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The Role of Development Finance Institutions (DFIs) in Building South Africa's Democratic Developmental State

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"Key to any successful developmental state is a thoroughly depoliticized and highly efficient civil service, which we do not have. This is tantamount to creating a Rolls Royce with a lawnmower's engine."[1]

"As government, we are continuously confronted with the question of how best to position our DFIs to enhance their capacities to deliver significant and tangible developmental results effectively and efficiently to all the qualifying needy individuals and institutions of South Africa. This means that the contributions of DFIs must be measured not by meaningless statistical numbers, but by their direct impact on the lives of the ordinary people of South Africa observable through sustained improvements in incomes and standards of living because of access to DFI funding, projects, facilities, and infrastructure base."[2]

"South African economists seem to know how to read a compass, but not a map. They base their arguments on theories for the Developed World, without knowing where this country is really positioned . . . What makes the New Growth Path (NGP) different from previous growth plans is that it has a strong thrust towards addressing the problems of our Third World economy and doing what is right for everyone, not just some of us."[3]

1. INTRODUCTION AND PURPOSE

As instruments for the mobilization of scarce finance capital, DFIs have an unambiguous role in attaining the ends of developmental states. For the most part, DFIs are typically policy tools in the hands of states to forge developmental objectives by addressing imperfections in markets for finance and investment capital, assisting markets to foster growth, and contributing to the public good. Despite these roles, DFIs are embedded in broad institutional arenas of contestations and compromises about the nature, quality, and reach of the state in the economy. Specifically, debates about the efficacy of DFIs in the service of developmental objectives are inextricably tied to how states articulate the development agenda, how they delineate the distinctive roles of public and private actors in financing of development, and how they relate to society at large. Defining the operational arena in which DFIs thrive is the province of state elites navigating competing interests and constituencies, processes that furnish a window into the arena of policy articulation and implementation. Thus, how the state interacts with markets and private actors, particularly the business sector is at the core of analysis of the financing of development.

[1] Anonymous businessman cited in "Planning with Patel," *Mail and Guardian*, November 26-December 2, 2010.
[2] Budget Briefing by Deputy Minister, National Treasury, Nhlanhla Nene, National Treasury, May 11, 2010.
[3] Economist Michael Power on the New Growth Path cited in "Power Slams New Growth Path Critics," *Creamer Media Engineering News*, January 27, 2011.

This chapter seeks to evaluate the contribution of DFIs to the South African economy within the wider context of debates about the construction of a developmental state. Understanding these roles furnishes perspectives on the opportunities and challenges faced by the South African state in mobilizing public resources for development outcomes. The chapter will, first, address the substantive debates about developmental states. Policy pronouncements and proclamations in the post-apartheid era have converged about the business of constructing a developmental state. It is important to probe the depth and breadth of this process against the backdrop of experiences and practices elsewhere. Second, the analysis will examine the historical and contemporary roles of DFIs in the South African economy. We shall focus on five DFIs--the Industrial Development Corporation (IDC), the Development Bank of Southern Africa (DBSA), the Khula Enterprise Finance Limited, the Land Bank, and the National Housing Finance Corporation (NHFC)— which have the mandates to contribute to the construction of a developmental state. The key questions will centre on how the state has articulated the mandates of these institutions and how it has positioned them to advance the mission of erecting a developmental state. This section will be followed by an exploration of the New Growth Path (NGP) and its implications for DFIs. Subsequently, the analysis will examine key strategic vulnerabilities, opportunities, and pathways for building a democratic developmental state. In the concluding sections, the chapter will identify options for boosting the contribution of DFIs to developmental outcomes in South Africa.

2. DEVELOPMENTAL STATES IN COMPARATIVE PERSPECTIVES

Debates about developmental states have historically revolved around the contrasting approaches to the role of the state in the economy, typified by the English model, inspired by Adam Smith's invisible hand of the market versus the German model, articulated in the works of Friedrich List who proposed a more interventionist role for the state to guide the economy and produce rapid outcomes, particularly in the transition from agriculture to industry.[4] At the heart of these debates is the precise role between the state (public authorities) and markets (private, largely business actors) in steering the development process. Smith famously saw unfettered markets as the drivers of industrialization with the state only providing the institutional environment for growth. List, on the other hand, expressed profound pessimism about the ability of the private sector to propel Prussian modernization along the previous lines prescribed by Smith. Thus, List launched an assault on market fundamentalism that attended English industrialization. The market-state distinction and how to reconcile this divide remains a core analytical point in understanding the nature of developmental states.

For lack of an apt analytical delineation, this chapter suggests that we could distinguish between first generation developmental states marked broadly by growth-orientation and the second-generation ones whose emphasis is to balance the priorities of growth and redistribution. The first-generation versions, rooted in List's prescriptions for Prussian modernization also characterized the development trajectories of Japan since the Meiji Restoration and the Southeast Asian

[4] On these contrasting perspectives see Adam Smith, *The Wealth of Nations*. London: Penguin, 1776; and Friedrich List, *The National System of Political Economy*. London: Longman, 1909. See also Alexander Gerschenkron, *Economic Backwardness in Historical Perspective*. Cambridge: Harvard University Press, 1962and Robert Wade, *Governing the Market*. Princeton: Princeton University Press, 1990.

economic development into the mid-1980s.[5] These economies had a unique state structure characterized by a stable, centralized government, a cohesive and competent bureaucracy, and coercive institutions. Through these institutions, the state played a strategic role in "governing" and steering markets in directions that produced primarily growth-oriented policies. With these relatively strong and insular institutions, these states had few redistributionists demands from society, enabling governing elites to mobilize resources and invest them in various industries for achieving high growth. As late industrializers, these developmental states were driven by the single-mindedness of catching up with the rest of the industrialized, forcing the collective mobilization of national resources to achieve these ends. Equally significant, first-generation developmental states created private business groups and conglomerates that worked closely with state elites to achieve its industrial goals; the private public partnerships in the formative developmental context hastened the growth-orientation, but it also led to marked levels of economic concentration. These states were also able to realize rapid industrialization because of the authoritarian and coercive policymaking context where people's voices in decision-making were muted. Authoritarianism insulated elites from the pressures of competing interests, lending coherence and competence to policymaking arena that permitted the strengthening of the alliance between business actors and state elites in policy formulation and implementation. As Peter Evans remarked, these states played developmental roles as custodians, midwives, and shepherds in the economy.[6]

The East Asian variants of first generation developmental states faced formidable challenges in the mid-1980s because of the inherent tension between bureaucratic efficiency and popular accountability and the excessive concentration of economic power in core institutions.[7] While these states had made considerable progress in rapid industrialization and fostered growth through aggressive export-orientation, their extreme insularity from popular pressures produced institutional sclerosis that began to undermine their efficiency. Furthermore, authoritarian developmental states became victims of their own successes: after helping to jumpstart their economies from rural to urban economies, they helped create constituencies with larger stakes in representative institutions and democracy. As Johns Minns remarks with respect to the demise of the South Korean developmental state in the mid-1980s: "The most important reason why the South Korean state was no longer able to carry out its plans for industrial development with anything like the old certainty or focus was its inability to control the burgeoning working-class movement. The sheer pace of industrialization created wage workers so fast that they overwhelmed the very considerable mechanisms of repression."[8]

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[5] Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy*. Stanford: Stanford University Press, 1982; Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization*. Oxford: Oxford University Press, 1989; Peter Evans, "Transferrable Lessons? Re-Examining the Institutional Prerequisites of East Asian Economic Policies," Journal of Development Studies 34, 6(1998): 66-86.
[6] Peter Evans, *Embedded Autonomy: States and Industrial Transformation*. Princeton: Princeton University Press.
[7] For analysis of the demise see Ziya Onis, "The Logic of the Developmental State," *Comparative Politics* 24, 1 (1991): 109-26.
[8] John Minns, Of Miracles and Models: The Rise and Decline of the Developmental State in South Korea," *Third World Quarterly* 22, 6(2001): 1032.

