

State Capture and the undermining of South Africa's Economic Development

Dr Kenneth Creamer^{1*}

Introduction

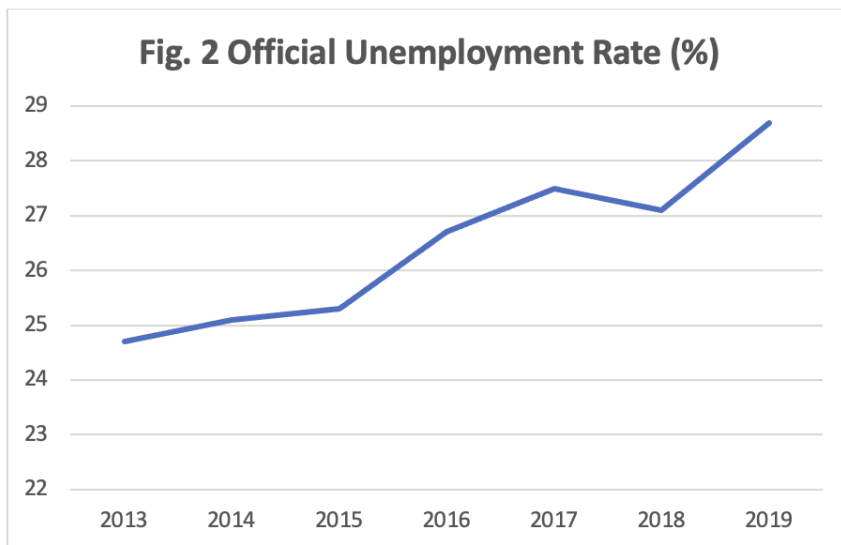
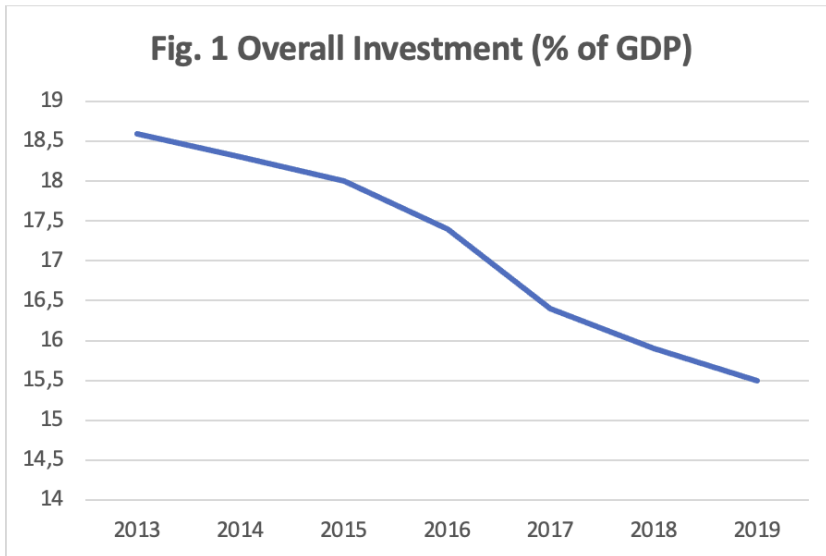
State capture has compromised South Africa's vision of a developmental state that envisaged overcoming the evils of apartheid through a state-led programme of inclusive growth and economic transformation.

The imperative for inclusive economic growth is hard-wired into South Africa's post-1994 constitutional dispensation. The constitution requires that the state must take reasonable measures to progressively provide access to socio economic rights – such as health, education, social security, and housing – based on available resources. The nexus between the increasing resources from economic growth and expanding access to socio-economic rights is key to the redistribution of income, wealth and opportunity that is required to transform South Africa's unequal society into “a society based on democratic values, social justice and fundamental human rights”.²

From 1994 to 2010 the average annual real rate of economic growth was 3,2%, but from 2011 to 2019 (prior to the impact of the Covid pandemic) the average annual real rate of economic growth fell to 1,5% leading to a reduction in per capita income as population growth exceeded the rate of economic growth. Investment levels also fell sharply from just under 19% of GDP to about 15% of GDP from 2013 to 2019 (Figure 1), as compared to the country's National Development Plan target of 30% of GDP. Official unemployment also rose during this period from 24,7% in 2013 to 28,7% in 2019 (Figure 2)) (Source of Data South African Reserve Bank).

