to comply with the provisions of the code.

South Africa: 2009 King Code for Governance

Application of the King III Code is mandated by sector-specific laws or regulations (such as by the Limited Listings Requirements of the Johannesburg Stock Exchange, JSE). Although no specific implementation guidelines have been developed for SOEs, the King Code does refer to recommended practices for SOEs, which means compliance is only required for those which are listed in the JSE.

Zimbabwe: Corporate Governance Framework (CGF) for State Enterprises and Parastatals

The CGF were designed around four pillars of corporate governance which are responsibility, accountability, fairness and transparency to promote the efficient use of public resource and accountability for stewardship of SOEs. The CGF is binding for all SOEs in Zimbabawe and compliance is to be moniotried by relevant bodies. It draws on national philosophy an doctrine (*Ubuntu*), but als draws on other regional and international codes including the OECD SOE Guidelines.

Sources : Government of Mauritius (2006), Government of Malawi (2011), Government of Zimbabwe (2010), South African Institute of Directors (2009).

3. What have other regions and countries done?

While internationally-recognised guidelines exist for SOE governance, the *OECD Guidelines for the Corporate Governance of SOEs* ("*SOE Guidelines*"), it not obvious that the *SOE Guidelines* are always relevant or applicable in other regions or national contexts, including the Southern African context (OECD, 2005). A process of mutually-assisted SOE reform necessarily starts with a common understanding of what constitutes good practices and existing national practices, on which a regional consensus on agreed reform priorities can be established. Other regions, including the Baltic States and the Asian economies have developed their own set of regional guidelines or recommendations. These various approaches are described below.

OECD Guidelines for the Corporate Governance of SOEs

As mentioned the internationally recognised *OECD SOE Guidelines* are a blueprint for effective corporatisation and commercialisation of SOEs among OECD economies. The Guidelines are derived from the *OECD Principles for Corporate Governance* (OECD, 2004) and are organised around six chapters that focus on policies that would ensure good corporate governance, taking the perspective of the State as an owner (Box 2). They are primarily oriented towards SOEs using a distinct legal form, having a commercial activity and where the State has significant control through full, majority, or significant minority ownership. Each Guideline is made up of a number of good policy practices. These practices are supplemented by annotations that contain commentary intended to help readers understand their rationale.

Box 2. OECD Guidelines on the Corporate Governance of State-Owned Enterprises

I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises

The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.

II. The State Acting as an Owner

The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

III. Equitable Treatment of Shareholders

The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.

IV. Relations with Stakeholders

The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.

V. Transparency and Disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

VI. The Responsibilities of the Boards of State-Owned Enterprises

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

The *SOE Guidelines* are a legal instrument and thus a requirement for any existing or future member government of the OECD. However it is up to national governments to determine how they wish to adapt the overall principles of the Guidelines to their national context. The use for specific national guidance for SOEs varies from country-to-country. Although most OECD countries do not have comprehensive corporate governance codes for SOE, some have developed administrative guidance, which reflect certain of the recommendations provided in the *SOE Guidelines*.[2]

Baltic Guidelines for Corporate Governance in State and Municipality owned companies

One regional example that may of particular interest in the context of the Southern Africa SOE Network is the regional process organised around the *Baltic Guidelines for Corporate Governance of State and Municipally owned companies* initiated among three countries in the Baltic region (**Estonia**, **Latvia** and **Lithuania)**. The *Baltic Guidelines* are a set of voluntary guidance aimed at national and regional reform priories. They provide a roadmap and as a way to help Baltic countries achieve international best practices with its recommendations specifically tailored to meet the needs of the Baltic countries (i.e. countries in the late stages of transition), but draw on the *OED SOE Guidelines*. Similar to the *OECD SOE guidelines*, the *Baltic Guidelines* are intended to be applicable despite differences in legal traditions or economic development among the intended countries and their respective SOEs. The difference is in the regional aspect, which is reinforced by the fact that there is some shared history and commonality in terms of the countries' development paths. The Baltic regions also chose to adopt a regional approach to corporate governance as part of realising and maximizing the benefits of regional integration goals.

