Solve the SOE challenge

ACTION SIX

PRIORITIES
FOR SA'S NEW GOVERNMENT

CDE

AGENDA 2024

About CDE

The Centre for Development and Enterprise, an independent policy research and advocacy organisation, is South Africa's leading development think tank. Since its establishment in 1995, CDE has been consulting widely, gathering evidence and generating innovative policy recommendations on issues critical to economic growth and democratic consolidation. By examining South African and international experience, CDE formulates practical policy proposals outlining ways in which South Africa can tackle major social and economic challenges. CDE has a special focus on the role of business and markets in development.

CDE disseminates its research and proposals to a national audience of policy makers, opinion formers and the wider public through printed and digital publications, which receive wide media coverage. Our track record of successful engagement enables CDE to bring together experts (local and international), senior government officials (national and local), business leaders, politicians and civil society organisations to debate critical challenges facing the country and the policy implications of research findings.

The AGENDA 2024 series

Series editor: Ann Bernstein

Reports in the AGENDA 2024 Series are based on CDE's many policy initiatives, commissioned research and think pieces, as well as consultations and workshops with experts and stakeholders.

This special project has been guided by the CDE Board, a select group of senior business leaders, a strategy group of analysts supplemented by other senior advisors.

This document and the other reports that will follow in the AGENDA 2024 series are available from CDE and can be downloaded from www.cde.org.za.

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AGENDA 2024: Priorities for South Africa's new government

AGENDA 2024 is based on CDE's extensive policy work and recent collaboration with experts, business leaders, former public servants, and others across our society. The project sets out to answer what is by far the most important question facing South Africa: **what can a new government do to get the country back on track after 15 years of stagnation and decline?**

We cannot afford to keep making the same mistakes while hoping for a different outcome. We need a new vision of how to govern South Africa and a carefully crafted strategy to make it happen. Confronted with a generational challenge to get tens of millions of people out of poverty, the new government must take bold action.

AGENDA 2024 makes the case for a policy agenda that is substantially different from what we have seen over the past 15 years. It consists of a series of carefully selected and crafted actions to signal a new approach to reform. We have to prioritise fixing the basics and sending strong signals that a new determination and focus will characterise the seventh democratic government. The right priorities are essential and the first step of reform is to appoint excellent people into senior government positions.

Our priority areas for action are:

- Fix the state
- Drive growth and development by freeing up markets and competition
- Build a new approach to mass inclusion
- Tackle the fiscal crisis
- Strengthen the rule of law

This report is the sixth in CDE's AGENDA 2024 series, **ACTION SIX: Solve the SOE challenge.**

See also:

- **ACTION ONE: Reorganise the Presidency and the Cabinet**
- **ACTION TWO: Appoint the right people in mission critical public sector jobs**
- **ACTION THREE: Fix the fiscal crisis**
- **ACTION FOUR: How to appoint a strong judiciary**
- **ACTION FIVE: Energise the NPA**

ACTION SIX: Solve the SOE challenge

Introduction: SOEs are in crisis

To address our socio-economic challenges, South Africa needs to achieve rapid and sustained economic growth. But, for at least a decade and a half, growth rates have been exceptionally low. One of the key reasons for this has been the ongoing operational and financial crises that have characterised large state-owned enterprises (SOEs).

In general, the performance of the major SOEs since 2009 has been disastrous. Eskom and Transnet have wrought the most damage, but many others, including, but not limited to, Passenger Rail Authority of South Africa (PRASA), Denel, South African Broadcasting Corporation (SABC), the South African Post Office (SAPO), and South African Airways (SAA) have malfunctioned significantly.

"One of the key reasons for the country's exceptionally low growth rates has been the ongoing operational and financial crises that have characterised large state-owned enterprises"

In the early 2000s, the amount of power actually available from Eskom's fleet on any given day was 90 per cent of total generation capacity. By 2017 this had fallen to 70 per cent, and by 2023 it was down to 55 per cent, although it has subsequently recovered.[1] At the same time, the passenger rail system overseen by PRASA has all but collapsed. Passenger rail trips per month dropped from 54 million in 2008 to 1.7 million in 2022.[2] South Africa's ports, for which various divisions of Transnet are responsible, are among the worst in the world. The World Bank's 2023 Container Port Performance Index ranked Cape Town last out of the 405 ports surveyed. Durban and Gqeberha didn't fare much better, ranking at 398 and 391 respectively.[3]

In this action report we make a case for increasing the competitive pressures on some of the major SOEs as a broad and long-term approach to solving the SOE challenge. Our focus is primarily on Transnet and Eskom, as they play a prominent role in providing the electricity, rail and port services that businesses require to function. They have also been at the centre of this and the previous administrations' reform efforts.