^{1*} Dr Kenneth Creamer, School of Economics and Finance at the University of the Witwatersrand, Johannesburg, South Africa. Some of this chapter draws on research undertaken by the author for a Presidential Economic Advisory Council Briefing Note presented in January 2024.

² Extract from the Preamble to South Africa's Constitution adopted in 1996.



Although, some of the reasons for South Africa’s deteriorating economic performance during the era of state capture was due to structural factors, such as, the decline in the global prices of key mineral exports from South Africa including iron-ore, coal, gold and platinum; a shortage of electricity leading to ongoing processes of loadshedding, and a lower-growth global economic environment following the Great Recession of 2008-09, state capture’s corrupt repurposing of the state for self-enrichment by politically-connected individuals, played a decisive role in weakening the state’s capacity to coordinate investment; lead processes of economic development; and guide the economy towards higher levels of

inclusive growth. The economic damage wrought by state capture has been significant and has arguably undermined South Africa's post-1994 constitutional vision.

At a deeper, theoretical level, state capture has undermined the kind of state capability required for the function operation of the kind of developmental state that has proven effective for leading sustained periods of economic growth and transformation in a number of post-colonial and other societies, particularly in Asia. The very state capacity that has historically been required to lift millions of people out of poverty and into more productive economic activity has been undermined by state capture during a period when it is most needed in re-build and reconstruct a post-apartheid South African economy and society.

Theorising the developmental state

This vision of the developmental state was informed *inter alia* by the growth model of a number of countries in East Asia in the 1980's and 1990's required effective state leadership, usually characterised as state guidance of expanding market activity, including through strategic roles played by state owned companies.

Economist Robert Wade in his 2003 book *Governing the Market* challenged claims that the rapid growth of East Asian countries was due to either free market policies or state-led polices, rather he argued that economic growth and development in these countries was advanced via a synergy between markets and the state, providing for the coordination of policy instruments and investment decisions.

The seminal World Bank study *The East Asian miracle: economic growth and public policy* (1993) lays out a similar argument as to the important role of the state and the market in economic growth development applying the framework to eight high performing Asian economies at the time – Hong Kong, Indonesia, Japan, Malaysia, South Korea, Singapore, Taiwan and Thailand.

Asian developmental states played an important role in overcoming what economists term 'co-ordination' problems. That is where state leadership plays a in ensuring that a number

of inter-connected actions required in order to solve a problem do indeed take place. A *coordination problem* exists where A and B can only be achieved if they are done simultaneously, usually by a number of different parties. Without A happening, B cannot happen, and without B happening, A cannot happen. Developmental states, through well-designed policy interventions, can play a specific role in overcoming co-ordination problems, but a prerequisite for this is that there be an effective civil service, free from political interference or from the influence of vested interests.

The East Asian miracle: economic growth and public policy (1993) outlines this as follows: “We identify a class of economic problems, coordination failures, which can lead markets to fail, especially in early stages of development. We then interpret some of the interventionist policies in East Asia as responses to these coordination problems—responses that emphasized cooperative behaviour among private firms and clear performance-based standards of success. Competitive discipline is crucial to efficient investment. Most economies employ only market-based competition. We argue that some [these Asian countries] have gone a step further by creating contests that combine competition with the benefits of cooperation among firms and between government and the private sector. Such contests range from very simple nonmarket allocation rules, such as access to rationed credit for exporters, to very complex coordination of private investment in the government-business deliberation councils of Japan and Korea. The key feature of each contest, however, is that the government distributes rewards—often access to credit or foreign exchange—on the basis of performance, which the government and competing firms monitor. To succeed, selective interventions must be disciplined by competition via either markets or contests. Economic contests, like all others, require competent and impartial referees—that is, strong institutions. Thus, a *high-quality civil service* that has the capacity to monitor performance and is *insulated from political interference* is essential to contest-based competition.” [author’s own emphasis]

The era of state capture in South Africa, as exposed through the Commission of Inquiry into Allegations of State Capture (the Zondo Commission), where the activities of state owned companies were repurposed to advance corrupt personal agendas, stands in stark contradiction to the vision and practice of actual developmental states that have been

effective in lifting countries out of poverty through leading sustained periods of economic growth in their countries.