Box 3. Key messages of the Baltic Guidelines for Corporate Governance in State and Municipality owned companies

Some of the important messages found in the Baltic Guidance on the Governance of Government-owned Enterprises are:

- GOEs are important economically, politically and socially. They are too important to tolerate inefficiencies, self-interested rent-seeking or their use as political playgrounds.
- Better GOE governance will have a positive impact on state budgets, on the public's perception of government, and on the quality of infrastructure and services.
- The proper governance of GOEs requires depoliticisation of decision making and the operational separation of the state's shareholder oversight from its industrial policy and regulatory functions.
- A written ownership policy needs to guide the state. It should define: the purpose of state ownership; what institutions represent the interests of the state; expected outcomes of state ownership; and the methods by which the outcomes are to be achieved.
- A professional supervisory board is essential for directing the GOE and holding management to account. Supervisory board members should be professional and competent, and not nominated based upon political considerations
- Professional managers are best suited to manage commercial enterprises. They require operational autonomy. At the same time, managers need to be held fully accountable for their performance.
- Both GOEs and the public sector bodies responsible for their oversight need to be accountable to the public through greater disclosure and transparency.

Source : Excerpt. Baltic Institute of Corporate Governance (2010).

[2] Among some of the most advanced SOE governance systems "SOE owners" are not keen on a specific national code on account that their SOEs are incorporated according to ordinary company law and follow the same rules as private listed companies.

The *Baltic Guidelines* make recommendations to the government, exercising the ownership function, to the supervisory board, and to the management team. They also provide recommendations relating to reporting and auditing. They are applicable to government activity that can be considered commercial in nature, in which the state holds an ownership interest, irrespective of the legal form of the enterprise, whether the state holds a majority interest, or whether the state exercises control. It should be noted, however, that they are not intended for state agencies whose primary mission is the achievement of social/public objectives. (Box 3.)

Policy brief on corporate governance of state-owned enterprises in Asia: recommendations for reform

Not unlike the OECD's and the Baltic Guidelines, the Asian economies have developed a set of regional reform priorities for SOEs (albeit in a slightly less ambitious approach that those discussed above) in the form of a Policy Brief. The Policy Brief provides a set of recommendations for policy reform in order to improve the corporate governance of SOEs in the economies of Asia. It is a consensus document, whose purpose is to identify reform areas, support national reform efforts and establish a benchmark against which progress can be monitored.

The Policy Brief is organised broadly like the chapters of the *OECD SOE Guidelines*, however it differs is the fact that it identifies specific regional reform priorities for the Asian economies. In order to demonstrate the region-specific recommendations, it draws on good practices among Asian economies which are described in considerable detail. (OECD, 2010)

4. Proposed Process

The Network could be used as a platform from which to develop a set of "Southern African Guidelines on Governance of SOEs." This would involve the participation of the governments in the region as well as corporate governance institutions and corporate representatives. Such a document could be the shared property of all participants in the Network, associated with the SADC community or endorsed by a coalition of experts that wish to voluntarily associate themselves with the process. Participation in the development of guidelines would be voluntary. Once developed, endorsement of the guidelines, too, would be voluntary.

If there is no willingness among participants to proceed with the publication of actual Guidelines, a consensus on good practices and reform priorities (similar to the example of the Asian economies above) could be laid down in a "Regional Policy Brief on SOE Governance Reform". Going forward, the Policy Brief would serve as a guidepost for joint monitoring and progress reporting on national and regional reform efforts.

Although the need for such a regional guidance has been identified in previous phases of the Network, its success will require the active engagement and willingness of the economies involved. It should also be noted that the Africa Peer Review Mechanism (APRM) has also agreed to partner with the Network and OECD in this effort, in order for it to feed, as much as possible, into their corporate governance reviews of African States which are involved in the APRM process (of which a sizeable number are from SADC economies).

Depending on the level of ambition a first Workshop could be organised in April 2013 bringing together a "Taskforce" of countries which want to take the lead on developing a first set of principles. The OECD Secretariat would be willing to coordinate such a Workshop and Taskforce in addition to bringing in international experts to animate it. At least 4-5 countries must volunteer their time to make the workshop meaningful, fruitful and adequately representative of the diverse set of countries in of the SADC region. Participation in the "Taskforce" would also be extended to regional corporate governance experts from institutes of directors, corporate governance institutes, stakeholder organisations, in addition to SOE representatives. Following the workshop, countries which have taken a lead on the project can report back at the plenary of the next annual meeting of the Network (November 2013). Following the November 2013 meeting (i.e. the fourth meeting of the Network), all Network participants can take stock of the work achieved to date, and decide whether they wish to take forward the project with more or less ambition (i.e. a set of regional Guidelines or a Policy Brief).