Our central argument is that, while neither simple nor a silver bullet, a focus on strengthening the competitive pressures on SOEs like Transnet and Eskom will lead to a more coherent reform programme than what is currently in place. But it requires that the President and the government of national unity (GNU) undertake a series of vital and urgent steps.

Why fixing the major SOEs is a critical priority

The abject performance of South Africa's major SOEs has had massive second-round effects on the productivity of the whole economy. Without reliable electricity, businesses lose stock and hours of functioning and must invest in expensive alternatives. Loadshedding negatively impacts firm survival and corporate tax revenues, along with many other harmful effects. And, for as long as freight rail infrastructure is dilapidated, trains run irregularly and the ports are inefficient, businesses will struggle to get the inputs they need or to get their products to local and international markets.

In 2023, the South African Reserve Bank estimated that loadshedding was causing up to R899 million worth of damage to the economy daily.[4] Another estimate (by a Harvard team led by Professor Ricardo Hausmann) is that South Africa missed out on around R2 trillion in output between 2011 and 2020 solely as a result of the declining productivity of key network industries.[5] Updated to 2024, that figure may equate to over R4 trillion in current rands.

The SOE crisis has also had an adverse impact by reducing the resources available for other functions of the state. More than R330 billion was spent on SOE bailouts between 2008 and 2021, a figure that excludes the transfer of debt of R254 billion from Eskom to the state since then.[6]

Recent improvements in the provision of electricity, driven by large-scale investments in private generation and by significant improvement in Eskom's performance, are to be welcomed.[7] This is, however, no cause for complacency. Ongoing challenges highlighted in a statement by the Presidency and Business for South Africa on 14 August 2024 include, "rapidly rising electricity costs, unsustainable municipal entities, … a constrained grid with delayed expansion and stalling investment in new generation." Furthermore, progress on transport and logistics has not been as swift and extensive as anticipated. Transnet needs, according to the statement, "substantial interventions to improve performance to meet the needs of its customers and the market demand necessary for sustainable economic growth".[8] This was confirmed by Rudi Dicks, head of the Project Management Unit in the Presidency, who said: "It is critical to ensure that we get much more traction at Transnet, that they are much more vigorous, more ambitious and faster". He also said that greater capacity was needed at the Transnet board and executive committee level.[9]

"We must address the common causes for the crushing failures across energy and logistics, as well as in a range of other large, collapsed or collapsing SOEs, like PetroSA, PRASA, and the SAPO"

South Africa's growth rate will only move to the higher levels we desperately need once longer-term solutions to the energy and logistics crises have been found. The country must achieve a situation where access to reliable and affordable energy is guaranteed; where infrastructure has been upgraded to permit the efficient transport of goods; and where ports, rail and roads no longer hold back our exports.

Each of the major SOEs need specialised attention, and there are moves underway to prod them in the right direction. But besides the fact that this has taken far too long to happen, there is ongoing evidence of 'resistance to change' at SOEs like Transnet.[10] To make lasting progress we must address the common causes for the crushing failures across energy and logistics, as well as in a range of other large, collapsed or collapsing SOEs, like PetroSA, PRASA, and the SAPO.

The broad approach, we argue, must be based on reducing the protected status enjoyed by many SOEs located at key chokepoints of the economy – a status which they vigorously defend. Before setting out the solutions that emerge from this focus, we first explain the challenges that have underpinned the poor performance of many SOEs in the past.

The five key challenges of the SOEs

Role and mandate confusion

Significant mandate confusion and conflicts of interest manifest in the core functions of individual SOEs. What is Eskom's role in relation to growing independent power producers and facilitating a green and just transition? What is its role in transforming the structure of the energy generation industry as a whole? How is Transnet to weigh up the role of the National Ports Authority (which is supposed to maintain a level playing field for all service providers in the ports) and its corporate interests in maximising its own income and profit, including through Transnet Port Terminals, which provides services to users of the ports and, in principle, one of many possible tenants of the Ports Authority's properties? What policy goal is achieved by providing the Post Office with a monopoly over the handling of packages under one kilogram (kg), other than the subsidisation of the Post Office's other functions? Why is it optimal for those who send packages weighing less than one kg to subsidise other Post Office functions? The position is clearly indefensible on its own merits.