The second-generation developmental states stem from the Scandinavian experiences of balancing growth and equity concerns within the perspective of the post-World War II welfare states. Less driven by the necessity to catch up with the advanced capitalist economies, these experiences focused primarily on reconciling equity and growth objectives in circumstances where the labour movement and other social actors played a crucial part in the social democratic compromises around governance.[9] In democratic developmental states, there existed institutionalized partnerships between business and states elites for the realization of strategic goals, but these partnerships occurred alongside the building of democratic political institutions, particularly accountable and representative institutions. Apart from the legacy of welfare states, democratic development states in recent years have emerged from the increasing popularity of democracy and democratic governance in international policy discourse. Amartya Sen's idea about the role of freedom in the development process has underscored the importance of participation and individual choices for achieving optimum economic outcomes. Sen has also been a virulent critic of first generation developmentalism, contending that development as the expansion of freedoms should be compatible with development.[10] In looking at development in Mauritius, Richard Sandbrook has captured the essence of a democratic developmental state:

> "In principle, democracy is reconcilable with a developmental state. Not only may democratic politics motivate rulers to act developmentally, through strategies to enhance both growth and equity, but also their success in achieving growth and equity will help consolidate democratic institutions. Democracy may also augment the capacity of governments by generating legitimacy and improving administrative efficiency and rectitude through mechanisms of accountability. Finally, democratic institutions may enhance the autonomy of political and bureaucratic elites from capital in promoting equitable socioeconomic development."[11]

Peter Evans' concept of "embedded autonomy" and Gordon White's "consensual autonomy" are at the core of understanding the developmental state within the modern pressures and expectations for democracy. In development, state autonomy is important because an efficient and competent bureaucracy provides the vision and guidance to achieve national objectives. In a democratic setting, however, autonomous institutions alone cannot deliver developmental outcomes, hence the need for these institutions to be anchored in society. According to Evans, therefore, since the state cannot be detached from popular demands, it must be embedded in society, that is, "connected to concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and renegotiation of goals and policies."[12] Similarly, White contends that consensual autonomy may result from enhanced participation processes that not only binds

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[9] Mark Robinson and Gordon White, eds., *The Democratic Developmental State: Political and Institutional Design*. New York: Oxford University Press, 1998. See also Verena Fritz and Alina Rochal Menocal, "Developmental States in the Millennium: Concepts and Challenges for a New Aid Agenda," *Development Policy Review* 25, 5(2007): 531-52.

[10] Amartya Sen, "Democracy as a Universal Value," *Journal of Democracy,* 10, 3 (1999): 3-17.

[11] Richard Sandbrook, "Origins of the Democratic Developmental State: Interrogating Mauritius," *Canadian Journal of African Studies*, 39, 3(2005):

[12] Peter Evans *Embedded Autonomy*, p. 12.

accountable government leaders and bureaucrats to a widely-held strategic vision but also provide these leaders with the leverage against private firms in sustaining a social-democratic class compromise.[13]

Second generation developmental states are now the universal norm outside the few exceptions of China and Vietnam. In a sense, then, democratic developmental states are rooted in attempts to reconcile between efficient states and popular legitimacy; between technocratic competence and accountability, between autonomy and accountability; between common and competitive visions, and between private and public interests. States ably manage these demands through intricate institutional compromises that underlie the democratic process. More critical, in the search for these compromises, democratic developmental states depend on leaders that are both anchored in institutional frameworks and in the demands and expectations of society. Leadership is not only important in the articulation of national priorities and visions to achieve development objectives, but also to create the environment where major compromises among societal actors are negotiated. Understanding DFIs in South Africa development requires knowledge of the how the post-apartheid leaders have grappled with institutional compromises around the construction of a democratic developmental state.[14]

3. HISTORICAL CONTEXT AND TRENDS OF DFI's ROLE IN SOUTH AFRICA

Dynamic changes in South Africa's internal and external circumstances since colonial times shaped the place of public finance institutions in the economy. The export of gold and diamonds allowed South Africa's participation in the global economy while also domestically creating a symbiotic relationship between the public and private sectors. During apartheid, the weight of international isolation and sanctions forced the state to intervene aggressively in the economy through DFIs to promote growth and strengthen the policies of separate development.[15] For the apartheid state, DFIs, in close alliance with the private sector, were critical adjuncts to the state led goal of creating a racially based modern industrial economy and, in later years, the fortification of the economy against the effects of sanctions. In the post-apartheid era, DFIs have increasingly carved a niche in financing development objectives to correct the inequities bequeathed by apartheid.

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[13] Gordon White, Developmental States and Socialist Industrialization in the Third World," *Journal of Development Studies*, 21, 1(1984): 97-120.

[14] For an exhaustive discussion of the key issues see William Gumede, *Delivering the Democratic Developmental State in South Africa,* Midrand: DBSA Development Planning Division Working Paper Series No. 9, 2009; and Omano Edigheji, *A Democratic Developmental State in Africa? A Concept Paper*. Johannesburg: Centre for Policy Studies Research Report no. 105, 2005.

[15] For an overview of DFIs in history see Andrew Murray, Banking on the Rich: Development Finance South Africa," *Southern Africa Report,* vol. 14, no. 4, August 1999. For global comparative experiences see *The Growing Role of the Development Finance Institutions in International Development Policy*. Copenhagen: Dalberg Global Development Advisors, July 7, 2010.

The Land Bank

Of the five DFIs, the Land Bank is the oldest, created in 1912 as a rural and agricultural development finance institution. In the formative years of its establishment, the Land Bank played a role in supporting the development of commercial agriculture by white farmers. With long-term loans from the National Treasury, the Land Bank provided mortgage loans to bona fide farmers. Following the promulgation of the Marketing Act in 1936 that sought to promote price stability in agriculture, the Land Bank financed the farming input needs of farmers as well the crops from farmers. With the rapid growth in the financial base of the Land Bank, the National Treasury ceased funding it in 1959; subsequently, the Land Bank catered for its own long-term funding needs through issues debentures and promissory notes. In the post-apartheid era, the government saw the Land Bank as a critical institution to overcome the deep structural divide in the agricultural sector, particularly uplifting the incomes of black farmers. In 1995, the government established the Strauss Commission on Rural Finance to investigate how the Land Bank could promote the financing of both commercial farmers and the historically disadvantaged emerging farmers.[16]

To finance black farmers, the Land Bank established the Special Mortgage Bond for first-time landowners in the 1990s. The interest rate on these bonds was initially fixed at 15 per cent and later adjusted to 12 per cent. The amount that can be borrowed at this rate is limited to R250 000; clients who seek to borrow a larger sum must pay the normal Land Bank rate on the additional amount. As the only primary DFI working in agriculture and rural development, the Land Bank has expanded its mandate to provide financial services to small-scale farmers, agricultural cooperatives, and land reform beneficiaries, for which it has designed several new products. For instance, a finance scheme, the Micro-Agricultural Finance Initiative of South Africa (MAFISA), has enabled most rural farmers, particularly women, to have access to finance for their agricultural enterprises.