“Embedded autonomy” in economic planning

Developmental states were found to be most effective when they operated in a manner that was simultaneously autonomous as well as embedded. Autonomous, in that the state itself is the repository for developing the country’s economic plans, in a manner that is not captured by vested interests, but is in the interests of national economic development. Yet, for development programmes to be carried out effectively, they also have to be well embedded, in the sense that the design and implementation of programmes has to be firmly rooted in the political, social, and economic realities of the societies that they seek to grow and transform.³

Peter Evans wrote of “embedded autonomy” in 1995 when describing South Korea’s developmental state, as follows: “South Korea combined autonomy from private interest groups with ‘embeddedness’ in social ties that provided ‘institutionalized channels for the continual negotiation and re-negotiation of goals and policies’”⁴. Evans argued that these links were essential to ensure that government had access to the information needed to design workable policies, could adjust to changing circumstances and prod firms along new technological trajectories. Success was not so much about whether tariffs or subsidies were used, but by “the manner in which the cooperative relationship was managed dynamically over time.”⁵

Generally, the key lesson of effective developmental states is that a skilled public service is required that is able to operate in an autonomous, yet embedded, manner in guiding the economy towards higher levels of growth and transformation.⁶ For South Africa, this would

³ Successful developmental states have generally sought to professionalise the public service, protect it from political interference, and have positioned the public service as an ‘employer of choice’ for skilled individuals.

⁴ Evans, PB 1995 “Embedded Autonomy: States and Industrial Transformation” Princeton, NJ, Princeton University Press

⁵ Reka Jahasz, Nathan Lane and Dani Rodrik, “The New Economics of Industrial Policy” (August 2023) (p.32)

⁶ Mariana Mazzucato in her books, the *Entrepreneurial State* and the *Big Con*, offers important insights as she argues the necessity of building a skilled public service, which is not weakened by outsourcing and the corrosive role of external consultants.

require skilled and professional public servants capable of designing detailed economic policy interventions, as guided by the objectives of government's political leadership. These policy interventions would need to be autonomous, that is, in the interests of national development, but also be well embedded, that is, informed of the realities of the South African economy and businesses operating within it, without being capture by vested parties who seek to manipulate government's economic policy development process in their own interests.⁷

During the era of state capture in South Africa there was a loss of autonomy for many state programmes – as a narrow set of criminal interests began to subvert lawful processes in order to redirect resources and benefit from a range of government activities including, public sector procurement, the granting of mining licenses, the purchasing of coal by Eskom, the purchasing of trains by Transnet, and even from the placement of government advertising.

State capture is distinct from arms-length, legitimate consultations between government and business. During legitimate consultations, government is the ultimate and autonomous repository of economic policy in the national interest, and lawful and formal processes are respected. To succeed, the design of such autonomously set policy must be properly embedded and informed by the experiences of incumbent businesses as well as of new business entrants.

Given South Africa's history of racialised capital formation, the model of "embedded autonomy" poses specific challenges. Systematic land dispossession and the exclusion of black South Africans from many social and economic activities during the country's colonial and apartheid periods have led to deep distrust of accumulated capital, wealth, and privilege, as well as a general lack of common purpose and social cohesion. It is a necessary

⁷ "Many democratic governments need substantial renewal of their administrative systems... [I]t is essential to identify, attract and keep the highest possible quality of people with diverse intellectual and personal backgrounds. This means paying competitively... It is important to have spine of long-serving and dedicated public servants... diverse intellectual backgrounds should also be valuable. Most difficult policy issues have multiple facets and cannot be decided by people with one dominant professional background... [G]overnments set the rule of the game. They must be, and be seen to be, independent, impartial and competent when doing so... [T]he guardian ethos of public service and the law must be kept distinct from the commercial ethos of business." (Martin Wolf, "The Crisis of Democratic Capitalism" (2023))

part of nation-building in the current period that corrective action be taken to break down patterns of racial exclusion and privilege in a manner that builds a more racially inclusive and equal society.

It cannot be a question of *whether* corrective policies, such as, black economic empowerment, preferential procurement, employment equity and affirmative action are implemented, but rather a question of *how best such policies should be implemented* to achieve improved racial representation throughout the economy and inclusive economic growth.⁸

Stimulating growth through a just energy transition

A critical current policy area in South Africa, in which the application of embedded autonomy to guide planning is applicable, is government's role in leading a just energy transition for the country. Through a well-managed just energy transition, South Africa should seek to build a new growth model for the country based on the foundation of a new energy-industry-complex. Apartheid South Africa's previous minerals-energy-complex, which together with the super-exploitation of black labour, used abundant coal energy to support competitive export industries - is a thing of the past and cannot serve as a growth driver for South Africa in the twenty-first century.