"Users of the services of many SOEs don't pay what they owe, and the state does not enforce payment obligations. As of February 2024, municipalities owed Eskom over R74 billion, while vast amounts of electricity are stolen by households illegally connected to the grid"

One of the most significant sources of confusion about SOE mandates is that, while they were conceived as platforms to facilitate the provision of essential goods and services, they have also long been considered key levers of economic transformation. This has applied to who sits on the boards, the makeup of senior executive teams as well as ensuring a high level of 'empowered business' participation in SOEs' supply chains. It is unclear whether these practices have created significant levels of transformation or how this would be measured. What is clear, however, is that the transformation imperative and how it is implemented impacts negatively on SOEs' operational and capital expenditure costs.[11] Indeed, the mechanics of implementing transformation-related policies will usually reduce SOEs' overall productivity, and the pursuit of transformation has often been used as a rationalisation for a failure to deliver on an SOE's core mandate.[12] As the World Bank put it in 2018: "[South African SOEs] typically have both commercial objectives and broader public policy objectives, but balancing these goals can be difficult and lead to negative effects on efficiency and performance."[13]

The SOE's commercial crises

SOEs face existential commercial challenges with expenditures exceeding revenues, and, in many cases, it's hard to see how this gap can be closed. Key causes of this are:

- **Unfunded mandates.** Some SOEs have policy mandates that are not fully funded from the fiscus. They must then use more profitable services to subsidise unfunded activities, imposing costs that ought to be covered by taxpayers on users of the SOE's services. For example, some of SAA's loss-making international routes "appear to have been selected as part of a non-commercial mandate," including supporting the South African tourism industry.[14] In the case of the Post Office, government has tended to avoid rationalising branches in rural areas regardless of profitability, arguing that the national footprint of the SOE remains essential as an access point for government services. However, prolonged financial distress has now resulted in hundreds of branches being closed.[15] The point here is not that these mandates are inherently problematic, but that if government imposes them but does not fund their delivery, then the SOEs' finances must be compromised.

- **Non-payment for services.** Users of the services of many SOEs don't pay what they owe, and the state does not enforce payment obligations. As of February 2024, municipalities owed Eskom over R74 billion, while vast amounts of electricity are stolen by households illegally connected to the grid.[16]
- **Over-spending on capital projects.** To be financially self-sufficient, SOEs must ensure investment spending can be recouped through sales. This is much harder if the costs of investment projects are not managed. And it is impossible if capital projects fail to deliver the expected increase in marketable services, as has been the case with Eskom, PRASA and others. Most notoriously, Eskom delivered its badly functioning Medupi and Kusile power stations more than eight years late and R300 billion over budget.[17] The causes of this range from skills deficits and the higher costs associated with the implementation of transformation policies even before including the (considerable) malfeasance and corruption in procurement processes.
- **Increases in operational costs.** SOEs have failed to keep their operational costs at commercially sustainable levels as a result of ballooning salary bills, excessive emphasis on the role played by preferential procurement in achieving economic transformation, and intense corruption. One consequence of this is that many SOEs have skimped on maintenance, which increases costs over the long-term. For example, in 2015, Eskom reported to the Standing Committee on Finance that it failed to undertake maintenance, because the "costs of this were intolerable".[18] Reports suggest that over the past 11 years Transnet underspent by R30 billion on maintenance, while spending on salaries increased by R5 billion.[19]
- **The impact of crime on sales.** PRASA, Transnet and Eskom have all been severely affected by crime and sabotage. These raise costs (replacement, security, insurance) and reduce the quantity of saleable services produced. In 2024, Transnet's chief commercial officer Bonginkosi Mabaso said at least 4 million of the 12 million tonnes of the freight volume the entity could not deliver was due to criminal activity.[20] Many instances of theft and sabotage have been reported at Eskom power stations.[21]

Shareholder interference and weak boards/managerial appointments

The long-term performance of SOEs has been compromised by direct intervention by the shareholder minister in ordinary business decisions. Former Public Enterprises Minister Pravin Gordhan was blamed for the exodus of top management in Transnet and Eskom in 2023 due to interference.[22] Minister in the Presidency, Khumbudzo Ntshavheni, was accused in 2023 of meddling in the selection of the SABC board in an effort to block the appointment of a former SABC head of news.[23] Apart from the damage this kind of interference does to the business, it also undermines the authority of both executive management and the board, helping to foster unhealthy corporate cultures and rivalries.