Since the 1990s, the Land Bank tried to be self-sustaining, but it has confronted several challenges that reversed its previous record of financial sustainability. As the Minister of Finance, Pravin Gordhan noted in August 2010, the Land Bank has been beset by:

> a parasitic and unethical leadership, lack of control systems, lack of accountability, poor business direction, poor corporate governance, leading to corruption and mismanagement, and lack of proper risk and credit policies . . . The Land Bank is living proof of the billions of rands that can be lost and the damage that can be done both to the institution and its capacity to assist those in need. There is a cultural change that is developing in South Africa. There are people who want to feed off an institution like the Land Bank, a public institution funded with taxpayers' money for the benefit of citizens, particularly the poor citizens of South Africa. The history of the Land Bank over the past few years shows how people who are only interested

[16] The Land Bank, *The Contribution of the Land Bank to the Development of the South African AgriIndustry*. Pretoria: The Land Bank, April 2008.

> in themselves, only interested in their own pockets and who have an opportunistic approach, can destroy these institutions. This is a culture that must be fought…Otherwise all public institutions that should serve the poor will be captured by the small elites to serve their purposes.[17]

Facing governance problems, the Land Bank lost most of its market share; in 2009, the Land Bank accounted for less than one tenth as much agricultural debt as South Africa's mainstream commercial banks. Many clients of the Special Mortgage Bond facility – many of whom are land reform beneficiaries– struggled to service their loans, forcing the Ministry of Agriculture, Forestry and Fisheries and the Land Bank to create a black farmer rescue programme in 2009 to prevent about 200 emerging farmers from having their farms auctioned off because of debt to the Land Bank.[18] In addition, the Land Bank has been criticized for primarily servicing its historic client-base --white commercial farmers. Emerging farmers and land reform beneficiaries have been paying considerably higher interests than their established commercial counterparts. After pressure from the National African Farmers Union, the Land Bank devised a scheme to provide low interest rates to emerging farmers for long-term mortgage loans. However poor clients, overall, are still receiving short- and medium-term loans at interest rates well above the prime bank lending rate.[19]

When it became apparent that the Land Bank was in financial turmoil, the government transferred it to the National Treasury in July 2008. As part of attempts to reverse course, the revamped Land Bank came up with a new development framework in 2008/2009 that seeks to contribute to making rural areas viable economic units by reducing unemployment, income inequalities, and rural vulnerabilities. Its development focus is primarily helping emerging and distressed farmers restore their financial and organizational sustainability. By leveraging partnerships with other development agencies and enhancing systems corporate governance, the Land Bank hopes to turn things around. To allow it to effectively implement its turnaround strategy, the Minister of Finance announced support for the Land Bank to the tune of R1 billion in 2009; it was also allocated a R750 million in 2010/11 financial year, a further R750 million in 2011/12 and R1 billion in and 2012/13.[20]

The IDC

The IDC was created in the 1940s as a vehicle to encourage industrial development. In the 1940s, it provided financing for industrial activities in the manufacturing sector. With South Africa facing threats of global isolation in the 1950s and 1960s, the IDC concentrated on investments in

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[17] Speech by Finance Minister Pravin Gordhan at the Launch of the Land Bank's Annual Report, 19 August 2010 (Pretoria: Ministry of Finance, 2010).

[18] Ibid. For problems that have confronted the agricultural sector at large see Mike de Klerk, "The Financial Crisis in South African Agriculture and Post-Apartheid Agrarian Transformation," *Canadian Journal of African Studies* 27, 3(1993): 361-79.

[19] Andrew Murray, "Banking on the Rich."

[20] "Land Bank Back on Track, Eyes Investors," *Bua News*, August 23, 2010, at http://www.southafrica.info/news/business/landbank-230810.html.

energy and natural resource beneficiation. With deepening isolation and economic sanctions in the 1970s and 1980s, the IDC invested in import replacement, resource intensive, and high-technology industries. In the post-apartheid period, the IDC broadened its mandate to include the generation of balanced economic growth; addressing the disparities created by apartheid; export promotion; and industrial development in the rest of Africa.[21] As a catalyst for sustainable development, the IDC identifies and supports opportunities that are not addressed by the market and provides risk capital to companies and individuals in partnership with the private sector. With 52 per cent of the asset base of South Africa's DFIs and through a wide array of financial instruments such as commercial debt (loans), equity (shareholding), wholesale and bridging finance, and venture capital, the IDC has played a strategic role in job creation and promotion of the economic prosperity. In its annual report for 2008/2009, the IDC noted that it had lowered the cost of job creation by 42 percent, from about R469 000 a job in the late 1990s to about R270 000.[22]

One of the core roles of the IDC since 1994 has been in financing emergent and historically disadvantaged entrepreneurs. Through leverage venture capital, loan finance, and equity, the IDC became central to the national objective of realizing black economic empowerment (BEE) and subsequently the broad-based economic empowerment (BBBEE). Toward this end, the IDC has designed several schemes and new products which offer risk sharing and low interest loans for BBBEE clients. The IDC's engagement with BBBEE include: facilitating ownership of businesses; ensuring transfer of skills to enhance management capacity and entrepreneurship; employment equity; procurement policies; and advancement of women in business. The support of BEEE also dovetails with the IDC's mandate toward small, medium, and micro-enterprises (SMMEs).[23] Although the IDC has diversified its financing base, there have been concerns that its investment base is still weighted heavily in favour of the traditional client base, particularly the Mining Energy Complex (MEC). A study of IDC financing between 1993 and 1998 revealed that despite the poor performance of MEC industries in creating jobs and generating export earnings, these industries received more than two thirds of IDC investments.

On the other hand, sectors such as agriculture, forestry, and fishing and SMMEs that are more effective in creating jobs received only 15 per cent of IDC finances. The study also found that IDC finances are unevenly distributed across the country, with the bigger proportion (40 per cent) devoted to the Western Cape, while poorer provinces (the Northern Province, the Northwest, the Northern Cape, and the Free State) got less than 7 per cent between them. It also revealed great disparities within provinces, with the former homelands doing worse. Of the total IDC loan portfolio of R2,741 billion dispensed to the Eastern Cape between 1993 and 1998, less than 1 per cent (R23 million) went to the former Transkei.[24] In attempts to improve on this record, IDC reported that sixty-eight per cent of its businesses funding in the 2008/09 were SMMEs, up from 56 percent in the previous period. In the in the aftermath of the global financial crisis in 2008-

[21] Geoffrey Qhena, "DFI Positioning: IDC Case Study," Sandton: IDC, November 23, 2006.

[22] Thokoane Tsolo, "Development Funding-Building Effective DFIs to Support Business Enterprises," Sandton: IDC, May 2009. "IDC Slices Job Creation Costs," *Business Report*, January 29, 2009.

[23] "IDC Pushes for more Support for Local SMMEs," *Business Report,* June 17, 2009.