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NOTE ON THE PARTICIPATION OF SOEs IN INFRASTRUCTURE PROVISION

Background Paper for Session 4
3rd 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 financers 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 an 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 shortages[6]. 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 financers

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 financers 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 models[7]; 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 in April 2013 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.) or operational challenges (functional separation, interaction with regulatory and competition authorities, role in procurement and PPP implementation and design) one at a time. Alternatively the workshop could propose an appropriate "division of labour" in order to make progress on several of these topics simultaneously.

- 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 November 2013 on the shared position. (If further communication and follow-up is necessary, participating countries are encouraged to communication via electronic means, conference call, etc.)

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NOTE ON STATE-OWNED ENTERPRISES IN THE DEVELOPMENT PROCESS

Background Paper for Session 5
3rd Meeting of the OECD Network on the Governance of SOEs in Southern Africa

State-owned enterprises (SOEs) are one of the largest sectors of the economy in many African countries. Data collected by the World Bank suggest that SOEs account for close to 20% of the total non-agricultural economic activities in an average low-income developing country. In certain transition or post-transition economies the share remains above a third. The importance of well-governed SOEs to the development process is further compounded by the fact that these enterprises tend to be concentrated in "strategic" sectors, such as infrastructure and finance, on which a broad range of private enterprises depend for their downstream competitiveness. The sections that follow outline, first, the potential proactive role for SOEs in development (section 1); and second, the key policy challenges that may arise if SOEs are not well-managed (section 2) – in which case poor corporate governance may jeopardize the achievement of the intended development objectives.

1. Proactive use of SOEs for development?

"Governments use various kinds of SOEs to manage the exploitation of resources that they consider to be the state's crown jewels and to create and maintain large numbers of jobs. They select privately owned companies to dominate certain economic sectors. They use so-called sovereign wealth funds to invest their extra cash in ways that maximise the state's profits. In all three cases, the state is using markets to create wealth that can be directed as political officials see fit. And in all three cases the ultimate motive is not economic (maximising growth) but political (maximising the state's power and the leadership's chances of survival)". (Bremmer, 2010)

Notwithstanding Bremmer's criticism of "state capitalism", some of the more successful developing economies, not least in Eastern Asia, have employed SOEs as a vehicle for economic growth – including by employing state-owned holding companies as vehicles of what has been termed "state capitalism". Such strategies clearly need to avoid the pitfalls listed in the following section, but they can be useful if they succeed in addressing market imperfections that may be holding back economic development. Such imperfections may include the total absence of a market for certain goods and services, insufficient production size in sectors where there are demonstrated economies of scale, and economic and societal externalities. Examples of the latter kind would include some developing countries' success with investing in, initially overly ambitious airports and national air carriers with a purpose of gaining scale and providing external benefits to the domestic business sector.

The role of SOEs in the development process probably needs to be seen against the background of different levels of development. The most obvious role for state ownership can be made in particularly poor economies, where in some sectors SOEs are established to compensate for an absence of private companies. As economies advance, some SOEs might become important players in the market place as well as important sources of employment and government revenue. If particularly successful, some SOEs may even become perceived as "national champions", the protection of which takes precedence over other economic priorities.

This situation is fraught with risks for governments, because such companies tend to have strong insider interest and support groups in the political establishment which shield them from normal competitive pressures to adapt. At this stage of the development process priorities may first shift toward reforming the governance of SOEs in order to prevent them from operating inefficiently, leading to a haemorrhaging of fiscal resources and a loss of competitiveness in other businesses that depend on their services. A case for continued state ownership can thus be made, especially if regulatory frameworks are weak and/or there is little actual or potential competition in the market place.

As countries approach middle income level, governments begin to devote greater energy to determining which goods and services are better provided by public vs. private entities. A rational choice will be made on the basis of market efficiency – although in practice political constraints (e.g. vested interests, pressure groups and patronage) will continue to play a role. At this stage, some SOEs may be sold to individual investors, acquired by competitors or listed on the stock market. China provides an illustrative example of a country approaching this situation, which has triggered significant internal debate about the role of SOEs and their reform (see Box 1).

Box 1: The current state of SOE policy and reform in China

The progress of SOE reform in China has been relatively stagnant for some time. Clarifying the underlying concepts and direction of SOE reform is beneficial for opening up dialogue and pushing forward transformation.