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By undermining the board and executive management, such interventions make it harder for SOEs to attract skilled and experienced board members and senior staff, who may be disinclined to work in an environment in which corporate governance norms are violated. The problem is self-reinforcing because shareholder interference is facilitated (and sometimes rationalised) by the fact that SOEs' leadership is weak, with far too many board and managerial appointees lacking qualifications, skills, experience, and, too often, integrity. This was at the heart of concerns about the composition of Transnet's audit committee – prior to the appointment of Clarence Benjamin – which until then had no chartered accountants.[24]

As the Zondo Commission showed, appointments to key positions in SOEs were intended to weaken governance to facilitate looting, with its report stating: "State capture ... was facilitated by a deliberate effort to exploit or weaken key state institutions and public entities ... through strategic appointments and dismissals at public entities ".[25] But even where this has not been the case, weak appointments result in badly run entities that are not focused on (or capable of achieving) long-term commercial and operational sustainability.

Subversion of procurement processes and/or failure to adhere to processes

SOEs' supply chains have frequently been subverted and repurposed to direct funds from legitimate functions for illegitimate and corrupt purposes. One of the most notorious examples is the 2012 Eskom-facilitated deal to transfer ownership of Glencore owned Optimum Coal Holdings to Tegeta, co-owned by erstwhile President Jacob Zuma's close associates, the Gupta family, and the President's son Duduzane Zuma.[26] Numerous other examples – such as the Auditor General's revelation that PRASA's R1 billion in irregular expenditure was the result of years of flouting tender processes – show that procurement, of any kind and at any price point, has frequently been corrupted.[27]

Given the size of the SOEs' procurement budgets, the impact of corruption in these organisations may be more significant and more debilitating than corrupt practices in many line-function government departments. This is particularly so when a large proportion of SOE procurement is in the form of huge, once-off capital projects, where corruption can fatally undermine the commercial and operational success of those projects. Corruption (and adverse audit findings) can also have material effects on SOEs' reputation for commercial integrity, undermining access to private capital markets, which, in turn, creates pressures on the fiscus.

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The regulation challenge

Regulators have been crucial in shaping how SOEs operate, and that is likely to remain the case. There is widespread concern, however, that regulators, especially those in the biggest, most prominent sectors - like electricity and transport - have not been up to the job. In the case of electricity, the regulator is supposed to achieve the complex, some would say impossible, task of balancing the interests of producers and consumers. While the previous chief executive officer of Eskom accused the National Energy Regulator of South Africa (NERSA) of ignoring for 15 years Eskom's request for 'cost-reflective tariffs', consumers decry the steep price increases the regulator has imposed over, at least, the past decade.[28] It is also clear that NERSA has frequently failed to do its job adequately, raising serious concern about a lack of capacity in this critical institution. Recently the High Court ruled as unlawful NERSA price hikes that were determined without the necessary "cost-of-supply studies". NERSA's head of electricity regulation, Nhlanhla Gumede, admitted that NERSA has been using "an inappropriate pricing methodology which is not founded in the Electricity Regulation Act but rather on the repealed 1987 Eskom Act". As far back as 2020, Gumede had already raised the alarm. He said then that, "we are using outdated methodologies in terms of how we set prices, how we regulate the sector and how we've structured the industry. We are not moving with the times."[29] According to reports, neither the Minister of Electricity and Energy nor private energy producers believe that NERSA will be able to deal with the complexities that will emerge as the market is liberalised.[30]

In the transport sector, where the regulatory system is to be dramatically reformed and centralised, business insiders have expressed concern that appointing independent persons with the required level of expertise and no affiliations to any industry group or business is likely to be a challenge. A recent report calls on government to ensure there is no political interference in the appointment of key personnel, and to ensure the newly established Transport Economic Regulator is adequately funded and capacitated to fulfil its mandate.[31]

How competition can strengthen SOEs

As the section above shows, there are numerous factors that explain the parlous state of the SOE sector. At the outset it should be clear that competition cannot solve all these challenges. Nor will unfettered competition be desirable if the playing field is unequal. There are limits to using competition for the production and delivery of some of the public goods and services that SOEs are mandated to provide. Competition between alternative providers of electricity transmission lines or rail tracks between major centres would not be efficient, for example. Some transformation mandates, furthermore, may be desirable and the delivery of many services cannot be wholly driven by the profit motive.

> **"If a sustainable solution to the crises in the SOEs is to be found, it won't be about wholesale privatisation, but it will involve introducing competitive pressures and disciplines into the sector"**

However, even where some portion of what an SOE does is a 'natural monopoly', there are many ways to introduce competition between service providers which, having paid an SOE to secure access to shared (public) infrastructure, can compete to provide services to customers. In these circumstances, the SOE is paid for the value created by the infrastructure, but the service providers are only paid if the services they provide offer their customers value. Competition for customers results in lower costs and greater quality of service, while infrastructure is maintained and expanded through the fees paid by service providers to access it. Government can also turn to competing providers to deliver public goods and services, thereby achieving lower costs, better service and less managerial complexity.