A new energy-industry-complex - based on investment in renewable and clean energy (solar and wind supported by battery, pumped-hydro, and gas and diesel peaking capacity) as well as modernised transmission and distribution systems - would provide a new energy platform for the competitiveness of South African industry. In the medium term, and if complementary investments are made into human capabilities, the new

⁸ This kind of debate on how best to achieve black economic empowerment is raised in *Growth Through Inclusion in South Africa* (Centre for International Development Harvard University Working Paper No 434) (November 2023). "The state faces major burdens in preferential procurement rules that undermine core functionality in the pursuit of black economic empowerment... These overly broad systems should be revisited as there are more effective ways to include previously disadvantaged groups in all parts of the economy and to promote local production, including SMMEs. The evidence suggests that preferential procurement — through its costs on state performance — may be doing much more harm than good for the intended beneficiaries... In the context of collapsing state capacity, any secondary and tertiary goals should be set aside urgently to unburden public entities to serve their core functions. Thus, we recommend continuing to expand the relaxation of preferential procurement requirements on all SOE procurement..." (p. 77-78)

energy-industry-complex would create far more jobs than it would displace. New jobs would be created both directly, via construction and infrastructure employment, as well as indirectly via linked manufacturing, industrial and export activity.⁹ This requires a turnaround, as currently South Africa's electricity shortage has reached a tipping point and is resulting in de-industrialisation and job losses in key sectors.

An early indication of how effective electricity sector policy reform can be if it is based on improved government and private sector coordination has been the decision to remove the licensing requirement for firms wishing to produce their own electricity. This policy, which has resulted in significant investment and job creation, was adopted out of necessity due to load shedding, but it was generally complementary with government's programme to address the electricity generation shortage, advance the energy transition, and restructure the electricity sector in line with modern technological developments. The policy decision was also well embedded in that it has the support of business and labour representatives, was designed to reduce unnecessary red tape, and was aligned with firms interests to make such investments in order to secure more reliable access to electricity, which was usually lower cost, and which assisted them in achieving their lower carbon emission targets.

A related area that requires decisive state policy leadership is the rebuilding of South Africa's electricity grid, as over 14 000 kms of new transmission lines and related equipment are required by 2032 in order to advance the country's energy transition and restore energy security. The lack of transmission infrastructure is a constraint on investment in new generation capacity and delays in building new transmission infrastructure will likely prolong loadshedding. Yet, powerlines manufacturers have argued that their businesses require more consistent demand for their products over the ten-year period, as they may not survive if they must wait for the boost in demand in the later part of the ten-year period. It

⁹ South Africa's electricity sector – including coal, nuclear, gas, battery, and renewable technologies – relies to a large extent on imported technology. In recent years, the importation of solar panels and batteries has increased sharply. The building of new generation capacity, entailing in large part the installation of this equipment, has led to an increase of construction employment. Significant potential exists for increased local production of electricity-sector components, particularly if South African manufacturers can identify components to integrate into global supply chains and can supply African electrification projects. In fact, then newly built local solar and wind production facilities were closed when procurement of renewable electricity was halted by Eskom leadership in 2016 in contradiction with government policy. Consistent procurement of renewable energy over the next few decades, together with the potential development of export markets, will provide effective and sustained demand for the local manufacture of renewable energy components.

would be a serious planning failure if South Africa sees its relevant domestic manufacturing capacity dissipate and thereafter needs to import previously locally produced materials for the building of transmission infrastructure. An alternative approach needs to be explored. There is potential to bring the transmission build process forward by developing a framework for private-public partnerships to facilitate private sector investment in independent transmission projects, such as has been done in a number of countries, including Brazil and India. This will facilitate the use of private sector balance sheets and capacity, in addition to the capacities of Eskom's transmission entity, in order to accelerate the build programme. Such a process will require autonomous design of the national transmission grid requirements, and independent bidding processes, such as, those undertaken by the IPP Office to facilitate investment in new generation capacity. But will also need to be well embedded in order to attract investor interest.

