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REPUBLIC OF SOUTH AFRICA

POSITION PAPER

The Contribution of SOEs to Vision 2030: Case studies of Eskom, Transnet and PRASA

The National Planning Commission is releasing this Position Paper for public comment.

Feedback should be provided in writing by June 30, 2020.

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Executive Summary

This Position Paper represents the National Planning Commission's assessment of SOE performance and contribution to achieving the NDP's Vision 2030. Recommendations are made in respect of governance, finance, market structure and Government policy and processes. These findings and proposals are even more urgent in the context of the covid-19 pandemic. Their implementation will be essential to an ever greater imperative to course correct towards a development path that is consistent with Vision 2030.

With the support of the African Development Bank, the NPC commissioned a series of papers to support evidence based deliberations surrounding SOEs.

These papers are being released for comment alongside this Position Paper, with the aim of enabling public engagement on this critical topic. This work contributes to a wider assessment by the NPC of economic performance.

Focus of the research

- Three case studies of critical infrastructure SOEs, specifically Eskom, Transnet and PRASA (Passenger Rail Agency of South Africa).
- Three logical steps:
  - The first step involved lifting out what the NDP says with respect of the vision for energy, commercial transport and commuter transport in their contribution to economic development and inclusion to achieve Vision 2030.
  - The second step was to lift out what the NDP said about the role for Eskom, Transnet and PRASA.
  - The third step was to review what the NDP says were the critical dependencies to ensure that these SOEs make their contribution ('what needs to be true').
- Three considerations that affect their contribution to the NDP:
  - **Assessment of Performance:** this determines what the precise performance targets would be to achieve NDP Vision 2030, as compared to the Shareholder Compact, as compared to actual performance.
  - **Assessment of Governance:** this determines what was expected by the NDP of SOE governance to achieve NDP Vision 2030, compared to actual governance. This comparison contributes to a gap analysis on governance.
  - **Assessment of market structure:** this determines structural reforms to change the market structure so that other forms of provision of the good or services, other than state-provision, can arise.

The Main Findings

The three critical infrastructure SOE's studied here, namely Eskom, Transnet and PRASA, are not performing well in delivering to the aspirations of the NDP. This is largely owing to:

- years of uncertain policy expectations
- precarious funding strategies
- poor institutional accountability and poor governance
- political interference

All have led to the chronic underperformance of some SOEs, and in some cases, near-collapse.

Significant shortfalls in delivery have an impact on economic growth and have led to worrying increases in government debt and have since spilled over into increased national credit risk. Most problematic is the adverse impact non-performing SOEs have on the lives of the poorest and vulnerable members of society and in constraining economic development.

In these three case studies, there were many areas of commonality related to where there was success in delivery (e.g. black economic empowerment) and where there was not success (e.g. lack of accountability, poor governance, political interference, poor funding strategies, amongst others that will be highlighted).

NPC Recommendations

This NPC Position Paper was written to assess the alignment of SOE performance, structure and governance in delivering to relevant NDP objectives. Three sample SOEs are the focus, namely Eskom, Transnet and PRASA. The objective was to then synthesize more general lessons for application to other SOEs.

The NPC has developed these analytical tools for government and advisory bodies as part of these case studies to improve performance of SOEs, particularly in as far as it relates to the delivery to NDP Vision 2030 goals. These include:

- a performance framework to realign and calibrate SOEs mandates with the NDP.
- an analytical framework to assess the purpose and positioning of an SOE in a developing market economy.
- governance and accountability mechanisms required to improve transparency, accountability and coordination

Governance Reforms

The NPC recommends that shareholder compacts need to be aligned to the NDP and using the method developed as part of the studies commissioned by the NPC and the AfDB. The core economic mandate, improved governance and sustainable funding should account for 70% to 80% of the weighting in a shareholder compact. The shareholder compact should be a binding contractual agreement. The framework should measure outcomes, rather than inputs, activities or outputs of an SOE.

The institutional governance of SOEs must be strengthened. This includes:

- Appointment of management and boards must be done in line with acceptable corporate governance norms.
- Internal accountability must be improved. This can be achieved by narrowing performance management indicators, stronger linking of executive remuneration to outcomes achieved rather than measurement of activities, inputs or outputs, and finally by requiring more systematic public disclosure of the main objectives from SOE Shareholder Compacts, as well as of an assessment of the achievement of these annual objectives in public reporting and to Parliament, to facilitate public scrutiny.
- Given the challenges experienced, Government could consider reforms in the approach to state ownership and oversight. Three options are proposed by the studies commissioned for the NPC's consideration. However, the NPC also proposes that most of the effort should be focused on improvements in accountability, governance, financial and operational performance, and an emphasis on whether there should be a holding company could distract from more essential immediate interventions. Nevertheless, the NPC welcomes feedback on these options and other proposals from stakeholders.

Financial Reforms

- Provide the SOEs with clear instruction on the balance between commercial and developmental objectives and clarify the process on the costing and funding of each.
- Separate the accounts and reporting of commercial and sub-commercial activities to improve transparency of cost allocation[1].
- Approve additional budget support with improved strict, ex-ante conditionality. This has also been widely adopted to date but with limited success. The funding is often needed at a crisis point when National Treasury is faced with financial crisis of an SOE that is "too big to fail"; and conditionality appears rarely applied or adhered to.