Further, many of the challenges in the SOE sector should be seen as at least the indirect consequence of the SOEs' existence as legally protected monopolies. This shields them from the competitive pressures that would force them (and their shareholder) to behave differently. If a sustainable solution to the crises in the SOEs is to be found, it won't be about wholesale privatisation, but it will involve introducing competitive pressures and disciplines into the sector. Indeed, this has begun to happen in energy-generation and logistics, though there is a long way to go in both domains.

A corollary of this is that the current approach to holding SOEs accountable has clearly failed: even if shareholder compacts and annual performance plans were focused exclusively on maximising SOEs' operational and commercial efficiencies, they cannot substitute for the discipline created by competitive pressures. Or as David Lewis, the former head of the Competition Tribunal, has written, one should "have more confidence in the prospect of JD Group disciplining an Ellerines than of a Minister of Furniture achieving similarly efficient and equitable outcomes".[32]

"Important as public-private partnerships may be in raising efficiency in the short-term, on their own, they are not a sustainable solution to improving SOEs' performance"

Wherever competition is possible and/or desirable, it should be encouraged, because it is competitive pressure that constrains costs and maximises efficiency in service provision. For example, there can and should be multiple firms providing freight rail services between Durban and Johannesburg, each of which competes with the others and pays the owner of the railway line for its use. Although there has been slow progress in some areas, government is moving towards making this possible.[33]

Competition is also possible in the ports. It may be that having a single landlord for all ports is optimal, but the fact that a range of port services – including the loading and unloading of cargo containers – is provided by only one firm, means that there are no competitive pressures on it to maintain high levels of efficiency at the lowest possible cost. That the firm – Transnet Port Terminals – is a division in the same vertically integrated, state-owned logistics company that is also the ports' landlord, compounds the problem and creates insurmountable conflicts of interest. How can the landlord ensure that the port services provider will meet its service level commitments, at the risk of losing its concessions, if they are both divisions of the same company? Again, government is slowly moving in the right direction, but there is a long way to go before the structure of port ownership and operations creates the incentives needed to maximise efficiency. Unless and until genuine competition for customers is built into the structure of port services, no solution to the incredible inefficiencies of our ports will prevent backsliding.

The crux of this argument is that it is not enough to say that the state of the SOEs is the result of bad governance. What needs to be recognised is that bad governance is enabled by the SOEs' status as protected monopolies, and the consequent absence of the disciplinary effects of firms having to compete for business. Because customers of the SOEs could not (and cannot) vote with their feet, the procurement processes of these monopolies could be subverted with a level of impunity that would not have been possible if revenues had dried up. This is proved in the case where customers did have a choice - Transnet Freight Rail (TFR) - where inefficiencies were punished by customers moving to road transport, an outcome that is in no-one's long-term interest, but which became inevitable as there were no market forces that would ensure that TFR would get its act together.

One implication of all of this is that important as public-private partnerships (PPPs) may be in raising efficiency in the short-term, on their own, they are not a sustainable solution to improving SOEs' performance. A PPP allows a private sector partner to assist the SOE produce goods and services, but it does not introduce competition into the relevant market (except, perhaps, when the tender for the concession is issued, and then only if the process is not skewed to ensure outcomes favourable to politically connected firms). Instead, the PPP may simply enjoy the fruits of the SOE's monopoly position rather than introducing competition. Helpful as this may be in improving delivery in the short-run, in the medium- to long-run it is more likely to result in higher prices and lower quality services than a model in which firms actually have to compete for business. One danger is that PPPs of this kind become a substitute for competition, and further amendments to the PPP regulations are required to address this.[34] Another is that they become a new vehicle for elite enrichment through new forms of crony capitalism in which private players extract monopoly profits without themselves facing competition.

New Public-Private Partnership (PPP) regulations

After a long and drawn-out process, the National Treasury drafted amendments to the PPP framework[42], which were published for comment on 19 February 2024. The deadline for comments has passed, but there is no indication that the process has been finalised, although the Treasury has made a public commitment to completing it before the end of this financial year. Most private sector commentators welcomed these changes but felt that there was more to be done before a substantial ramping up of private investment in PPPs would occur. A common sentiment was that PPPs will continue to be hampered until skills shortages in crucial parts of government are addressed and departments adopt a ruthless focus on implementation. The regulation changes can be summarised as follows:

- The amendments make provision for establishing two PPP pathways – one for high-value projects and a simplified version for low-value (less than R2 billion) projects.
- The new regulations limit the ability of accounting officers to cancel good projects while providing greater security to investors. They also enable the identification, management and reporting of fiscal commitments and contingent liabilities.
- An important aspect of the amendments is cementing the regulatory recognition of the PPP Advisory Unit, which is responsible for providing support to government officials during the initiation and preparation for PPPs. The PPP Unit will also provide technical advice to National Treasury, which may be required when considering approvals in respect of proposed PPPs.
- Historically, PPPs were seen as a government-led process, and unsolicited proposals were not accepted. The amendments state that a procuring institution may consider an unsolicited proposal if it is innovative and aligns with one or more of the procuring institution's strategic objectives. Various measures are included to incentivise such unsolicited proposals.