[24] Andrew Murray, "Banking on the Rich."

2009, the IDC found itself at the centre of debate with some analysts arguing that the IDC should be used to rescue troubled sectors, while other suggested that sectors that are not competitive should not receive artificial and unsustainable stimulation.

The DBSA

The DBSA was created in 1983 by the apartheid government to promote and coordinate economic development in the homelands. After 1994, the bank was oriented more narrowly toward infrastructure financing. The DBSA Act of 1997 reconstituted the bank's mandate to provide "financial, technical and other assistance…with a focus in its investments activities on infrastructure funding broadly defined and with the objective of acting as a catalyst to maximize private sector access to opportunities in the provision of public funding."[25] The Act also stresses the promotion of economic growth and service delivery, human resources development, and institutional capacity in South Africa, southern Africa and Africa. These roles gained momentum since 2006, with an increased focus on project origination and engagement with government. In the five-year plan articulated in 2010, the DBSA prioritized assisting the government with funding initiatives to stimulate growth by municipal authorities and the health, energy, education, and rural development sectors. This plan is consistent with the government strategic priorities established after the Polokwane conference in 2007, including:

- Speeding up growth and transforming the economy to create decent work and sustainable livelihoods;
- Massive programme to build economic and social infrastructure;
- Strengthen the skills and human resource base;
- Improve the health profile of all South Africans;
- Build cohesive, caring, and sustainable communities;
- Create sustainable resource management and use;
- Build a developmental state including improvement of public services and sustaining democratic institutions.[26]

DBSA manages its funding and lending to generate a surplus that is, in turn, used in the pursuit of its developmental mission. As a self-financing institution, the DBSA has retained a strong balance sheet, and good international and domestic credit ratings, permitting it to leverage funds for various development projects. In 1999, DBSA obtained a credit rating from Moody's, the international rating agency, enabling it to borrow without government guarantees. In recent years, it has broadened its funding base by obtaining funding for its projects from foreign development agencies such as the European Investment Bank (EIB), the French, and Finnish development

[25] Cited in David H. Scott, "Strengthening the Governance and Performance of State-Owned Financial Institutions. Washington DC: The World Bank, Financial and Private Sector Development Policy Research Working Paper, August 2007.

[26] DBSA, "Ad Hoc Committee: Coordinated Oversight on Service Delivery," Presentation/Submission to Public Hearings, February 4, 2010. See also DBSA, "Report to the Minister of Finance: Action Plan Regarding Accelerated Investment by DBSA in Infrastructure Development," November 2010.

agencies. The bank has also introduced new instruments to encourage investment in infrastructure such as a range of guaranteed products, equity, venture funds, and dedicated development and capacity building funds. Abroad and at home, the DBSA has forged cooperative relationships with the world's principal development finance institutions and local commercial banks as part of its pivotal role in enhancing delivery on regional infrastructure financing and job creation.

Khula Enterprise Finance Limited

To meet the growing need for financing of emerging entrepreneurs and SMMEs, the Department of Trade and Industry (DTI) established the Khula Enterprise Finance Limited in 1996. Khula does not provide finance directly; instead, it lends through financial intermediaries and banks by providing collateral for small businesses applying for loans from commercial banks. Catering for loans of R10 000 and over, Khula has focused on market failures, particularly business startups, SMME expansion, and BBEE. In 2004, Khula announced that it had facilitated the provision of over R1 billion of credit to SMMEs and in the process created over 100 000 jobs. About 51 percent of disbursements benefited black-owned and black-managed enterprises, while 38 percent of companies that received assistance were in rural areas. Women-owned and women-managed firms accessed about 49 percent of the disbursed funds.[27] But Khula has barely met the escalating demands for small business financing in the burgeoning informal sector, forcing debates on whether it should become a retail financial institution that provides funds directly to the SMMEs instead of using intermediaries. It has also faced criticisms for using intermediary institutions which charge extra interest to sustain their businesses; because of this, Khula's loan recipients obtain credit at above the prime lending rate, threatening their enterprises and business expansion plans.[28]

To address some of these problems, Khula has been exploring the possibilities of becoming more entrepreneurial by directly financing some of its clients. In 2009, it created Khula Direct a facility to provide direct loans to about R3 billion to small businesses over the next four years. At the same time, Khula rolled up the South African Micro-Finance Apex Fund (SAMAF) for loans of R300 to R10 000; filling a financing void, SAMAF seeks to give hundreds of thousands of start-up business owners the boost they need to survive and thrive. To improve support to SMMEs, the National Empowerment Fund, the Industrial Development Corporation, the Small Enterprise Development Agency and Khula have developed an internal referral system to help small companies get proper, quick and relevant advice and assistance. Khula has also established joint venture funds with private enterprises that invest in start-up businesses.

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[27] "October Defends State Funders of SMMEs," *Business Report*, October 7, 2004.

[28] "Khula Turns around from R25m Loss into R9, 8m Profit," *Business Report*, September 26, 2008. "Proposal to Expand Role of Khula Provokes Controversy," *Business Report*, August 3, 2008.

The NHFC

The National Housing Finance Corporation (NHFC) was founded as a DFI in 1996 with the principal mandate of broadening and deepening access to affordable housing finance for the low to-middle income households. Given the serious housing backlogs, the NHFC is at the centre of government policy to facilitate sustainable human settlements and develop a housing finance market to low-income earners. Its target market in affordable housing covers households with total incomes of less than R15 000. There are, however, estimates that 60 per cent of NHFC funding goes to those earning less than R7 500. The NHFC flagship program is Breaking New Ground (BNG) that funds programs to upgrade and eradicate informal settlements. Since its formation, the NHFC has acted as a wholesale funder and risk-manager; it funds its activities at no cost or in the least expensive manner that translates into lower costs for funding to clients. Between 1996 and 2008, its capital base grew from R1 08 billion to R2 5 billion. In the State of the Nation address in 2006, President Thabo Mbeki announced the transformation of the NHFC into a bank, considerably expanding its mandate.[29]

The NHFC has aggressively sought partnerships with the private sector in providing funding to its target market. This is done mostly through co-funding arrangements with other financial institutions. More crucial, the NHFC has collaborated with the DBSA in easing the housing backlog across the country. For instance, in 2005, the NHFC announced that it had made between R200 million and R300 million available to housing projects in Cape Town while the DBSA had earmarked R1.2 billion for infrastructural projects in that area.[30] Building on their comparative synergies as DFIs, the two institutions have subsequently used integrated financing to fulfil the government's objective of upgrading informal settlements. Similarly, in November 2009, the French DFI, Agence Française de Développement (AFD) injected R225 million into the NHFC to fund low-cost housing and urban renewal projects in central Johannesburg.

4. SOUTH AFRICA's NEW GROWTH PATH (NGP) AND ITS IMPLICATIONS FOR DFIs

The New Growth Path (NGP) initiative was unveiled in 2010 to focus attention on job creation and equitable growth, perceived as the missing links in South Africa's economic development. The themes that dominate this initiative are: enhancing both social equity and competitiveness; systemic mobilization of domestic investment to create sustainable development; and social dialogue on encouraging growth and employment.[31] The NGP constitutes the latest initiative in South Africa's attempts at creating a democratic developmental state that balances the objectives of equity and growth against the backdrop of unresolved and polarized policy debates on the pace and direction of economic policy. Questions about whether the NGP is novel in conception or

[29] National Housing Finance Corporation (NHFC), "NHFC Fact File," at http://www.nhfc.co.za/content.asp?level1ID=3&level2ID=27

[30] "Joint Effort to Ease Housing Backlog," *Business Report*, February 7, 2005.