1. Enterprise growth and the entrance and exit of state-owned capital. The "entrance and exit of the state-owned economy" refers to the movement of state-owned capital investment, rather than the "entrance and exit of state-owned enterprises." In other words, enterprises' pursuit of growth is not influenced by shareholder composition and equity structures; and the entrance and exit of state capital from industries or companies is not subject to the constraints of individual enterprises. The current constraint is that state-owned assets haven not truly been capitalised.

2. A shift in the dominant direction of SOE reform. The dominant direction of SOE reform should shift from how to manage SOEs to finding a management style that can promote the development of productive forces in the capitalization of state-owned assets. The structural adjustment of the state-owned economy is not about using administrative strength to change individual SOEs business structures, but rather about the dynamic optimisation of the layout of state-owned capital; enterprise system innovation needs to move further to turn state ownership into shareholder ownership and convert "top-level SOEs" into diversified equity companies. These two reforms focus on one point, namely, the capitalisation of state-owned assets and the shift away from "state-owned and state-run" to a "joint-stock system."

3. Privatisation and the entrance and exit of state-owned capital. The entrance and exit of the state-owned economy should not follow the lines of the privatisation of the former Soviet Union and Eastern Europe; the exit of state capital from a particular enterprise cannot be linked with the crime of "partition without permission' of state property.

4. Adjusting "licensed management" and the layout of state-owned capital. Adjusting the layout of state-owned capital requires the completion of two major tasks: first is the capitalisation of state-owned assets, a process which should be entrusted to professional investment institutions to manage; second is the cancellation of "licensed management" and the overall restructuring of SOEs to establish the enterprises' independent market position. "Licensed management" refers to the state giving a portion of its assets to enterprises to manage in order to improve the efficiency and vitality of enterprises; this has also led to an entanglement of ownership and management at the enterprise level.

5. Areas in which state capital can play a role. In principle, sectors which are important to the state and that non-public capital has no intention or is unable to enter, such as fundamental science research, major science and technology projects, SME financing, the development of new industries, critical infrastructure, as well as public rental housing, compulsory education, social security and other fields, all provide important space for state capital to play a strong role and reflect its value.

6. Social security, public welfare funds and state-owned capital. China could consider transferring 30 percent or perhaps even 50 percent of state-owned capital held up in general industries into social security and public welfare funds, thereby allowing state-owned assets to once again be owned and shared by society.

7. Administrative monopoly and government regulation. The government has formed administrative monopolies (or franchises) in a number of industries, which are "controlled" by SOEs and are thus government-controlled monopolies. This kind of macro-regulation runs contrary to the laws of economics. Moreover, in areas in which social benefits exceed business benefits, it is not practical to rely on state monopolies as opposed to institutions and regulations to achieve social goals.

8. "Maintaining and increasing the value" of state-owned capital. The public nature of state capital is reflected in two types of investment. The first type involves the pursuit of financial returns, or using investment income to compensate for social deficits and maintain the social bottom line. The other type is directed at achieving public goals, and includes guiding social investment in areas in which the market fails, promoting scientific and technological progress and industrial upgrading, protecting economic and national security, and supporting people's livelihood and infrastructure projects. However if "maintaining and increasing the value" of state-owned capital are taken to inappropriate heights, unfair competition and lower socio-economic efficiency may result.

9. Relationships between government and enterprise. Enterprises have been divided into different levels based on ownership and administrative subordination relationships. With local protectionism still rampant, the unequal competition among various forms of ownership has been exacerbated; these two types of strong anti-market competitive forces have reduced economic efficiency and inhibited development potential.

10. False dichotomy between State advances and private sector retreats. The pursuit of the ruling party and government is not about which party advances and which party retreats, but rather about encouraging fair competition among enterprises and maximising the development potential of all capital and resources. Casting off the corporate "ownership tag" and breaking the shackles of "state vs. private" will once again liberate productive forces.

11. Realizing a pro-market economy with state-owned assets. So far, we have equated the state-owned economy with SOEs and regarded "state-owned enterprises" in their practical form as the only way to achieve a state-owned economy in the industry arena. Yet other means are available: in general industries, the capitalisation of state-owned assets will be an important breakthrough to further deepen reform.

Source: Chen (2012).