Structural Reforms

- Where there are repeated failures in operational performance, or where fiscal and credit risk starts to outweigh benefits, government has a duty to implement organisational reforms. These include corporate governance, funding, and policy and process reforms.
- Where chronic operational, governance and financial underperformance continues, and organisational reforms are inadequate, structural reforms should be introduced. This means opening the provision of the service or infrastructure to other economic actors besides the state and/or changing the structure of state ownership. The debate about structural reforms must move away from the unhelpful binary and ideological privatise/nationalise discourse.
- It is the underlying nature of the market conditions that must guide the decision to create or retain an SOE or components thereof. It is hard to see on either constitutional or efficiency grounds why the state should use public resources to intervene with an SOE in private commercial activities where the market is competitive and produces outcomes that are acceptable to both sellers and buyers, or where light failings can be regulated. Scarce resources would be better directed to where markets do not operate efficiently.

Policy and Process Reforms

- Introduce a single state ownership policy.
- Introduce mechanisms of compulsory consultation on mega-transactions.
- Improve transparency and provide greater powers of oversight to stakeholder forums.
- Strengthen or introduce new sectoral regulation, and improve regulatory capacity.

[1] For example, Eskom has a mandate to provide reliable and competitively priced electricity to mining, industry and business, but it also has a mandate to extend affordable access to electricity services to poor households.

1. Introduction

1.1. Background

1.1.1. The NPC is preparing a review of progress towards the NDP Vision 2030. This includes a substantial review of economic progress. This covers a range of critical areas such as energy policy, township and rural economies, infrastructure delivery, SOE performance, education, macro-economic policy, industrial futures, labour market policy and digital readiness.

1.1.2. The present study focuses on the performance of infrastructure SOEs, in their contribution to achieving the NDP's Vision 2030. An assessment of SOEs is of critical importance given the fundamental role they play in the economy.

1.1.3. This study provides tools to review and align the infrastructure SOEs to better support government's long-term economic strategy as laid out in the NDP.

1.1.4. The NPC study focuses on the following:

- Three case studies of critical infrastructure SOEs, specifically Eskom, Transnet and PRASA. These entities are critical and have had performance challenges, so benefit the most from this focus. The learning from these case studies also contributes to generalized learning and recommendations.
- Three logical steps:
    - The first step involved lifting out what the NDP said in respect of the vision for energy, commercial and commuter transport in their contribution to economic development and inclusion to achieve Vision 2030.
    - The second step was to lift out what the NDP said about the role for Eskom, Transnet and Prasa.
    - The third step was to review what the NDP said were the critical dependencies to ensure that these SOEs made that contribution ('what needs to be true').
- Three considerations that affect their contribution to the NDP:
    - **Assessment of Performance:** this determines what the precise performance targets would be to achieve NDP Vision 2030, as compared to the Shareholder Compact, as compared to actual performance. A close reading of the NDP reveals eleven areas in which a SOE must perform to achieve the expectation of the NDP. These include:
        - the core mandate
        - the development mandate
        - financial sustainability
        - clarity in the written mandate
        - leadership
        - expertise
        - partnerships
        - clear institutional governance
        - environmental sustainability

- transformation responsibilities, and
- the delivery of specific priority projects indicated in the NDP.

These eleven outcomes form a standard common framework for all SOEs and are translated into specific performance indicators. Reported and modelled statistics of current performance were compared with the level of performance expected by the NDP. This comparison contributes to gap analysis on SOE performance.

- **Assessment of Governance:** this determines what was expected by the NDP of SOE governance to achieve NDP Vision 2030, compared to actual governance. This comparison contributes to a gap analysis on governance
- **Assessment of market structure:** this determines structural reforms to change the market structure so that other forms of provision of the good or services, other than state-provision, can arise. A range of structural reforms are set out in the papers. Discussion of structural reforms should not become trapped between the unhelpful extremes of nationalisation versus privatisation, as this overlooks other partnership arrangements that stop short of privatisation and which can improve delivery of the good or service

1.2. Objectives of the papers

This study assesses the contributions of three (3) SOEs in achieving the aspirations set for them in the NDP. The papers were written to assess the alignment of SOE performance, structure and governance in delivering to relevant NDP objectives. More specifically, to analyse the specific performance of selected SOEs against the NDP, market structure, and governance and policy considerations with respect to three sample SOEs - Eskom, Transnet and PRASA - and then to synthesize more general lessons for application to other SOEs.

1.3. Context

1.3.1. **The NDP recognises that infrastructure state-owned entities (SOEs) are pillars and engines of economic development.** SOEs provide critical economic infrastructure and services needed to power the economy, as well as support jobs in manufacturing, trade and exports. They also give citizens basic goods and services like water and sanitation, energy and transport. The NDP identifies that economic infrastructure and services provided by SOEs are the foundation of inclusive development and economic transformation.

1.3.2. According to the NDP, the SOEs aim and intention is to provide core economic infrastructure and services efficiently; to drive economic development and trade; to drive down the costs of doing business; to lead on spatial and industrial transformation; and to provide minimum basic goods and services like water and sanitation, energy and transport. Therefore, in order to achieve national development goals, it is critical that SOEs operate effectively and efficiently.

1.3.3. Overall, SOEs are an important part of the economy and contribute about 8.5% of GDP, as well as employ more than 250 000 people.

1.3.4. Having state owned monopolies in critical areas of delivery that do not perform in transforming the economy acts as a binding constraint in achieving our national goals towards economic advancement and inclusion. This makes such a study quite critical to this overall review by the NPC.

1.3.5. *The NDP asserted that "the electricity crisis of 2008 and other developments exposed institutional weaknesses…… Averting such problems requires clear institutional* *arrangements, transparent shareholder compacts, clean lines of accountability and sound financial models to ensure sustainability. ….Laws that govern regulation are often confusing, conflating policy with regulation* (NDP, p 45/6). The NDP was precise in its recommendations to improve SOE performance and this study assesses whether these were implemented and if so to what effect.