[31] *The New Growth Path: The Framework*. Pretoria: Ministry of Economic Development, 2010.

possesses new implementation tools are interesting to pose in a brief comparative examination of previous policy planks. A more accurate reading of the role of DFIs in the NGP also needs this comparative perspective.

At the heart of the previous development blueprints and visions such as the Reconstruction and Development Programme (RDP), the Growth, Employment and Redistribution Programme (ASGISA), and the Accelerated and Shared Growth Initiative for South Africa (ASGISA) were bids to stabilize macroeconomic aggregates and address a wide range of socioeconomic objectives.[32] More poignantly, these initiatives sought to evolve a common consensus and vision around overcoming the two significant legacies of apartheid's political economy: first, bridging the wide gulf between the first and second economies--one rich and well developed, the other poor and marginalized--and second, finding a compromise between a heavily concentrated and monopolistic private sector and a public sector that was confronted by pressures for redistributive ends.[33] How these conflicts were resolved in the past is significant in analyses of the achievements of the mandates of job creation and growth encapsulated under the NGP and the fate about the future of the developmental state.

The RDP, GEAR, and ASGISA captured the jostling about national vision(s) for development between the state and the private sector.[34] The public face of the state since the 1994 transition has been the Tripartite Alliance within the African National Congress (ANC). At one level, the alliance epitomized the need for political coalescence about national priorities that would enable policy makers to correct the ills of the past while forging a new future collectively. Incorporating COSATU and the Communist Party in the alliance was important given the centrality of labour in debates around equity and employment. On one hand, the alliance promised the inklings of a strong state with the courage and conviction to embark on a developmental path tempered by democracy and participation. Yet, by the same token, managing the diversity of the alliance presented obstacles to national visioning, particularly as the private sector and global forces started to contest the ability of the state to deliver its promises of delivering a democratic developmental state.[35] Ranged against the public sector with a priority focus on service delivery, job creation, and growth was a largely monopolistic private sector with considerable stakes in the old economic order. Once aligned to the apartheid public sector in setting development objectives, the 'new' private sector

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[32] Joachim Wehner, "Development Strategies in Post-Apartheid South Africa," *Africa Spectrum*, 35 2(2000): 183-92; Jesmond Blumenfeld, "South Africa's Post-Apartheid Dividend," *The World Today* 47, 1(1991): 3-7.

[33] For a summary of the post-apartheid economic policy debates see S. Terreblance, *A History of Inequality in South Africa, 1652-2002*. Pietermaritzburg: University of Natal Press, 2002; Ben Fine and Zav Rustomjee, *South Africa's Political Economy*. Johannesburg: University of the Witwatersrand Press, 2006).

[34] Adam Habib and Vishnu Padayachee, Economic Policy, and Power Relations in South Africa's Transition to Democracy," *World Development* 28, 2(2000): 245-63; United Nations Development Programme, *South African Human Development Report*. Cape Town: Oxford University Press, 2003.

[35] Patrick Bond, "South Africa's 'Developmental State' Distraction," Mediations Journal, at http://www.mediationsjournall.org/articiles/developmental-state-distraction; and Ben Fine, "Looking for a Developmental State," Alternatives International, September 12, 2007 at http//alternativesinternational.net/article1195.html..

gradually started to disengage from state policies that seemed to compromise market principles; its key actors were now willing to make compromises with the state if only the core planks of the capitalist state, particularly low wages and tolerance for unemployment, remained part of public policy.[36]

Over the years, reconciling the strains within the alliance and between it and the private sector invariably produced policy paralysis and incoherence that, combined with weak state capacity and accountability mechanisms, led to an operational environment that was not conducive to a consistent national vision. Thus, the public arena was overwhelmed by the competing demands between redistributionist goals on the part of government and the private sector that continually invoked growth to restrain the hands of potentially errant state elites. The additional pressures of South Africa's reintegration into a global economy that had moved decisively in the direction of trade liberalization and openness presented new challenges to the articulation of policy.[37] Compounding the problems of coherence was that the fact that national visions never went beyond the modesty of five-year plans, subjecting planning to the vagaries and precariousness of political business cycles and compromises.

The fractious debates that marked the transition from the triumphalism and enthusiasm of the RDP to the hard realities of GEAR symbolized the first substantive conflicts over policy embracing the questions of bridging the first and second economies and the tensions between the public and private sectors. The RDP was inaugurated as the basic policy framework in the early phase of the post-apartheid dispensation with explicit promotion of social goals of bringing better education, health care, housing, and other social amenities to the majority—the second economy. The RDP also proposed job creation through public works—the deliberate employment of jobs through building houses and provisions of services. Social measures to correct the pervasive legacy inherent in the second economy, however, competed against the equally germane priorities of promoting growth, attracting foreign investment, and the continuing the pattern of capital accumulation around the historically dominant Mining-Finance Complex (MFC). In the late 1990s, when the redistributionist and growth goals of RDP began to collide, the state came up with GEAR, ostensibly the "implementation" arm of RDP. Thus in 1996, the government pushed GEAR as a five-year plan aimed at strengthening economic development, broadening of employment, and redistribution of income, and socioeconomic opportunities in favour of the poor. GEAR's neoliberal vision was anchored on an annual Gross Domestic Growth (GDP) growth rate of 6 per cent as a motor of employment generation. However, GEAR's aim to develop a competitive, fast-growing economy through stringent monetary and fiscal discipline, conflicted with the RDP goal

[36] For analyses of the role of the private sector in the new dispensation see S. Terreblanche *A History of Inequality in South Africa*," and Patrick Bond, *Unsustainable South Africa*. London: Merlin Press 2002.

[37] On the impact of globalization see see Padraig Carmody, "Between Globalization and (Post) Apartheid: The Political Economy of Restructuring in South Africa," *Journal of Southern African Studies* 28, 2(2002): 255-75 and Bill Freund and Vishnu Padayachee, "Post-Apartheid South Africa: The Key Patterns Emerge," *Economic and Political* Weekly 33, 20 (May 16-22, 1998): 1173-80. [38] For a summary of this phase of South Africa's development see Padraig Carmody, "Between Globalization and (Post) Apartheid: The Political Economy of Restructuring in South Africa," Journal of Southern African Studies 28, 2(2002): 255-75 and Neva Seidman Makgetla, "The Post-Apartheid Economy," *Review of African Political Economy* 31, 100 (2004): 263-81.

of growth based on job creation, meeting people's needs, poverty reduction, and a more equitable distribution of wealth.[38]

The RDP-GEAR debates pitted social policy goals against economic liberalization and tight budgetary provisions, contributing to the fragmentation in the ANC alliance and the divisions over national visioning that have not disappeared since then. In his address to the nation in February 2001, President Thabo Mbeki acknowledged that there had been a net gain in employment between 1996 and 1999, but most of them had largely been in the informal sector.[38] Presenting the enormity of the problem, COSATU noted that GEAR, despite its name had "failed in term of economic growth, creation of quality jobs, and redistribution towards the poor…"[39] To address the emerging policy schisms, the Mbeki government came up with a compromise vision, ASGISA, following the 2004 elections to straddle the thin line between growth and equity through a policy of addressing poverty, underdevelopment and marginalization confronting the second economy. More boldly, ASGISA promised higher levels of growth and investment to halve unemployment and poverty by the year 2014.