CDE, 2024

The current approach to reforming SOEs: The National State Enterprises Bill

There have been specific interventions to improve the performance of major SOEs like Eskom and Transnet, with some positive, although generally very slow-moving results. With respect to a general approach to SOEs, the Presidential State-Owned Enterprises Council (PSEC) was established in 2020. Its mandate included crafting overarching legislation to govern SOEs. There is no public report from the Council so we do not know their analysis or recommendations.

It is assumed that one output is the National State Enterprises Bill, which was first introduced in January 2024, lapsed in May, and then revived in July 2024. Its major provision is the requirement to establish a holding company for SOEs, known as the State Asset Management SOC ltd. (SAMSOC), with the state as sole shareholder. The President would be the company's sole representative although he could delegate these powers to a member of Cabinet. The Bill includes a list of 13 SOEs which may be *considered* for transfer to the holding company. However, inclusion will be possible only after the due diligence process is completed and a recommendation to transfer the state enterprise – based on, amongst others, its strategic importance, financial viability and ability to raise capital – has been made to the President, which will almost certainly exclude the majority of these candidates.[35]

The 13 SOEs that may become part of SAMSOC

1. Air Traffic and Navigation Services Company
2. Airports Company South Africa
3. Broadband Infraco
4. Central Energy Fund (Pty)
5. Denel SOC Ltd
6. Eskom Holdings
7. Sentech
8. South African Airways
9. South African Forestry Company
10. South African National Roads Agency
11. South African Nuclear Energy Corporation
12. South African Post Office
13. Transnet

National State Enterprises Bill, 2024

The GNU is in the process of closing the Department of Public Enterprises (DPE). On 26 August 2024 President Ramaphosa transferred the administration of the seven entities that previously fell under the DPE to their relevant line departments, as follows:

- Alexkor to the Minister of Mineral and Petroleum Resources
- Denel to the Minister of Defence and Military Veterans
- Eskom to the Minister of Electricity and Energy
- South African Forest Company to the Minister of Forestry, Fisheries and the Environment
- South African Airways to the Minister of Transport
- South African Express to the Minister of Transport
- Transnet to the Minister of Transport

The President also signed a proclamation appointing the Minister in the Presidency responsible for Planning, Monitoring and Evaluation as the executive authority of the DPE, which will continue to exist until its staff and financial resources have been transferred.

The Minister in the Presidency has, at the same time, been assigned the responsibility of finalising and implementing the National State Enterprises Bill, which means she is likely to be tasked with establishing the state holding company.

> **"Appoint a high-level team led by business leaders to conduct a review of the financial position of all major SOEs to identify solutions to the most pressing challenges"**

The National State Enterprises Bill, which is under consideration in Parliament, has been criticised for its lack of specificity, and it is not obvious how a holding company, if it is finally established, will address most of the underlying challenges that SOEs face.[36] Indeed, it is likely that the cost and effort of setting up this complex new institution will far outweigh whatever marginal benefits such an approach to managing the SOEs might have .

In relation to the SOE debt crisis, Treasury has adopted a reasonably tough, although probably unenforceable, stance, and has set strict conditions for the entities when it has acquiesced to their requests for debt relief.[37] When Treasury provided Transnet with a R47 billion guarantee earlier in 2024, it did so on condition that Transnet take specific remedial actions, including exploring further divestment of non-core assets, reduction of the current cost structure, and investigating alternative funding models to finance infrastructure upgrades and maintenance.[38] Similarly, the relief Treasury provides through the Eskom Debt Relief Act is on condition that the utility takes actions such as selling non-core assets (e.g. the Eskom Finance Company).[39] Even with this change in approach – on paper – it is not clear how long it will take to put the major SOEs on a firm financial footing again, or if this will ever happen.

There are some positive developments in how SOEs are being managed. However, the approach lacks coherence, real urgency and, in the case of SAMSOC, is weak and unconvincing. A more focused, decisive approach is required, one that aligns with the long-run goal of strengthening the competitive pressures at play in the markets where energy, logistics and other services are produced.