1.3.6. The SOEs have commercial and developmental mandates, that are both meant to focus on SA's development agenda. In the present arrangement, the core mandate (on commercial terms) is to provide economic infrastructure and services that improve economic competitiveness and support the job creation strategies of Government, Business and Civil Society. SOEs are also expected to meet a non-commercial yet developmental mandate. For instance: while "Eskom has a mandate to provide reliable and competitively priced electricity to mining, industry and business…it also has a mandate to extend affordable access to electricity services to poor households." (NDP, 2012 p 442). To achieve these mutually-reinforcing roles, SOEs often find that they must cross-subsidise activities in a manner that is not always transparent nor even sustainable for the entity.

1.3.7. The infrastructure SOEs are under significant financial stress and now causing macro-fiscal stress. At the same time, there is contestation about access and pricing. It is worth noting that the NDP's view was that in the long term, users must pay the bulk of the costs for economic infrastructure, with due protection for poor households. The role of government and the fiscus was to provide the requisite guarantees so that the costs can be amortised over time, thereby smoothing the price path. The state was also meant to put in place appropriate regulatory and governance frameworks so that the infrastructure is operated efficiently and tariffs can be set at appropriate levels. For infrastructure that generates financial returns, debt raised to build facilities was meant to be on the balance sheets of state-owned enterprises or private companies that do the work. Guarantees were meant to be used selectively to lower the cost of capital and to secure long-term finance. Subsidies to poor households were meant to be as direct and as transparent as possible. Social infrastructure that does not generate financial returns – such as schools or hospitals – were meant to be financed from the budget (NDP, p 45)

1.3.8. While structural recommendations can be made, a commitment to effective governance is the most important starting point for an SOE turn around. It is simply impossible to maintain, turnaround or sustainably drive growth without it. Leadership instability and political interference appear to be the top challenges faced by many SOEs.

1.4. Outline of this Position Paper

1.4.1. This Position Paper offers the NPC's main conclusions arising from this review of SOEs. This Position Paper considers findings from the three case studies, namely Eskom, Transnet and PRASA. The case studies highlight main findings in respect of performance (in the three logical steps), and critical dependencies related to governance. A consideration of market structure is offered in each case to frame potential policy options for performance improvement. The position paper then offers insights derived from these case studies for the oversight of other SOEs.

1.4.2. Readers are alerted to the background papers prepared with the support of the AfDB and oversight of a team from the AfDB and NPC. The views of these papers are those of the consultants commissioned to develop them. However, the NPC encourages stakeholders to engage with the rich material and insights to deepen debate and thinking about the matter of strengthening service delivery, especially through the SOEs.

2. Case Study: Eskom

2.1. ***The NDP proposed that by 2030, South Africa's energy sector would drive national economic growth, social equity and environmental sustainability.*** To achieve this, the energy sector would make investment in energy infrastructure and provide reliable and efficient energy service at competitive rates. Social equity would be achieved through expanded access to energy at affordable tariffs. Environmental sustainability would be promoted through efforts to reduce pollution, mitigate climate change and to significantly expand the proportion of renewable energy in the overall mix.

2.2. ***An Eskom that fulfils its mandate under the NDP would*** *"provide a reliable electricity supply in a sustainable and efficient manner in order to assist in lowering the cost of doing business in South Africa and enabling economic growth, by being well governed and remaining financially viable, while meeting a developmental mandate and transitioning to a low-carbon economy" (*Genesis-Analytics 2019 pg. 9).

2.3. "*Eskom has a mandate to provide reliable and competitively priced electricity to mining, industry and business, but it also has a mandate to extend affordable access to electricity services to poor households."* (NDP, p 142)

2.4. Eskom accounts for more than 90% of South Africa's electricity supply. Eskom provides 59% of electricity directly to customers, with municipalities distributing 41%. Independent Power Producers (IPPs) contribute 5% of power generated. Some sectors and industries also generate their own electricity for their own private use.

2.5. Some examples of specific priority targets set for Eskom by the NDP included:

2.5.1. to increase access to electricity to 90% by 2030 with off-grid options available to the outstanding 10% of the population.

2.5.2. Procuring at least 20 000MW of renewable electricity by 2030, importing electricity from the region, decommissioning 11 000MW of ageing coal-fired power stations and stepping up investments in energy-efficiency.

2.6. In addition to the Eskom case study prepared by Genesis, stakeholders are encouraged to read the NPC's Economy Series Position Paper on Energy (NPC 2019) where further detail can be found on this as well as other critical energy policy recommendations.

2.7. The reports prepared by Genesis make the following points that are supported by the NPC.

2.7.1. ***Eskom has since 1994 supported a developmental agenda through improved access of our people to electricity, especially through grid connections.*** According to the General Household Survey published by Statistics SA, access to electricity increased from 76.7% in 2002 to 84.7% in 2018 (Stats SA). Eskom has, therefore, been successful in this regard.

2.7.2. ***Eskom is struggling to fulfil a core economic mandate, which is to provide electricity supply in a reliable and efficient manner***. Eskom has not fulfilled its responsibility to support growth in the economy and has increased national fiscal and credit-downgrade risk. While electricity is supplied at affordable levels in comparison to international benchmarks, load shedding and distributional losses significantly constrain Eskom's ability to supply electricity reliably and efficiently. This has severely impacted the all business sectors.

2.7.3. The establishment of Kusile and Medupi power stations has required significantly more than expected capital expenditure and will still require further capital expenditure to enable completion. This added considerably to Eskom's current debt burden of R400bn. Long delays in completion of Kusile and Medupi, combined with design and structural concerns have impeded electricity generation at these plants, thus the ability to generate revenue from the operation of these plants has been constrained.