One of the instruments for achieving this objective was to leverage the first economy to address the second economy through increased levels of public expenditure to develop small business and broad-based empowerment. But ASGISA also acknowledged the fundamental constraints, notably the poor performance of SMME in growth and employment generation, the shortage of skilled labour, and the weakness in capacity and leadership in policy development and implementation. By 2008, ASGISA's policy projections were under threat from domestic skepticism, but also the debilitating impact of the global credit crunch and world recession that whittled down infrastructure spending and government revenues.[40]

DFIs were caught in between the search for a functional blueprint that would narrow the gap between the first and second economies and a compromise among core actors and constituencies over internecine economic debates. During RDP, GEAR, and ASGISA, DFIs found themselves addressing both the demands of serving the first economy and jumpstarting the second economy. As they tried to find their institutional feet and mandates, DFIs became the centre of intraalliance and societal conflicts about prioritization and sequencing of the imperatives of growth and equity.[41]

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[38] State of the Nation Address of the President of South Africa, Thabo Mbeki: House of Parliament," Cape Town, 6 February 2001.

[39] Cited in Richard Knight, "South Africa: Economic Policy and Development," at http//Richardknight.homestead.com/files/sisaeconomy.html.

[40] For debates on the transition to ASGISA and its achievements see the Organization of Economic Development (OECD), *Economic Assessment of South Africa, 2008: Achieving Accelerated and Shared Growth for South Africa*. Paris: OECD, 2008.

[41] There have been contrasting ideas about DIFs and development. See, for instance, Draft *COSATU Position Paper for the Public Service Summit,* February 2009 which states that: "We must start the long overdue national debate on whether the strategies and investment mandates of the DFIs promote the five priority areas of government`s development programme - decent jobs, education, health, fighting crime and corruption and rural development. Or are DFIs still locked in the pre-Polokwane paradigm of trying to mimic commercial lenders, ignoring their obligation to finance development that benefits all our people, but often applying even more risk-averse strategies?"

Whether these operational conditions have changed hinges primarily on shifts in the content of the NGP initiative and the institutional actors converging around its articulation and implementation.

The NGP proceeds from the same premise as the previous policy platforms: that South Africa is one of most unequal societies in the world, creating a potentially combustible social milieu with implications for political stability and prosperity. Unlike previous documents, however, the NGP prioritizes employment creation or employment intensive growth primarily because of the recognition that the current levels of joblessness and inequality are unsustainable. The NGP identifies strong growth opportunities in the agriculture, mining, and tourism industries – the country's "natural strengths", with the potential to generate large-scale employment.

Unlike in the past, the NGP proposes policy stability and coherence underpinned by social dialogue to establish a consensus on long-run goals and a vision that address job creation over at a least a decade. With the target of creating five million decent jobs by 2020 (most of them created by the private sector), the NGP seeks to "use both macro and micro-economic policies to create a favorable overall environment and to support more labour-absorbing activities. The main indicators of success will be jobs (the number and quality of jobs created), growth (the rate, labour intensity and composition of economic growth), equity (lower income inequality and poverty) and environmental outcomes."[42]

DFIs will contribute to meeting the targets and benchmarks established by the NGP because the initiative has delineated the five "job drivers" for measuring progress and success: public investment in infrastructure; labour-absorbing activities across the main economic sectors; taking advantage of new opportunities in the knowledge and green economies; leveraging social capital in the social economy and public services; and regional integration in Africa. Most of the DFIs have explicit growth-employment mandates, a position that should enable them to assist in meeting the job targets. For instance, the IDC annually reports on how its investment goals such as loans for black empowerment have contributed to job creation. In recent years, the IDC has invested over R1bn per year into the clothing and textile industry which is labour intensive and has multiplier effects on other industries. As the IDC has increasingly shifted to a broad-based approach investment across the economy, its role in job creation has widened. In collaboration with Khula, the IDC has, in recent years, has introduced a multifaceted approach to assisting and developing SMMEs, which includes funding those with viable business plans, and providing technical support and training for potential entrepreneurs. Under the NGP, the IDC estimates that enhanced investment in the traditional mining sector can create 140,000 jobs by 2020, and 200,000 by 2030. Furthermore, because of its increasing focus on the green economy and industrial activities associated with it, the IDC will be important to job creation in this sector. Both the IDC and Khula will play job-creating roles in social economy initiatives.

Regarding financing economic activities to meet the job targets in both the domain of infrastructure and regional integration/spatial development, the DBSA has a comparative advantage. The NGP envisages the creation of 250,000 jobs a year until 2015 through investment in energy, transport, water and communications infrastructure, and housing. At the regional level, the NGP anticipates

[42] "The New Growth Path: The Framework."

the government aggressively using the DFIs to address backlogs in regional logistics, water and electricity infrastructure through an African Development Fund. Collaboration around regional investments is, in turn, expected to generate about 60,000 direct jobs by 2015 and about 150,000 by 2020. In the agricultural sector, the Land Bank, with draw from its experience of financing small holder agricultural schemes and commercial agriculture will be critical to meeting the NGP goals of 300,000 jobs in small holder schemes plus 145,000 in agro-processing.[43]

Because they help in developing, translating, and implementing public policy into tangible outcomes, the institutional roles of DFIs in the NGP will depend on how they have been incorporated in the articulation of the visions around the initiative. Clarity in the articulation of goals and problems is fundamental to defining successful implementation strategies. In the past, the transitional problems around redefining the mandates of some of the DFIs such as the IDC and DBSA plus the creation of new ones such as Khula and the Land Bank presented some obstacles in their ability to participate decisively in the conception and articulation of previous government policy blueprints. As these problems are gradually resolved and as public policy attains a measure of clarity, the NGP provides an opportunity whereby DFI mandates can be closely aligned with government policy objectives.

5. KEY STRATEGIC VULNERABILITIES AND CHALLENGES FOR DFIs

Bridging the first and second economies with the tools and resources available to DFIs presents the key challenge to meaningful development interventions. The expectations and demands about jumpstarting the second economy have not matched the resources available, creating a disjuncture that has hampered consistent public policy. Thus, DFIs have operated in the difficult circumstances of heightened expectations about their capacity to redress existing inequities and spur economic growth. These roles are made more difficult by the fact that some private sector actors often perceive interventions by DFIs as running counter to principles of sustainable economic viability. The competing ideological strains within the governing alliance have also compounded the policy context: while some alliance members have favored an unabashedly statist role that would transform DFIs into pivotal guides of the market, some took am anti-statist political line that increasingly affirmed the role of market forces in allocating resources. Only gradually did a policy compromise gravitate about the notion of DFIs as the mediators in partnerships between the public and private sectors for the purpose of creating a win-win ‘crowding in’ relationship. From this perspective, DFIs were aligned closely to objectives of meeting the demands of the largely second economy and pave the way for private sector investment in this economy, particularly the poor and disadvantaged areas. This broad operational environment has, in turn, yielded additional challenges that DFIs have faced:

[43] “The New Growth Path: The Framework.”

