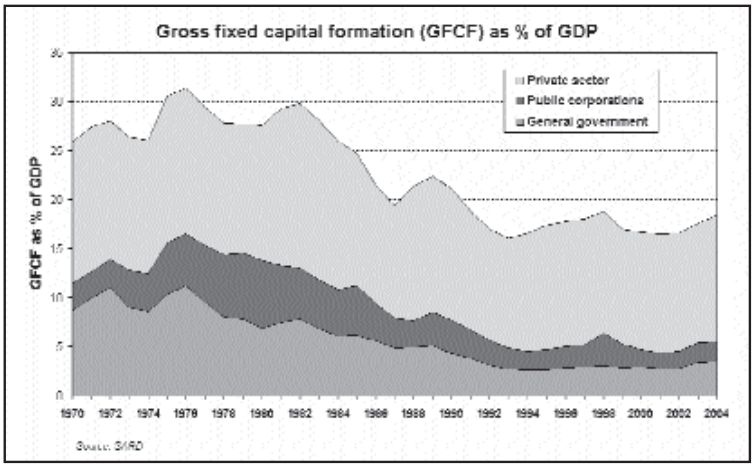
SOEs back up 'developmental state'

The state-owned enterprises (SOEs) are amongst the largest and most economically significant organisations operating in South Africa. As part of its new focus in becoming more of a 'developmental state', the SOEs are being seen as the core 'tool' with which the state aims to leverage its capex programme. **M Walker** and **L Farisani** explore the role of the SOEs in facilitating industrial development.

While strategies and policies designed and implemented by the national government since the advent of democracy have engendered significant economic results, it is questioned whether the current approach to industrialisation will generate the required levels of growth, competitiveness and employment to break South Africa's poverty and unemployment cycle. The challenge facing policy makers, however, is to identify existing capabilities and assets upon which growth can be leveraged and to reach consensus on the tools, organisational structures and prerequisite strategies needed to achieve these goals in the shortest period of time, with the least 'wastage' of resources, and with the maximum socio-economic impact possible.

Identifying South Africa's niche capabilities and assets is easy enough. The country is first and foremost a resource-based economy and remains a resource-based exporter of raw and refined products and a net importer of manufactured goods. This is despite the fact that remarkable success has been achieved in the development of upstream and downstream activities associated with the extraction and processing of such resources and significant local R&D prowess has been generated in a variety of high-tech input goods and services, which are exported throughout the world. (*Engineering News*, 2000; *Mining Weekly*, 2001; Roberts, 2004). To evolve beyond this stage requires broadening existing demand-supply linkages between firms and creating opportunities for the emergence of new manufacturing capabilities.

FIGURE 1
Gross Domestic Capital Formation (GCFC) as a % of GDP, 1970-2004



Determining whose responsibility it is to enable such an economic shift and to put in place the prerequisite structures and policies, however, is more complex. As evident from Figure 1, over the past decade the private sector has played a principal role in the growth and expansion of the national economy accounting for around 75% of total domestic fixed investment (GDFI), 80% of total output, 86% of employment, and 80% of gross domestic product (GDP). By contrast, although dominant in the 1970s and 1980s, the involvement of the government, and specifically public corporations, has been considerably low.

The concern is that if this current pattern of investment continues as is, the rift between the 'first' and 'second' economies will widen rather than shrink. Large private corporations, while intrinsically committed to

alleviating socioeconomic challenges, are nevertheless driven by the need to meet shareholder expectations and maintain profits. Resolving macroeconomic challenges and establishing a climate in which foreign direct investment (FDI) will be attracted is essentially a prerogative of government, and therefore requires its involvement. The critical issue, however, is determining the level of intervention needed. An industrial policy based purely on free-market principles is unlikely to generate the conditions needed to establish a vibrant manufacturing sector and increased employment opportunities. Neither would a purely interventionist one. In essence what is required is a balance between the two approaches. Evidence from East Asia suggests that government intervention that is targeted and aimed at specific strategic industries and sectors is the best option capable of engendering significant macroeconomic benefits over the long-term.