2.7.4. ***Eskom is currently not financially sustainable, particularly due to a debt burden***. Interest-bearing debt increased from R41billion to R400billion from 2006/2007 to 2017/18. The central challenge is an apparently unconstrained growth of debt to unsustainable levels. The severity of its precarious financial position is demonstrated by Eskom having to borrow in order to make interest payments on its debt.

2.7.5. ***Eskom is unable to reduce costs in response to falling demand and is susceptible to a utility debt trap.*** Although Eskom has faced falling electricity volumes, it was meant to scale down costs by closing old power plants. The avoidable costs of supply are greater than the current regulated tariff level so Eskom should benefit from decommissioning. However, due to the delays in completing Medupi and Kusile, it has been unable to decommission old inefficient plants and realize cost savings.

2.7.6. ***Eskom is unable to attain a level of investment to conduct much-needed maintenance.*** There are significant maintenance backlogs: over R35bn in power plant infrastructure maintenance overdue. Eskom is currently distressed by an unsustainable debt burden.

2.8. We would add the following comments that are consistent with Genesis' findings:

2.8.1. Genesis reviews 11 performance indicators related to Eskom's core mandate, its development mandate, financial sustainability, environmental sustainability, transformation, delivery of specific key projects, institutional governance, mandate, leadership, expertise and partnerships (Genesis-Analytics 2019a). These are translated into 56 very specific metrics, with comparisons of current performance, Eskom's target according to its shareholder compact, and what this metric should have been to achieve the NDP.

2.8.2. There is poor alignment between the NDP, the shareholder compact and actual performance in critical areas. We recommend that the background report on performance be carefully considered (Genesis-Analytics 2019). As an indication, some significant examples include:

2.8.2.1. Written after the 2008 energy crisis, the NDP said there should be no load shedding. As we know, there has been considerable load shedding. The shareholder does not appear to have set hard load shedding targets in this context.

2.8.2.2. Generation capacity was meant to be increased continuously, with an expectation of 6 382 MW of generation capacity installed and commissioned by 2030. The shareholder compact targets 800 MW and by 2018 there was no new installed capacity.

2.8.2.3. Renewable energy capacity procured by 2030 should be 20 000 MW if the NDP were achieved. By the end of 2018, the shareholder compact required almost 5 000 MW and the actual was about 3 700 MW.

2.8.2.4. New power capacity built should have been 40 000 MW by 2030. By the end of 2018, 12 041 MW was built, as compared to the shareholder compact which required 18 000 MW.

2.8.2.5. The benchmarked primary energy cost efficiencies were targeted by the NDP to achieve 37,56 c/kWh, the actual cost by end of 2018 was 45,44 c/kWh, and there was no stated Eskom target indicated for this item.

2.8.2.6. The price of electricity was meant to become more cost reflective, while still globally competitive. The NDP proposed reaching 120c/KWh, this is reflected in Eskom's target, but the average price was 93,79 c/kWh.

2.8.2.7. The NDP's CO2 emission target would be 0,93 tCO2/MWh as compared to an actual of 1,10 tCO2/MWh, and there was no CO2 emission target in the shareholder compact. Relative particulate emissions sent out should have been less than 0,3 kg/MWh, to which the shareholder compact aligns, but the actual is 0,47 kg/MWh.

2.8.2.8. There were ten CEOs between 2009 and 2018, as compared to an expectation of two.

2.8.2.9. 100% of whistle-blower cases should have been reported to the police as compared to 2%. There should have been no irregular expenditure, as compared to the actual of R6,6 billion in 2018, as against no available shareholder target.

2.8.3. ***Eskom is not sufficiently promoting the transition to a resilient low-emissions future economy and continues to expend significant pollution externalities.*** Compliance with South African National Environmental and Air Quality Management Act (NEMAQA) emissions standards related to nitrogen oxides (NOx), sulphur oxides (SOx) and particulate matter (PM) is relatively costly to the extent that Eskom cannot afford to incur costs for compliance. These costs for retrofitting are estimated at over R300bn. This means that negative externalities in the form of non-compliant emissions are not being priced into the current tariff. Thus far, custodians of the NEMAQA have instead granted five year rolling exemptions, due to the financial strain on the SOE. It is unclear as to how enforcement of NEMAQA and related regulations will be enforced in future.

2.8.4. ***Some part of Eskom's challenges is caused by policy indecision in respect of resource planning.*** In the 1990s there had been an intention to encourage private investment, but that was not pursued. Neither was Eskom enabled to build and nor were electricity prices raised sufficiently to cover depreciation. Despite various announcements, policy indecision continues to hamper progress in addressing the state of Eskom and of electricity supply more generally. This is evidenced in slow and uncertain progress in respect of introducing an independent buyer, separating out transmission, and independent power producer procurement.

2.8.5. ***There have been significant governance and organisational culture concerns:*** Eskom's governance and reputation have been negatively affected by state capture and mismanagement of funds widely reported. It is a concern that the board and executive management has continued to struggle in finding stability. It is hoped that the recently appointed CEO will have the opportunity to build and stabilise executive leadership.

3. Case Study: Transnet

3.1. Commercial transport plays a critical role in supporting industrialisation, diversification, trade and development. The NDP envisaged a transport system that was "*reliable, economical, with smooth flowing corridors linking its various modes of transport (road, rail, air, sea ports and pipelines)"(NDP, 2012 p 183).* This was meant to address "*corridors dominated by outdated, malfunction prone railway technology and poor intermodal linkages….(and) Ports (that) are characterised by high costs and substandard productivity relative to global benchmarks*". Shifting to rail was meant to lift pressure off the road network and reduce carbon emissions. A reformed transport system was meant to support a re-orientation of production away from an apartheid space economy and enable the industries of the future.