1. Lack of Clear Articulation of Public Policy

As indicated above, the initial policy frameworks such as the RDP, GEAR, and ASGIA reflected the tensions around the state's role in the economy and its relationship with the private sector; these tensions affected the positioning of DFIs as vehicles for development.[44] Lack of elite consensus on the pace and direction of change helped to produce an environment of crisis management, experimentation, and ad hoc decision making. Contributing to the lack of clear policy articulation was the limited time horizons for these policies. Underscoring the differences was the debate among core policy protagonists on whether DFIs should play a developmental versus neo-liberal agenda.[45] In the post-apartheid, the absence of coherence in policy articulation centred about the bifurcation of the policymaking context between conservative macroeconomic policies that marginalised the state versus activist state intervention to deliver social and economic services for poor and marginalized communities.[46] While these policy differences continue to dominate public discourse about the future, the NGP has tried to galvanize consensus about the significance of managing the national imperative of overcoming the structures of inequality by establishing links between growth and job creation. The NGP has also put a premium on forging a national long-term development vision and horizon to overcome the short-term nature of policymaking in the past.

2. Limited Collaboration and Coordination among DFIs

For a long time, the major DFIs have had overlapping and competitive mandates; consequently, their investment activities were not well coordinated toward a common development objective. Since they belong to different ministries (Treasury, Trade and Industry, Agriculture, and Housing) it is obvious that they would face coordination problems. In the apartheid era, the Department of Finance together with the DBSA played a quasi-commanding role in designing and regulating the development finance system, but there were severe limits in their ability to influence the policies and practices of other DFIs because of bureaucratic boundaries. The decision by the Jacob Zuma administration to create the Ministry of Economic Development and the Planning Commission in the Presidency are efforts to provide more coordination among the DFIs. It is also instructive that that the Ministry of Economic Development has established a task team on DFIs and State-Owned Enterprises (SOEs) to explore modalities of boosting the developmental impact of DFIs.

Equally significant has been the transfer of IDC and Khula to the Ministry of Economic Development from the Department of Trade and Industry. Before the transfer, there had been a marked proliferation of lending and investment instruments competing with the mandates of the two major DFIs—the IDC and Khula. Thus, the Khula model in the SMME sector inspired new DFIs such as the South African Micro-Finance Apex Fund (SAMAF) Apex Fund, the National

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[44] Geoffrey Qhena, "DFI Positioning: The IDC Case. "Pretoria: IDC, November 23, 2006.

[45] See for instance, Draft COSATU Position Paper for the Public Service Summit, 3rd version, February 2010.

[46] "MPs are Challenged by Development co-ordination," *Business Report*, November 3, 2004. See also Joachim Wehner, "Development Strategies in Post-Apartheid South Africa," *African Spectrum* 35, 2(2000): 183-92.

Empowerment Fund, and Ntsika.[47] Every year, DTI officials have faced harsh criticisms from parliament about maintaining its plethora of development institutions that did not know what the others were doing, making it difficult to correlate their functions. In turn, DTI admitted that harmonizing the many agencies to work seamlessly presented a formidable challenge.[48] With the transfer, the DFIs are expected to better contribute to the government's strategic plans, in particular the Industrial Policy Action Plan and the NGP. According to the Economic development Minister, Ebrahim Patel, all the DFs transferred to his new ministry would have to cut operational costs and become more efficient so that their funds reached the enterprises expeditiously.[49] During the State of the Nation address in February 2011, President Zuma proposed the merger of Khula and SAMAF, as well as the IDC's small business funding initiatives into a single small business funding body. In the agricultural sector, the Land Bank is competing for roles and resources with financial schemes such as MAFISA that have enabled most rural farmers, particularly women, to have access to finance for their agricultural enterprises.

3. Vulnerability to External Economic Shocks

As the 2007-2008 global economic recession revealed, DFIs are subject to the fluctuations in the global economy that limit credit and escalate the costs of raising finance in risk-averse markets. Under such tight market conditions, DFIs become even more risk averse, adopting management strategies which diminish the commitment to social and equity goals. The dilemma of global recessions for DFIs is that now they are expected to shoulder the increasing burdens of providing finance, they confront obstacles in raising capital from diminishing markets. Given DFIs vulnerability to oscillations in financial markets, there have been suggestions in South Africa for alternative models of financing for DFIs to guarantee financial sustainability such as leveraging government pension funds for developmental purposes. Since early 2009, there have been many voices advocating for the government to find ways of using the R1.5 billion in private and public pension funds for investment in development projects. Half of these funds (R 700 billion) would come from the Public Investment Corporation (PIC) that manages the public service's pension fund. But critics of using PIC funds for developmental aims have argued that such investments would undermine South Africa's financial stability and would be tantamount to forcing people to invest in low-yielding investments.[50] Because of threats of external shocks, most of the DFIs have been encouraged to aggressively raise money on the capital markets to boost their funding capacity, alongside recapitalization by the government. The IDC and NHFC have, for instance, been encouraged to enter capital markets to get loans using its balance sheets as guarantees.

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[47] "Proposal to Expand Role of Khula Provokes Controversy," *Business Report*, August 3, 2008.

[48] "MPs Turn their Anger on Trade Agencies," *Business Report*, March 7, 2005; "MPs come Down Hard on Development Bodies," *Business Report*, May 10, 2002.

[49] "Patel's Brief Cuts Across Departments," *Business Report*, March 5, 2010

[50] Terence Creamer, "South Africa Seeks to Remodel IDC on Brazil's Industry-Supporting BNDES," *Engineering News*, 23 October 2010. [52] Terence Creamer, "South Africa Seeks to Remodel IDC on Brazil's Industry-Supporting BNDES," *Engineering News*, 23 October 2010.

4. Mismatch between Static Mandates and Changing Policy Priorities

DFIs are guided by the broad mandates of correcting market and institutional failures, but their distinctive sector roles need to reflect the changes in government priorities and approaches. The refocusing of apartheid-era DFIs toward social concerns such as black economic empowerment, rural development, and SMMEs is an example of matching mandates to changing policies. Similarly, under the NGP, DFIs are reviewing their roles to meet the pressing needs of job creation and growth. Yet there is a general reticent by the government to transform DFIs into effective vehicles for industrial policies that would support the developmental state. This shyness stems from reluctance to step onto the toes of the conservative private sector and torpedoing the intricate compromise around private-public partnerships that undergirds the democratic developmental states. Recent discussions about creating a 'new IDC' modelled on Brazil's Banco National de Desenvolvimento Economico e Social (BNDES) reflects a potentially radical shift toward restructuring the IDC in the service of bold developmental goals. Through raising capital domestically and internationally, BNDES has contributed significantly to Brazilian industrialization.[52] South Africa is now contemplating building on this model to secure multiple sources of financing for IDC that would provide more additional financing for investment in the manufacturing sector.

The problem of duplication of DFI-related policy instruments could be resolved if the mandates of existing DFIs could be broadened to encompass new evolving agendas. For instance, rather than creating Khula and its sister institutions as specific tools for intervention in the SMME sector, the government could have expanded the mandate and resource base of the IDC as the principal institution toward this sector; promoting Khula and its affiliates perpetuates the marginalization of a sector that by all evidence is one of the leaders in job-creation.