One of the critical failures of industrial policy post-1994 was the inadequacy of supply-side interventions, which were insufficient in scale to assist in the restructuring of the manufacturing sector. Recognising the need for change, the government has since adopted a new approach and set an agenda to become more a 'developmental' state. This involves creating the capacity at every level of government to mobilise and direct social, economic and political resources where they are needed most, and facilitating targeted investment in new productive capacity, particularly in energy and logistics. This is based on the recognition that 'We [South Africa] cannot expect to increase the levels of investment if our infrastructure cannot match demand or if it offers services that do not match other economies that we inevitably must compete against for investment' (*Engineering News*, 2004b). It also involves the direct participation of the private sector. Indeed, in his budget address earlier this year, Finance Minister Trevor Manuel stated: 'We are particularly mindful of the need to improve the alignment between public infrastructure and investment plans and business development. Private-public partnerships (PPPs) are to play a key role in big infrastructure projects' (*Financial Mail*, 2005).

A key element in the shift to becoming more 'developmental' is the government's aim to increase the contribution of public sector investment by 20% above its current level. It is envisaged that such public investment will affirm government's commitment to growing the economy and alleviating poverty. This will create a base from which to attract additional investment, 'crowd-in' private sector resources, and stimulate spill over effects throughout the economy, particularly in the development of new firms, black economic empowerment (BEE) deals, and the export capabilities of companies (*Engineering News*, 2004a). The government has set aside a five-year period, 2004-2009, in which to commence its expanded public works programme. While various projects, amounting to some R60 billion, have been planned as part of this initiative (including Gautrain), the state-owned enterprises (SOEs) are envisaged as the core 'tool' with which the state aims to leverage and catalyse latent economic potential in different regions of the country.

SOES IN FACILITATING INDUSTRIAL DEVELOPMENT

The SOEs are amongst the largest and most economically significant organisations operating in South Africa. In 2004, the six SOEs (Alexkor, Ariva.kom, Denel, Eskom, Transnet, Telkom) had a combined turnover of R83.7 billion and combined assets of R175.5 billion. Approximately 136 000 people are employed in these organisations, constituting some 1.2% of formal sector employment (11 million). Activities extend from the provision of infrastructure and essential inputs into the economy to developing advanced technologies and competitive manufactures. The depth and breadth of linkage development arising between these companies and other sectors in the economy is extensive. Consequently, any decision taken with regard to their involvement/position in the economy will engender significant spillover effects. A key feature in the economic transformation since 1994 has been a re-evaluation of the role of the SOEs in the economy. Having first gone through a process of privatisation and realignment, SOEs are now regarded as being important catalysts in facilitating investment and driving efficiency. Steps are being taken in each SOE to improve operational and organisational structures and to plan investment programmes to parallel the government's public works programme.

Although the Department of Public Enterprises (DPE) will oversee the capital expenditure process, each SOE will be responsible for devising and scheduling its own investment programmes, raise the capital, and implement the projects. It is important to note, that in adopting its 'developmental' approach the government's role is limited to setting the agenda, providing strategic direction and approval, and providing initial investment. The bulk of the investment required to fulfil the CAPEX budgets has to be sought independently by the SOEs, and most of this is envisaged to come from private-public partnerships. At present there are only two SOEs – Transnet and Eskom – that have submitted investment programmes with targeted projects to the DPE, and are in the process of establishing contracts with specialist consultants and key equipment suppliers (*Engineering News*, 2004b). To ensure that all levels of the economy benefit from the investment programme, coordination will be sought between the SOEs and the metropolitan councils of Tshwane, Johannesburg, Ekurhuleni, Durban, Nelson Mandela and Cape Town. In this way greater integration

will be achieved between port, rail and energy infrastructure with the urban-development plans of the megacities.