1.1 The "industrial policy" argument

As mentioned above, the provision of state capital may in some cases serve as an important tool for solving market failures that lead to suboptimal productive investment. Three sources of market failure are usually cited. The first has to do with the local capital markets which, if poorly developed, will severely constrain investment – especially where large and long-term projects are concerned. A relative to the "capital shortage" is a "skills shortage" where the profitability of an investment depends on a learning period that might be longer than private investors are prepared to contemplate. A historic example of this is provided by the developmental history of Israel, which in the nation's earliest phases involved large government (and trade union) investment into nascent industries to overcome both kinds of shortage. The second source of market failure is information asymmetry. In a budding democracy or a "mixed governance" regime the government has better information about the likely medium to long term business and regulatory environment than do the market participants. Clearly, a first-best solution would be to enhance transparency, but it takes time for a government to establish credibility and in the meantime long-term investment projects might rely to a higher-than-usual degree on the public purse.

The third source of market failure involves coordination problems. Government involvement may alter the nature and path of productive investments, especially when a given regional activity is subject to "externalities" (e.g. spillovers to seemingly unrelated activities). For example, the investment in public utilities have a knock-on effect on the profitability of dozens of other industries, which means that the societal benefits of such investment will be much bigger than the returns of any individual investors. Most such externalities accrue to the areas normally dominated by government, but they can also occur in competitive parts of the economy. Taking the example of the air transport sector again, a frequently cited example is the investment by a growing number of Asian and Middle Eastern governments in national "flag carrier" airlines with the hope of developing their capital cities into international business hubs. However, two caveats apply. First, the ability of public officials to overcome this particular kind of market imperfection assumes a very high degree of foresight. Investment in capital intensive business activities, if not properly executed, entails the risk of large costs to the public purse and the crowding out of more profitable alternatives. Secondly, the case for using public funds in lieu of private investment is strongest when capital markets are shallow. Where a vibrant private sector exists governments can often obtain a more efficient outcome by manoeuvring the incentives of private companies (e.g. through subsidies or tax concessions) than by entering into the fray themselves.

1.2 The role of development banks

The "jury is still out" on whether the models of state capitalism practiced, in particular, by some Asian and Middle Eastern countries has, on the whole, been beneficial for their development processes. What is clear is that those models have sunk large sums of public money into prioritised investment projects. Not all governments have access to such large pools of capital. It is therefore perhaps unsurprising that a large number of countries have looked to specialised finance institutions to play a similar role at a lower cost by (selectively) levering the investment of private companies. Pronouncements by the Presidency of the Republic of South Africa in the first half of 2012 were taken to indicate that the country is currently contemplating such steps[3]. A further interesting development is the ongoing discussions about establishing a multilateral development bank among the so-called BRICS countries[4].

Table 1: The number of development banks around the world (2011)

	Development agencies[5]	General development banks[6]	Special-purpose development banks[7]	Commercial banks with development objectives[8]	Total
Africa	***3***	***26***	***21***	***20***	***70***
The Americas	4	29	18	1	52
South & East Asia	13	23	22	27	85
Eurasia		8	2	9	19
Europe		7	3	2	12
Middle East		1	3	3	7
Oceania	1	5	5	4	14
Multinational		20	5	3	28
Total	21	119	79	69	288

Source: Musacchio and Lazzarini (2012).

[3] Mail and Guardian (2012).

[4] Financial Times (2012).

[5] Including investment authorities, training centres and organisations that provide technical assistance but do not specialise in giving out loans.

6 Providing loans for (or investing in equity of) industrial and /or infrastructure projects. Includes also institutions that provide guarantees rather the outright loans.

7 Financial institutions specialising in credits to agriculture, small and medium-sized enterprises or the construction industry.

8 Public or private banks operating in the regular market but having part of their portfolio focused on specific sectors that the government is targeting.

The number of national and regional development banks remains very large – not least in the African continent where an estimated 25% of all the world's such institutions are domiciled (Table 1). The link with the SOE economy is twofold, because the development banks are (with a few notable examples) themselves SOEs, and the firms in which they invest often become partly dependent on them to the extent that the development banks have at least a direct say over the governance of these companies.

The role of development banks can be further compounded by their role as investors in the equity markets. Usually they hold only minority stakes in listed enterprises, but they may in some cases decide to act in concert with other government-influenced shareholders. A frequently cited example was the joint intervention in 2009 by Brazil's development bank (BNDES) and a number of state-linked pension funds to force the mining company Vale do Rio Doce to align itself with the government's industrial policy priorities. It should be noted, however, that such interventions are usually controversial and often not consistent with good practices of corporate and public governance.