3.2. If Transnet were to be successful in meeting the goals of the NDP, its contribution would lower the cost of doing business by providing appropriate port, rail and pipeline infrastructure in a cost-effective and efficient manner.

3.3. The NDP had also indicated special priority projects. Amongst others this included coal transport corridors for Eskom and for export, the upgrade of the Gauteng-Durban corridor, the North-South Corridor linking Durban and Dar es Salaam, and the completion of the new multi-product pipeline.

3.4. The reports by Genesis draw the following conclusions, which are supported by the NPC:

3.4.1. ***Transnet has demonstrated a strong commitment to racial transformation*** and the empowerment of historically disadvantaged groups when it comes to its internal operations.

3.4.2. ***The performance of Transnet pipelines proves to be reliable and efficient,*** approaching aspirational levels of those of the standards of the NDP.

3.4.3. ***Transnet is meeting its core mandate in respect of heavy commodity export lines.*** Rail is efficient on export lines (coal and iron ore).

3.4.4. ***Transnet is not meeting its core mandate in relation to general freight.*** There are concerns about the cost effectiveness and consistency of the general freight network. This is evidenced by the poor market share of rail for moving general freight domestically: presently rail accounts for 15% of logistics market share when logistics models suggest a 40% would maximise logistical efficiency.

3.4.5. ***Operational service has proven skewed towards the extractive economy, perpetuating South Africa's minerals-dependency in the economy.*** Far greater efficiency is realised on export lines which demonstrate densities up to six times that required to break even yet general freight line densities are only half that required to be a self-funded entity. Tariffs levied demonstrate a favouring of trade in commodities. In 2018, port tariffs were almost 200% higher than the sampled international average on containers yet they were over 90% lower than the sampled international average on coal. A strong focus on commodity export lines perpetuates the resource-dependent and extractive economy. While commodities can drive economic growth, the NDP expects this growth to drive a diversification of the economy away from resource-dependence.

3.4.6. ***Transnet does not sufficiently promote effective intermodal linkages to support an integrated logistics network.*** Intermodal linkages that allow for efficient trans-shipments between modes is prohibitively expensive at 130% above the benchmark target. According to the NDP, one of the core mandates of SOEs are to promotes effective intermodal linkages to maximize freight hauling and distribution efficiency (NDP, 2012). The NDP aspires to an intermodal market share of 43%, whereas the current market share is 24%. The Transnet stated target, however, is even lower than the NDP's stated target, sitting at 15% of the market share. The poor performance in intermodal connectivity is evident in just over 50% of target intermodal market share. Palletised goods, which are easily transhipped between modes and predisposed to intermodal hauling, only have 0,1% market share captured by Transnet.

3.4.7. ***Rural economies are not sufficiently serviced by Transnet.*** Transnet provides limited and decreasing connectivity with rural markets. Presently Transnet accounts for about 22% of rural freight logistics market share, and just 5% of agricultural freight market share.

3.4.8. ***Transnet is currently financially sustainable, but there are material concerns on the horizon.*** Whilst its balance sheet is in good standing, questions have been raised about the ability to maintain and expand its operations as demand increases. Despite a year-on-year decrease, Transnet still reports a positive cash balance and generated approximately R23 billion from operating activities in 2018. Recent qualified audits, however, have raised concerns about Transnet's creditors pulling its debt facilities which would result in Transnet potentially ceasing to be a going concern.

3.4.9. Cross-subsidisation between operations injects opaqueness into the financial viability of different units and limits the ability to develop funding models appropriate to commercial and sub-commercial activities. Further, the ratio of resourced to theoretical capacity, aged locomotives and signalling systems indicate a serious underinvestment in maintenance.

3.4.10. ***Transnet is failing to promote the transition to a low-carbon economy by providing legitimate alternatives to transport by road***. Emissions from the transport sector account for almost 11% of total greenhouse gas emissions; and road transport accounts for 91% of this.27 The current road-rail balance for freight results in a carbon "overspend" of approximately two million tons of carbon per year. Positioning rail as the competitive alternative to road would reduce this overspend.

3.5. We would add the following comments that are consistent with Genesis' findings:

3.5.1. The performance framework provided by the Genesis study covers the 11 areas, with 97 indicators. ***There is significant divergence between what would be required by the NDP, what is in the shareholder compact and actual performance.*** In some cases, there is simply no hard target such as service to the agricultural sector. As noted, this has undermined industrial diversification and global trade.

3.5.2. ***Transnet has made very uneven progress in meeting the requirements for specific projects mandated to it in the NDP***. Specifically, there are significant shortfalls in relation to delivering on the upgrading or development of the Durban-Gauteng corridor, Durban port capacity, the heavy-haul coal corridor from Waterberg to Richards Bay, infrastructure for transport of liquified gas. Good progress has been made in relation to procurement of locomotives and mineral export line expansions, the Multi-Product Pipeline is close to completion. There has been delivery related to iron ore exports and transport of manganese domestically.

3.5.3. Transnet lacks a clear written publicly available mandate with valid information to support reported performance. Transnet continues to maintain a culture that limits information sharing.

3.5.4. There have been significant gaps in leadership, governance and accountability. A high turnover in executive leadership has resulted in 70% of executive committee member working in acting positions. It is hoped that the recently appointed CEO will have the opportunity to build and stabilise the executive leadership. The Board nomination process lacks transparency and continues to be highly politicised. The board has not been stable and continues to require fuller set of expertise as expected by corporate governance standards. Ethical standards have not been met with over R8bn in irregular expenditure, and only 6% either recovered or under investigation. It is not clear if Transnet does have a long-term technical expertise strategy.