TRANSNET AND ESKOM'S CAPEX PROGRAMMES

Combined, Transnet and Eskom's five-year investment programmes amount to an estimated R135 billion. Transnet Limited is responsible for the core transport operations and consists of Spoornet, South African Port Operations, National Port Authority and Petronet. Transnet's R40.8 billion integrated investment plan aims to increase the capacity of ports, rail and pipelines in order to boost the annual economic growth rate to between 4% and 6%. Eskom, as South Africa's principal energy utility, is directing its investment programme (R92.9 billion) to improving power generation, transmission and distribution.

Provisional economic assessments of the direct and indirect impacts arising from these investment programmes highlight that civil engineering and construction; metal products (excluding machinery; electrical machinery); non-electrical machinery; coal mining; finance and business services; transport equipment (motor vehicle, parts and accessories); basic iron & steel; and fabricated metal products will be the main economic sectors that will benefit. As the largest concentration of industrial activities in South Africa (with an estimated 8 000 industries), Ekurhuleni stands to reap the greatest spillover effects from the increased demand for capital equipment and services. However, there are a number of threats, which may restrict the full linkage potential of the SOE Capex investment plans from being realised, particularly in the short-term.

First, for those manufacturing sectors projected to benefit from an increase in investment spending across the economy, the key short-term challenge is to ensure that the products produced are competitive relative to imports. Manufactured imports and exports have increased as a consequence of trade liberalisation and integration into the global economy, however, large trade deficits persist in certain areas. The strength of the rand and high input cost such as steel, due to the practice of import parity pricing (IPP), have contributed to increased imports of machinery. These trends are likely to influence the degree to which equipment is sourced from abroad. Initial estimates put the proportion of spend by the SOEs on imported equipment at between 30 and 40%. This high level of import reliance can also be attributed to other factors such as the nature and scale of the products required, and the type of suppliers from which the products will be procured. With regard to the latter, most of the large original equipment manufacturers (OEMs) contracted to Eskom and Transnet to undertake the investment projects are foreign-owned and while they have a long history of involvement in the South African industrial arena will continue to source new, refurbished and replacement parts from their parent companies and undertake limited manufacturing locally. In order to reduce the adverse effect of import dependence, it will be critical for the government to work with the SOEs and their suppliers to identify opportunities for import replacement, the local manufacture of wear parts and consumables, and the establishment of maintenance contracts.

Second, while the affected manufacturing sectors need advanced technology in order to be competitive, they are labour-intensive activities, employing large numbers of semi- and unskilled employees. Growth of these sectors has the potential to create jobs if the appropriate measures are in place, such as competitive input prices, skills development and training, and reliable services (electricity and logistics).

The third critical issue relates to the shortage of skills, particularly in engineering and artisanal type activities. As the SOE Capex programmes coincide with other public works programmes, interventions are needed at the private and public level that enable the fast-tracking of funds for training facilities and programmes. While the lead times between recruiting and producing an appropriately trained employer are generally quite long, suppliers and SOEs need to look beyond the time frame of the investment programme to opportunities in future investment projects, i.e. the transferability of skills.

CONCLUSION

It is apparent that the government's perception regarding its role in the economy has shifted in the past few years and has become more 'developmental' in approach. A core feature of this is that public involvement is limited to providing the initial foundation upon which further investment, growth and development can be catalysed. Given their strategic importance in the economy, SOEs are envisaged as the tool to facilitate this. Transnet and Eskom's five-year capex programmes represent a huge injection of resources into the economy. In order to ensure the maximum spillovers and benefits are achieved, close collaboration is needed between the government (DPE), the SOEs, their suppliers and other participants to ensure constraints and bottlenecks are identified and appropriately addressed.

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Walker and Farisani are with the Corporate Strategy and Industrial Development research programme, School of Economic and Business Sciences, University of the Witwatersrand.

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