Clearly, projects as large as the just energy transition, so necessary for South Africa's economic growth and development in the years ahead, need to be undertaken in a corruption-free manner and must be led by competent and ethical public servants and managers of state-owned companies. If there is to be a repeat of state capture and corruption during the management of such projects, this would again severely undermine the country's economic development with dire consequences for the living standards and prospects of the majority of South Africa's people.

Governance of State Owned Companies

Through the Zondo Commission process, there was a detailed ventilation and exposure of the corrupt activities that had crippled many state-owned companies and public services in recent years. Yet, there have been delays and unevenness in how the Zondo Commission's recommendations have been applied and interpreted. Even though there has been some progress, there have not been many prosecutions and in some instances prosecutions are taking a long time – this has resulted in a general failure of accountability, leading to a sense of disillusionment and lawlessness.

This failure to deal with state capture effectively and put key state owned companies back on track, particularly Eskom and Transnet, has proved to be a major setback to South Africa's economic performance. There needs to be greater focus on improved state owned companies governance and operations for the sake of economic growth, investment, and employment.

The nature of the challenge is well articulated in South Africa's November 2023 *Medium Term Budget Policy Statement*, which states that the improved performance of the electricity and rail, ports and logistics sectors should take into account the interests of "not just a particular entity, but the transformation of the sector as a whole".

If this "transformation of the sector as a whole" approach is to be followed, then it would be contradictory to argue, as some have, that state owned companies should be put under their 'line' ministries. So-called line ministries, such as, energy and transport, are in fact 'policy' ministries responsible for driving electricity and transport policy for 'the sector as a whole'. They should not have this task clouded by also having to take on the responsibility of looking after the interests of specific SOCs.

If SOC's are placed under 'policy' ministers, reforms are likely to be too limited and skewed in the interests of the SOC's. The problem with blending policy and shareholder responsibilities is that it creates significant moral hazard. For example, in the electricity sector what is good policy for an industry experiencing a global technological disruption, will not necessarily be in Eskom's immediate commercial interests. In such a context, it's crucial that the policy Minister is free to make decisions in the interest of the sector as a whole and the wider economy, rather than to allow the 'state owned company tail to wag the policy dog'. In the current context, truly transformative power comes from being able to approach sector policy in the interests of economic growth rather than from the perspective of state owned company-linked interests.

One advantage of the proposed State Owned Companies Holding Company, as envisaged in the *National State Enterprises Bill*, is that the proposed Holding Company will be responsible for state owned company 'operations' functions and will not be responsible for sector 'policy

making' functions. Sector 'policy making' functions will continue to be the responsibility of the relevant policy minister.

On the other hand, there are certain weaknesses with the SOC Holding Company proposal in its current form, in that the proposal does not explicitly deal with many of the core issues and challenges that SOC's face, such as, how they should deal with technological change and how they should delineate their commercial and public interest functions.

The large number of SOCs should be reduced by a sensible combination of liquidation, amalgamation and strategic partnerships.¹⁰ SOC's that remain must have strong boards consisting of relevant senior government officials, private sector leaders (with no conflict of interest), relevant professionals such as lawyers and accountants, and industry experts. The independent (non-government) directors should out-number the shareholder representatives.

SOC board appointments – as well as appointments to regulatory bodies, like Nersa – should follow a transparent process for deciding the criteria for appointment, and then should follow an independent nominations process to identify, vet and ultimately recommend the candidates needed to ensure the SOC has the mix of directors it requires. By allowing an independent nominations process to unfold there is a much greater probability of the right appointments being made.

The Zondo Commission recommendations in this regard are that the appointment of board members to state owned companies should follow a truly independent and transparent process free from political manipulations so that the ultimate appointment is genuinely the result of a merit-based selection process. Specifically, the Zondo Commission recommends that for the appointment of board members and senior executives of state owned enterprises a Standing Appointment and Oversight Committee should be established to

¹⁰ A tailored approach to strategic partnerships could range from brief emergency running of key infrastructure points, for example, in ports and rail by private sector operators, engagement with turnaround private sector specialists to reset SOC's, through to equity stakes in existing SOCs, with the state remaining as the majority shareholder (the so-called Telkom model).