3.5.5. ***Private sector partnerships were meant to be promoted, potentially accounting for about 5% of market share in ports and rail.*** A draft private sector participation framework for transport has now been approved by Cabinet. However concrete progress is slow in this regard. Three branch-line concessions were concluded in 2017/18.

4. Case Study: PRASA

4.1. The NDP envisaged a public transport system that could "*bridge geographic distances affordably, foster reliably and safely so that all South Africans can access previously inaccessible economic opportunities, social spaces and services*" (NDP, 2012 p 183)

4.2. "*A PRASA that contributes to the goals of the NDP will position rail as the backbone of public transport within an integrated transport network, by providing quality and affordable rail transport services that satisfy the commuter, intercity and international travel needs of households, and especially lower-income households" (*PRASA (2018) Corporate Plan (2019/2021)).

4.3. The NDP set several special priority projects to be pursued by PRASA including renewal of the commuter train fleet, station upgrades and improved facilities to enhance links to road-based services. This would require technological modernisation. It was anticipated that complete fleet renewal could take up to 15 years (NDP, 2012 p 189).

4.4. The reports by Genesis draw the following conclusions, which are supported by the NPC:

4.4.1. Overall, the performance report indicates that PRASA has replicated previous patterns of inequality and exclusion of low-income households. More specifically:

4.4.2. ***PRASA underperforms across indicators relating to its core operational objective, financial stability, investment related to maintenance and expansion of current operations, corporate governance and public interest objectives.*** This means few low-income citizens can get to work reliably, safely and cheaply. Unsafe and unreliable service has forced commuters to opt for expensive alternatives, with transportation accounting for 40% of household spending in some cases. PRASA's failing service is a critical impediment to South Africa realising the equitable and inclusive society envisioned in the NDP.

4.4.3. ***There has been a dramatic loss in customers.*** In the period between 2011 and 2017 PRASA lost 46,1% of passenger kilometres. Metrorail passenger trips fell from 650 million in 2009/10, to 213 million in 2016/17. The low and falling passenger numbers indicate that PRASA is not achieving the core mandate of providing transport that gives (predominantly low-income) households preferred public transport alternatives. Mini-bus taxis have become the preferred mode of commuter transport – for every train commuter there are nine commuters using mini-bus taxis – despite minibus taxis being 80% more expensive.

4.4.4. ***The low scores in the safety of commuters and reliability of trains are a deterrent to many customers.*** Passengers are not assured of their safety and security when using PRASA rail services. The evidence collated from the 2018/19 Annual State of Safety Report by the Railway Safety Regulator indicates that for the period 2018/19, 284 fatalities occurred in relation to the rail service. Moreover, the train service in unpredictable and prone to delays from mechanical, electrical, per way and signal failures. In a service that is primarily responsible for getting people to work, unpredictable timing and delay is a prohibitive barrier evidenced by the willingness to spend on more reliable options.

4.4.5. ***PRASA is unable to generate enough investment to fund its current operations.*** Commuter rail, with few exceptions, is unprofitable the world over. The importance of PRASA for economic transformation and inclusive growth should be recognised and reflected through adequate state assistance. The PRASA group reported a loss of R928 million in 2017/18, a 68% increase to the previous financial year. This liquidity crisis has flagged PRASA group's ability to operate as a going concern. A reduction in the rail operational subsidy by 1.7 billion over the 2019 MTEF is set to worsen an already constrained financial position. A reliance on ageing infrastructure increases the potential for operational failures and safety incidents. There have been indications of wasteful budget expenditure; slow roll-out of capital investment programmes and insufficient asset management (lack of security, repair and maintenance) leading to asset degradation which has ultimately impacted on the reliability and safety of PRASA's services.

4.4.6. ***There have been significant governance and organisational culture concerns:*** Opaque institutional relations and lack of reporting have enabled a culture of maladministration. The Shareholder's Compact is not in the public domain, with the Auditor General reporting that PRASA is unable to report on KPIs as the current compact was not concluded in consultation with the executive authority and therefore has no binding status. Chronic leadership instability severely limits the agency's ability to commit to and execute on a long-term strategy or deliver on operational performance. There appears to be R24 billion in irregular expenditure in 2018.

4.5. We would add the following comments that are consistent with Genesis' findings:

4.5.1. The performance framework provided by the Genesis study covers the 11 areas, with 42 indicators. ***There is significant divergence between what would be required by the NDP, what is in the shareholder compact and actual performance.***

4.5.2. ***The appointment of the board is unstable and negatively affected by political interference.*** The research team could not locate information to show the ratio of acting positions in the executive leadership.

4.5.3. ***Market structure issues must be addressed.*** About 2/3 of public spending on urban transport goes to PRASA, accounting for only 17% of trips. Over the past decade, there were four turnaround strategies, R80-billion in capital subsidies and about R10-billion in operating subsidy annually. Yet performance fell dramatically especially since 2015, causing a 60% drop in Metrorail customers and a 90% fall in long-distance rail passengers. Only half the PRASA coaches are in operation. As noted, this pushes commuters into taxis, which do not receive any subsidy. The current approach therefore leads to significant spending on commuter transport that does not yield any material result for improving the standard of living for low income households.

5. Reflections on the three case studies

5.1. The three critical infrastructure SOE's studied here, namely Eskom, Transnet and PRASA, are not performing well in delivering to the aspirations of the NDP.

5.2. This is largely because of years of uncertain policy expectations, precarious funding strategies, poor institutional accountability and poor governance, political interference, which all have led to the chronic underperformance of some SOEs, and in some cases, near-collapse.