2. Key policy challenges

The fiscal consequences of inefficient SOEs. A number of SOEs are inefficient, for which reason they are either in constant need of government subsidies or, if they remain profitable, fail to provide the national treasury with an adequate revenue stream. In addition, many such enterprises have the public sector as a "captive client" for their products and services, whereby they may impose a direct cost on the public purse through overpricing. This is clearly a diversion of scarce fiscal resources that are needed to fund economic and societal development. Addressing the inefficiencies according to commonly agreed good practices for SOE governance is consequently a top developmental priority[9]. However, the political economy of reform can be complicated: SOEs are among the main employers in many countries and the inefficiencies often include considerable overstaffing. Overcoming a resistance to change among entrenched group in practice often figures prominently among the reform priorities.

Reliable infrastructure and other strategic services. Apart from companies in the extractive industries, the most important SOEs are generally found in the utilities and financial sectors. A large number of countries have seen their economic growth temporarily, or structurally, stunted, due in part, by ill-functioning state-owned providers of transport, electricity and (at least until the advent of mobile telephony) telecommunication. A vibrant private sector is unlikely to evolve unless a reasonable safety of supply of these basic services is established. State-owned banks also dominate the financial landscape in a number of developing countries. If these banks are either inefficient or lending according to un-economic criteria (including to persons affiliated with the ruling circles) then the productive economy is held back by the cost, or lack, of financing.

SOEs crowding out entrepreneurship. Maintaining a level playing field between SOEs and private enterprises is important to prevent that the state sector from inadvertently holding back private sector growth. Basic principles of "competitive neutrality" must be adhered to, including non-discrimination, separating commercial and non-commercial activities and subsidising SOEs only where this is warranted by a demonstrated market failure. In rich and poor countries alike, essential economic innovations have sometimes been held back by the privileged position that governments granted, and continue to grant, to state-owned corporate incumbents[10].

9 The OECD Guidelines on Corporate Governance of State-Owned Enterprises offer one such reference point (OECD, 2005).

[10] The issue of competitive neutrality was the topic of a recent publication (OECD, 2012).

SOEs as a pole for irregular practices. The proximity to government and the access to subsidies provide SOE insiders with more opportunity for irregular practices than what is seen in most other parts of the economy. Their payroll can be used for political patronage or nepotism. Their services can be provided at bargain prices to politically connected constituencies. Their procurement processes can be compromised to provide a de-facto government support to suppliers.The relationship between SOEs staff and individual customers can be tainted by corruption. High standards of transparency, accountability and corporate governance are needed to counter such temptations[11].

3. A role for the Southern Africa SOE Network?

This note has suggested a few areas where national policies toward state-owned enterprises are of developmental importance. They can be summarised thus: (1) reform of inefficient SOEs to save scarce resources and avoid that these enterprises act as a drag on national competitiveness; (2) maintaining a level playing field to prevent state owned businesses from unduly crowding out private activity; (3) using SOEs proactively to remove obstacles to growth and remedy market failure; and (4) employing targeted financial vehicles such as development banks as a tool for developmental and industrial policy priorities. Network participants are invited to undertake an initial discussion of potential future work in all or any of these areas. On this basis, the following options for action by the Southern Africa SOE Network present themselves:

- The Network can serve as a platform for sharing the experiences of governments with SOE reform, including in the context of furthering developmental goals. A deliverable could be a study based on questionnaire and case/country examples detailing experiences with reform and assessing their economic and developmental impact.

- The Network can serve as a platform for sharing experiences of development banks and related financial institutions. A deliverable would be a good practice report detailing the experiences of individual institutions with furthering developmental goals and assisting corporate restructuring. This could also be linked with the work stream on SOEs in infrastructure, since much of the activity of development banks is directed lending and project finance for this sector.

- The Network can serve as a platform for discussing national and regional experiences with SOE-centred industrial policy and "state capitalism". A deliverable would be an analytical report detailing good practices in using SOEs to remove obstacles to growth, whilst at the same time tempering these with warnings against the risks and costs of excessive state interventionism.

- The ultimate outcome of these work streams could be a joint Africa-OECD policy statement on the role of state-owned enterprises in the development process. Regional organisations such as NEPAD and SADC could be invited to associate themselves with this statement. Such a joint statement would serve double purpose of placing the Network's work on SOEs more firmly on the "development roadmap" and clarifying the pros and cons of using SOEs to achieve development vis-à-vis the region's policy makers.

[11] The issue of transparency in SOEs is discussed in detail in OECD (2010).

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