make recommendations to relevant ministers regarding such appointments (including procedures to unblock stand-offs between the Standing Appointment and Oversight Committee and the relevant Minister on such appointments). The Zondo Commission recommends that membership of the Standing Appointment and Oversight Committee should be constituted as follows: a retired Judge nominated by the Chief Justice (as chairperson), the Minister of Finance or his or her delegate, a senior legal practitioner nominated by the Chairperson of the Legal Practice Council, a senior representative of the business community appointed by Nedlac, a senior trade union representative appointed by Nedlac, a registered auditor appointed by the Chairperson of the Independent Regulatory Board of Auditors; an industry expert appointed by the state owned company concerned and a senior representative of an established anti-corruption organisation (p.184-5).¹¹

A streamlining of the number and scope of SOC's combined with systems for improved SOC governance will lead to better leadership for SOC's and will likely result in improved performance, which will mean that SOC's can play a positive role in promoting economic growth, rather than continuing to retard economic growth and place ongoing bail-out pressures on the fiscus.

In addition to SOC governance reform, the need for a professional public service protected from political interference is a key outcome of the Zondo Commission. One of the reforms outlined in the Public Service Amendment Bill aimed to readjust the balance of authority and responsibility between political principals and senior government bureaucrats such as Directors-General. This amendment seeks to rectify measures in the original Public Service Act which were put in place to promote the transformation of the public service.

These reforms, as well as the recommendations of the Zondo Commission, are broadly in line with the proposals outlined in South Africa's National Development Plan (NDP) of 2011 for building a capable and developmental state. The NDP lists the following steps for stabilising the political-administrative interface within government, a necessary condition for building a skilled politically-insulated public service (at p 415):

¹¹ Judicial Commission of Inquiry into State Capture Report (Part IV) Vol.4 All the Recommendations.

- Ensure the public service is immersed in the development agenda but insulated from undue political interference.
- Strengthen the oversight role of the PSC by requiring departments to respond to PSC proposals and giving greater force to PSC recommendations.
- Create an administrative head of the public service with responsibility for managing the career progression of heads of department including convening panels for recruitment processes, performance assessments and disciplinary procedures.
- At provincial level, the same role should be played by the director-general in the Office of the Premier.
- Use a selection panel convened by the chair of the PSC and the administrative head of the public service to draw up a shortlist of suitable candidates for top posts. The selection panel should make use of competency tests and other assessment mechanisms.
- Move towards more long-term contracts for heads of department and reduce the use of three year contracts.
- Amend the Public Service Act to locate responsibility for human-resources management with the head of department.

Conclusion

This chapter seeks to outline a theoretical and historical basis for understanding the important role to be played by the state in guiding the economy onto a sustainable path of growth and development. In South Africa, state capture has fundamentally compromised the state's ability to play this developmental role and this failure one of the causes of the deteriorating performance of South Africa's economy.

An ideological consequence of state capture has been to call into question the foundational assumption as to whether the post-apartheid state capable of playing a leading role in guiding economic growth and transformation in the South Africa.

International experience offers evidence that the only way out of the structurally unequal economy inherited after centuries of colonialism and apartheid, requires the operation of an

effective developmental state machinery, capable of leading the reforms and transformations necessary to alter historical economic and social relations and improve livelihoods on a significant scale. One hope is that, if implemented, the Zondo Commission's recommendations will provide the basis for the reconstitution of the post-apartheid, democratic state so that a skilled and politically insulated public service can begin to operate in a manner that is capable, ethical and developmental, as this what is required in order to lift the South African economy onto a new, more inclusive growth trajectory and to build a more equal and productive society.

References

Centre for International Development Harvard University, *Growth Through Inclusion in South Africa* (Working Paper No 434) (November 2023)

Evans, PB 1995 “Embedded Autonomy: States and Industrial Transformation” Princeton, NJ, Princeton University Press

Jahasz, R, Lane, N, and Rodrik, D, “The New Economics of Industrial Policy” (2023)

Judicial Commission of Inquiry into State Capture Report (Part IV) Vol.4 All the Recommendations.

Mazzucato, M, the *Entrepreneurial State* (2011)

Mazzucato, M, *The Big Con* (2023)

South African Reserve Bank, Data on economic growth [KBP6006Z], gross fixed capital formation [KBP6282J] and unemployment [KBP7019J] (Sourced online, April 2024)

South Africa’s National Treasury, *Medium Term Budget Policy Statement* (November 2023)

South Africa’s *National Development Plan* (2011)

Wade, R *Governing the Market* Princeton University Press (2003)

World Bank, *The East Asian miracle: economic growth and public policy* (1993)

Wolf, M, *The Crisis of Democratic Capitalism* (2023)