5.3. Significant shortfalls in delivery have an impact on economic growth and have led to worrying increases in government debt and national credit risk. Most problematic is the adverse impact non-performing SOEs have on the lives of the poorest and vulnerable members of society and in constraining economic development.

5.4. In these three case studies, there were many areas of commonality related to where there was success in delivery (e.g. black economic empowerment) and where there was not success (e.g. lack of accountability, poor governance, political interference, poor funding strategies etc.). The common features related to not succeeding, according to the measurement framework, makes visible repeating trends in the three case studies:

5.4.1. Weak governance is an alarming feature; with many senior appointments over the last decade having been concluded largely for political ends, largely through the party system of cadre deployment.

5.4.2. A revolving door of senior appointments has not allowed for greater accountability by senior executives.

5.4.3. The technical skills-sets required for Boards have been under-resourced: specialist and experiential skills need to prioritise

5.4.4. A pattern of financial distress is caused by insufficient and opaque funding models, random funding decisions; poor delineation between commercial and non-commercial activities; and cross-subsidisation between profit-making and loss-making entities.

5.4.5. Institutional accountability is inadequate. Shareholders compacts serve dissimilar roles in different SOEs; are packed with KPIs that are linked to non-core functions; are sometimes insufficient and incomplete; and are not always available for public commentary. As a result, institutional accountability for non-performance is poor and weak. Because of the reasons listed above, it is difficult for government (and parliament, regulators, the press, civil society and the electorate) to hold SOEs to account for poor performance on its core mandate. There should be major improvements in public transparency and of the shareholders compact – so that parliament, regulators, the press, civil society, and the electorate can judge performance and hold the SOE to account.

5.4.6. Partnerships with the private sector have been minimal. The NDP expressly states that SOEs are to have a stakeholder-management framework to support their initiatives to partner with the private sector. The achievement of partnerships, however, has been dismal and disappointing across the board.

5.4.7. The emphasis on internal transformation programmes suggest that transformation is seen more as an internal human resourcing issue rather than an external role that can be achieved through the delivery of the core mandates.

6. NPC Recommendations

6.1. This NPC Position Paper was written to assess the alignment of SOE performance, structure and governance in delivering to relevant NDP objectives. Three sample SOEs are the focus, namely Eskom, Transnet and PRASA. The objective was to then synthesize more general lessons for application to other SOEs.

6.2. The NPC has developed these analytical tools for government and advisory bodies to improve performance of SOEs, particularly in as far as it relates to the delivery to NDP Vision 2030 goals. These include:

6.2.1. a performance framework to realign and calibrate SOEs mandates with the NDP.

6.2.2. an analytical framework to assess the purpose and positioning of an SOE in a developing market economy.

6.2.3. governance and accountability mechanisms required to improve transparency, accountability and coordination

6.3. Governance Reforms

6.3.1. ***The NPC recommends that shareholder compacts need to be aligned to the NDP and using the method developed in this report.*** The core economic mandate, improved governance and sustainable funding should account for 70% to 80% of the weighting in a shareholder compact. Targets must align to efficiently delivering to an economic development agenda. Specific recommendations in respect of the Shareholder Compacts include:

6.3.2. ***The performance of any SOE should be judged against the outcomes sought by the NDP***. There should be a consistent performance framework applied to all SOEs aligned to the NDP framework. A consistent performance framework will not only ensure the NDP become more manifest in the operations of the SOEs but will also diminish opportunities for political interference.

6.3.3. ***The shareholder compact should be a binding contractual agreement.*** The absence of legal weight diminishes consequence management for non-performance and therefore, the accountability of the entity and shareholder.

6.3.4. ***The framework should measure outcomes, rather than inputs, activities or outputs of the SOE***. Ongoing and regular assessments of performance are needed to understand where outcomes are being achieved, because a key determinant in the decision to retain or reform an SOE is its de facto performance of outcomes sought by the NDP.

6.3.5. ***The institutional governance of SOEs must be strengthened***. There are three outcomes that an improved institutional framework must achieve 1) improved accountability for performance; 2) the inclusion of checks and balances and oversight mechanisms to ensure "capture" of the SOEs en masse cannot occur; and 3) the introduction of shareholders who have a shared interest in the performance and sustainability of the SOEs. ***To this end, recommendations include:***

6.3.5.1. ***Appointment of management and boards must be done in line with acceptable corporate governance norms.*** This should see the end of political appointments, and an emphasis on proven professional experience and capability as expected according to these rules and norms. Leadership stability should be a priority. Under-performance should not be addressed by regularly changing the leadership.

6.3.5.2. ***Corporate governance should be strengthened.*** At a minimum this can include public disclosure of corporate governance policies, board charters, and similar. Training for all Boards and Executives on their core mandate and on their responsibilities and on ethics should take place.

6.3.5.3. ***Improve internal accountability.*** This can be achieved by narrowing performance management indicators, linking executive remuneration to outcomes achieved rather than measurement of activities, inputs or outputs, and finally by require more systematic public disclosure of the main objectives from SOE Shareholder Compacts, as well as of an assessment of the achievement of these annual objectives in public reporting and to Parliament, to facilitate public scrutiny. Including the use of independent experts or external committees in the performance evaluation will improve independence of the process.

6.3.5.4. ***Given the challenges experienced Government could consider reforms in the approach to state ownership and oversight.*** Three options are proposed by the reports prepared for the NPC's for consideration. (1) a comprehensive SOE holding company with a commercial company structure that may protect entities from political interference (2) a pilot holding company with DPE playing a leading role and (3) DPE retains ownership oversight under coordination of the Presidential SOE Council. Any decision would require careful consideration.