CDE Recommendations

Pressurising SOEs into becoming viable, effective entities can in many instances be achieved through an increase in competition. In our view that is the core focus and vision which should inform a workable, long-term SOE reform approach. Accordingly, our recommendations are formulated with the goal of ensuring increased competition firmly in mind. There are, however, a number of immediate actions that the President and the GNU should initiate.

The President: immediate actions

- It is widely reported that considerable work has been done by the **PSEC,** which has, apparently, commissioned detailed strategic and operational reviews of the major SOEs. These should be made public to maximise informed debate about the future of the SOEs. This is too important an issue for critical information to be restricted to a chosen few.
- **The President** should appoint **a high-level team led by business leaders** to conduct a review of the financial position of all major SOEs (or to review the work already concluded by PSEC) in order to identify solutions to the most pressing challenges. This process must deliver a menu of proposals for asset sales to address weak balance sheets. This should be linked to an explicit commitment in the 2025/26

budget to generate a flow of income from privatisation. This revenue should be ringfenced for reducing SOEs' debt or financing capital investment. (The high-level team should be appointed within a month, an interim report made public within six months and a final report to the President within 12 months. Report and actions to Parliament two months thereafter).

"Effective boards must be asked to commission skilled and independent public and private sector experts to review all large capital projects currently being executed by the SOEs these boards are managing"

Change the way the state manages SOEs

Structural change is urgently needed to create a coherent relationship between the state and the major SOEs, and to ensure the implementation of the reforms required to create competition between SOEs and other suppliers.

- **For now, manage the SOEs from the National Treasury.** There are risks associated with all the ways in which the state could conceivably manage the major SOEs. The goal must be to increase competition and reduce the protections and market dominance the SOEs have enjoyed. This will be opposed by many, not least by the SOEs themselves. Overcoming this opposition will require dedicated, skilled public servants answering to the President and Cabinet. These officials are unlikely to dominate in the line departments, which will also likely have strong incentives to block changes in alliance with SOE management. Nor should the management of the SOEs be located in the Presidency. There is limited capacity in the Presidency to engage meaningfully on the operational and strategic issues that face SOEs. The best arrangement (albeit one with risks) would be to have the Minister of Finance play the role of shareholder minister. Although this is the best solution out of a set of imperfect options, CDE recognises that there are some downsides. Firstly, it is generally not good public finance practice for Treasury to be involved in running big agencies as it creates conflicts of interest in the budget process and because Treasury does not have those skills. Secondly, putting such big supply chains under the management of Treasury makes Treasury itself a more attractive target for would-be state capturers. This is all the more reason for speedy reviews, and decisive action towards rendering SOEs more financially sound.
- When the time is right, **establish a small, new, highly skilled department**, led by the right people, committed to competition, and focused on ensuring that there are effective boards and that policies related to ensuring competition and regulating SOEs effectively are implemented. This, however, needs to be preceded by the adoption of a much more competition-oriented governing policy framework for the SOEs.
- **Review SOE boards and management.** Once SOEs are housed under the National Treasury, that Ministry must review the boards and management of all major SOEs, particularly in cases where boards or members have been in place for a significant period of time. Where boards are relatively new and/or are making decent progress, they should not be changed; where deficiencies are identified, active steps must be taken to replace incumbents. In the case of managers, a process for replacing unsuitable people must be designed so that it can be implemented as quickly as possible. In selecting new appointees, attention must focus first and foremost on their commercial and operational experience and knowhow.[40]
- Once in place, **effective boards** must be asked to commission skilled and independent public and private sector experts to review all large capital projects currently being executed by the SOEs these boards are managing. The goal will be to assess whether the capital projects are fit for purpose and the extent

to which their delivery and cost are being optimised. Where deficiencies are identified, these must be addressed through the renegotiation of contracts, and, where corruption is suspected, the law must be brought to bear quickly and effectively. These reports must be commissioned within a month of newly constituted or endorsed boards being established, and they must report on the results to the Presidency and the National Treasury within four months of being commissioned.

- **Strengthen the PPP framework.** Once a rational approach is adopted to bringing in private partners wherever desirable, the PPP regulations need to be further amended to attract and execute such partnerships. Making them less complicated and cumbersome remains a challenge, but attention must be devoted to ensuring that the arrangements properly incentivise private partners to deliver on time and within budget, by ensuring that the private partner bears some of the risks of such overruns. One principle might be that the less commercial risk transferred to a partner in a PPP, the greater the power of regulators to introduce competitors, transfer intellectual property, amend contracts or otherwise intervene in the market in which the PPP operates.
- **Focus on regulatory institutions.** There are ongoing concerns about significant weaknesses within key regulatory institutions, as well as about the extent to which regulators maintain their independence in discharging their mandates.[41] These issues must be addressed urgently and with a view to the future. Strong and independent regulators will become even more vital as competition is progressively introduced, requiring adaptation alongside ongoing regulatory oversight of both incumbent SOEs and new competitors.