For example, the reports put forward Option1 as a preferred recommendation. Yet the NPC has some concerns related to the poor track record in oversight of entities which could extend to the setting up of a new holding company and that isolating SOEs into a commercial holding company could reduce accountability of what are currently monopolies. The NPC also proposes that most of the effort should be focused on improvements in accountability, governance, financial and operational performance, and an emphasis on whether there should be a holding company could distract from more essential immediate interventions. Nevertheless, the NPC welcomes feedback on these options and other proposals from stakeholders.

6.4. Financial Reforms

6.4.1. ***Provide the SOEs with clear instruction on the balance between commercial and developmental objectives and clarify the process on the costing and funding each.*** SOEs typically face multiple objectives with unfunded mandates being a common cause of under-performance. Government should consider reviewing the overall mandate in conjunction with the line department, shareholder department, SOE and National Treasury agreeing on the costing and allocation of the funding model.

6.4.2. ***Separate the accounts and reporting of commercial and sub-commercial activities to improve transparency of cost allocation.*** About 60% of surveyed countries in an OECD study require SOEs to separate the accounts of commercial and sub-commercial activities to ensure transparent cost allocation. In most OECD countries, direct state support for SOEs is provided for sub-commercial public mandates. Removal of cross-subsidisation allows for direct state support on a transparent basis.

6.4.3. ***Approving additional budget support with conditionality.*** This has also been widely adopted to date but with limited success. The funding is often needed at a crisis point when National Treasury is faced with financial crisis of an SOE that is "too big to fail"; and conditionality appears rarely applied or adhered to.

6.5. Structural Reforms

6.5.1. ***Where there are repeated failures in operational performance, or where fiscal and credit risk starts to outweigh benefits, government has a duty to implement organisational reforms.*** These include corporate governance, funding, and policy and process reforms.

6.5.2. ***Where chronic operational, governance and financial underperformance continues, and organisational reforms are inadequate, structural reforms should be introduced.*** This means opening the provision of the service or infrastructure to other economic actors besides the state and/or changing the structure of state ownership. ***The debate about structural reforms must move away from the unhelpful binary privatise/nationalise discourse.*** There are a range of partnership options between the SOE, the government and the private sector. The design of these partnerships would be an opportunity around which to design a social compact between government, big business, labour and civil society interests. The study outlines the range of structural reforms that can be considered including: allowing private entry into value chain; outsourcing service contracts; short-term management, franchising and leasing contracts; selling parts of an SOE to an equity partner; concessions over parts of SOE infrastructure; closing parts of an SOE; enabling direct competition; public-private partnerships; wholesale privatisation; or SOE liquidation.

6.5.3. ***It is the underlying nature of the market conditions that must guide the decision to create or retain an SOE.*** Technology will constantly change market conditions and therefore periodic reassessment of the need for an SOE should be undertaken. As a general principle established in economic theory and in the NDP itself, SOEs should not be used as a substitute to provide government services; ***nor should SOEs be used in markets where private enterprise can create competitive outcomes.*** It is hard to see on either constitutional or efficiency grounds why the state should use public resources to intervene with an SOE in private commercial activities where the market is competitive and produces outcomes that both sellers and buyers are happy with, or where light failings can be regulated. Scarce resources would be better directed to where markets do not operate efficiently.

6.6. Policy and process reforms

6.6.1. ***Introduce a single state ownership policy.*** A single state ownership policy is a standard benchmark of OECD countries. This allows standard policy to be applied consistently to all SOEs regardless of ad hoc crises, or shareholder pressures. The consistent application of policy and procedure would improve transparency, accountability and co-ordination. The policy would need to provide general principles and a unified approach to the elements of SOE governance, the structure of oversight entities, the roles of the ownership entity towards individual SOEs, as well as the framework for board appointments and their accountability. It should also set out the director nominee process, including required skills, diversity, and balance of state representatives; guidance on the appointment process for SOE CEOs. It can also establish a publicly open directors' pool from which new external directors for SOEs are drawn. Finally, the policy should provide a process for the periodic review by the holding company of the rationale for the State's ownership of SOEs and examine options for asset divestment.

6.6.2. ***Introduce mechanisms of compulsory consultation on mega-transactions.*** Given the widespread abuse in the last decade in SOE procurement, government needs should consider additional oversight of large procurement transactions either at management-committee, independent audit committee-level, or at the national level with the appointment of oversight at the level of National Procurement Office.

6.6.3. ***Improve transparency and provide greater powers of oversight to stakeholder forums.*** The operation of large SOEs in strategic sectors impacts directly or indirectly on the lives of millions of South Africans. Yet the service delivery of these SOEs (especially in the case of natural monopolies) are not typically rated by consumers or businesses which depend on the quality and price of the services. Government can improve oversight of SOEs by systematically referring to stakeholder forums (including stakeholders from industry, consumers, civil society, labour, creditors and affected communities) in the evaluation of SOE performance. This would be particularly important in evaluating the fulfilment of public mandates as well as the SOE contribution to wider societal goals set out in the NDP.

6.6.4. ***Strengthen or introduce new sectoral regulation or improve regulatory capacity.*** Subsidies/taxes and regulation can address issues of competition and externalities. For instance, in the case of Transnet, a transport regulator could help to address issues of cost efficiency and reliability, and would be in line with rail regulators in China and UK, who set technical standards, monitor performance, review and set prices on a cost-plus basis; conduct extensive strategic reviews every five years and determine appropriate penalties for breach. Likewise, Eskom's performance could be improved by amending regulatory process to ensure tariffs are cost-reflective, and that municipal tariffs are not excessively marked up

7. Selected References

These papers are all available at:
https://www.nationalplanningcommission.org.za/Publications_Reports

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