"Every SOE must have a clear, unambiguous mandate that defines what it does, and why this is a state function, how it prioritises between different goals, and how it is financed"

Develop an overarching competition policy for SOEs

To solidify and extend these measures, government should develop an overarching competition policy that sets out the principles for the role of SOEs in the economy. This should be based on a thorough review of SOE-dominated sectors to identify where competition can be intensified. This is not the same thing as identifying areas in which the private sector can be brought in to assist with (or invest in) an SOE's operations. While the latter may be a necessary short-term expedient, there is clearly a need to ensure that the operators face greater competitive pressures than they have in the past.

The policy should specify the conditions under which the state is to use SOEs to produce goods and services and why, and the manner in which competitive pressures will be used to ensure commercial discipline and focus. This should then guide a review of SOEs across all spheres of government – national, provincial and local. The goals articulated in this policy should be that:

- Every SOE must have a clear, unambiguous mandate that defines what it does, and why this is a state function, how it prioritises between different goals, and how it is financed (including how its public interest function is financed).
- The large gap between operational costs and revenues is closed.
- The governance of SOEs is clarified. This should include the division of responsibility for policymaking, ownership of assets, maintaining financial sustainability, setting and regulating prices, and monitoring the quantity and quality of services. Careful consideration should be given to trade-offs between short- and long-term goals.
- SOEs' contribution to economic transformation is clarified, simplified and costed. Where trade-offs are made, these must be transparent and accounted for.

Implement additional reforms relating specifically to individual SOEs

- Eskom's transition to becoming a systems operator that purchases electricity generated by a large, diverse and decentralised producers' market must be accelerated. That requires removing the barriers and ending the foot-dragging with respect to properly constituting the new Eskom transmission company.
- Competition between multiple providers of freight services must be facilitated by a restructuring of TFR business along lines that attract long-term investment while ensuring competitive pressures are strengthened.
- The ownership and management of the ports must be spun out of Transnet to ensure arm's-length management of service providers in the ports, and the Ports Authority must be mandated to maximise competition between providers.
- Ownership of PRASA's operations must be decentralised, with the relevant metropolitan governments with sufficient capacity taking control over passenger rail services.
- Non-strategic SOEs operating in mature markets such as Denel, Safcol and SAA must be irrevocably denied access to future bailouts. If they cannot sustain their operations, they should be sold. This will be a complex process requiring additional planning, but it must happen.

Conclusion

Malfunctioning SOEs hold back growth. Detailed and specific recommendations for reform are required for each of the major SOEs. How the GNU manages and develops consistent, coherent policy for the large SOEs is a vital task which is currently confused and confusing. However, the general approach must be to increase the role of competition between service providers to discipline SOEs, so that they are incentivised to improve and develop their own sustainable solutions.

"How the GNU manages and develops consistent, coherent policy for the large SOEs is a vital task which is currently confused and confusing"

Our recommendations can be summarised as follows:

1. **The President** should:
   a. Release the detailed strategic and operational reviews of the major SOEs commissioned by the **PSEC for public consideration and debate**
   b. Appoint **a high-level team led by business leaders** to conduct a review of the financial position of all major SOEs

2. **The GNU** should:
   a. House the management of the SOEs in the National Treasury for the time being
   b. Review SOE boards and management to ensure they have the necessary technical, accounting and leadership skills
   c. Ask the new boards to appoint a skilled team of public and private sector experts to review all large capital projects being executed by the SOEs to assess whether they are fit for purpose
   d. Address issues in the PPP framework to ensure there is as much risk transfer as possible
   e. Strengthen critical regulatory bodies

3. **The GNU** should develop an overarching SOE competition policy that defines what should be handled through state owned companies and why, and how they will operate to promote growth and affordable services.
4. **The GNU** should adopt five priorities with respect to specific SOEs, with a focus on Eskom and Transnet:
   a. Accelerate Eskom's transition to a systems operator active in a competitive market
   b. Restructure Transnet's freight rail services to ensure competition
   c. Spin out the ownership and management of the ports from Transnet
   d. Allow metropolitan governments with capacity to take control of passenger rail services
   e. Deny non-strategic SOEs bailouts and sell off the assets of unsustainable SOEs

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