5. Difficulties of Accessing DFIs by Target Communities

Despite the efforts made in reaching the target communities, DFIs have been roundly criticized for remaining inaccessible to poor people, weak, and disadvantaged communities. As Murray has argued: "Insufficient finances are being directed to poor clients and institutions for fear that their weak management capacities and questionable abilities to generate revenue will mean that many of them will default on loan repayments. Consequently, rather than servicing new clients to redress apartheid's socio-economic deficits, DFIs seem locked in established patterns that serve the interests of an historic and wealthy clientele, thereby reproducing patterns of uneven development."[51] In addition, most DFIs have yet to overcome their urban bias. Issues of

[51] Andrew Murray, "Banking on the Rich: Development Finance South Africa," *Southern Africa Report*, vol. 14, no. 4, August 1999; "October Defends State Funders of SMMEs," *Business Report*, October 7, 2004. **[54]** "MPs Unhappy about Snail's Pace of Black Empowerment," Business Report, March 9, 2001˙

[55] "MPs Come Down Hard on Development Bodies, *Business Report*, May 10, 2002; "MPs turn **their** anger on trade agencies," *Business Report*, March 7, 2005; "Wholesaler or Retailer, Khula will Still Deliver," *Business Report*, November 26, 2004.

inadequate access are tied to questions of levelling the economic playing field, risk aversions by DFIs in choosing where to invest, and the limited financial base of DFIs to satisfy the enormous investment needs. The debates over the reach and benefits of BBEE for instance, underscore some of the dilemmas of access. Although the IDC, Khula, DBSA (and other government financial institutions such as Ntsika, Umsombomvu and Isabaya Fund) have invested widely in BBEE, these investments have so far mainly managed to enrich only an elite few and failed the developmental agenda that the country aspires to.[54]

Unlocking the entrepreneurial energies of millions of South Africans is the core objective of IDC, DBSA, and Khula, but the resources are miniscule compared to the needs and are concentrated in very narrow sectors of the economy. For instance while Khula, IDC, and other state institutions substantially increased their loans to new entrepreneurs from R88 million in 1997 to R397 million in 2001, most of these were in the retail sector in urban settings.[55] In its 2005 development report, *Overcoming Underdevelopment in South Africa's Second Economy,* the DBSA stated that some of the interventions aimed at addressing the challenges of the second economy are reaching a small group of people who are usually entrepreneurial, bankable and experienced instead of the wider poor population. Apart from the absence of a coherent, scale appropriate strategy for the second economy, a fundamental shortcoming of current efforts is a tendency to design assistance in a way that does not suit the ordinary, poor person.[52] The Land Bank has similarly been accused of benefitting a few black farmers and failing to tackle rural unemployment and poverty.

6. Lack of Capacities in Implementing Agencies

DFIs are not immune to the wider capacity concerns that have bedeviled the South African economy, notably skills constraints in finance, auditing, engineering, and project management. Most discussions on building the democratic developmental state have decried the shortage of technical and managerial skills that defy the policy pronouncements. Lack of skills is inextricably tied to low and poor investment in quality education, a problem that perennially polarizes South African society. Although most of the DFIs epitomize high levels of professional competence, there is a glaring lack of institutional capacity in most implementing institutions such as municipalities, beneficiary contractors, emerging SMMEs, and small farmers. DBSA has, for instance, targeted skills development at municipal levels through programs such as the *Siyenza Manje* initiative to strengthen local government governance, infrastructure delivery and financial management. The program involves the deployment of young professionals in finance, engineering, project management, and town planning to municipalities to transfer skills and implement projects. But DBSA has also acknowledged the severe constraints on these capacity building interventions, particularly the high vacancy rates and high turnover of staff in key positions in municipalities that hamper the attainment of responsive, accountable, and efficient local government system local governance.

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[52] The Development Bank of Southern Africa (DBSA). *Overcoming Underdevelopment in South Africa's Second Economy*. Midrand: DBSA, 2005.

6. KEY STRATEGIC DRIVERSOF THE DFIs IN BUILDING SOUTH AFRICA's DEMOCRATIC DEVELOPMENTAL STATE

DFIs are catalytic pillars in the state's bid to overcome the structural shortcomings of skewed resource distribution. In seeking to overcome the flaws of the market, DFIs have been one arm of state intervention in the economy to promote growth and reduce inequities. Given the obstacles of dealing with the entrenched legacies of apartheid, particularly the heavy concentration of resources and the existence of narrow but powerful private sector, the state has proceeded cautiously about intruding on the market and market mechanisms. As a result, the DFIs have also taken a modest approach to their intervention in the economy, opting to build linkages with the private sector and other stakeholders to forge a tentative compromise between growth and equity goals.

This tenuous compromise has held largely because, in the perennial political battles over the direction of policy, pressures for a state with strong intervention proclivities and instruments have not triumphed. Instead, the dominant forces and voices have converged about a policy framework of state-market relations that conduces to the unique circumstances and constraints inherent in South Africa's political economy. As intermediaries that channel national savings into investment, DFIs have remained strategic actors in the democratic developmental state whose hallmark has been to gradually alter the structures of socioeconomic inequities through growth promotion. By 2009, it was estimated that the total combined balance sheet of all South Africa's DFIs was R142 billion, significant resources to make a difference in reducing the country's dire levels of poverty and unemployment. Even though DFIs are embedded in difficult contexts where policymakers have to continually make trade-offs, the key strategic drivers of DFIs in building democratic developmental state are:

1. Assisting in Continuous Policy Conception and Articulation

DFIs are a central component of the developmental state, lending it ideas, vision, and directions. Ideally, the functions of DFIs ought to fit strategically into the long-term development plans adopted by ministries and departments that house the DFIs. Nonetheless, independent of these institutions, DFIs can also articulate positions that contribute to policy formulation and conception. For a long time, South Africa's DFIs have operated without an overarching policy framework or coordinating body. This was attributed partly to the slow pace of harmonization of the mandates of long-standing DFIs and the new ones created after the end of apartheid. Old DFIs were handmaidens of the state and private sector, working to legitimate the apartheid state; new ones arose to mobilize resources to target poverty and inequalities. It has taken almost fifteen years to merge these distinctive roles into a consistent program centred on employment as a national priority. The absence of a central organizational framework provided DFIs with the flexibility and latitude to develop distinctive approaches to resource mobilization and intervention in the economy, but this is hardly sustainable where policy coherence and organizational synergies are ever more important in the construction of the democratic developmental state.

National visioning and priority setting are at the heart of plans for a coherent program of strategic thinking about development and its outcomes. DFIs benefit from broad national dialogues that resolve the dilemmas about the trade-offs between growth and equity, and those between short and long-term investments in specific sectors of the economy. In a democracy, national debates on development are also significant because they establish the parameters of accountability, responsiveness, and engagement by the citizenry in momentous questions. South Africa has over the last few years been involved in establishing national coordinating institutions that will involve multiple stakeholders in the articulation of long-term visions about development with consequences for the operational roles of DFIs. The envisaged Economic Development Institute under the Ministry of Economic Development will be a forum for DFIs to engage multiple stakeholders in government, the private sector, and civil society in strategic thinking and production of useful policy ideas.[53] In addition, institutions such as the DFI Council and the Planning Ministry in the Presidency are vital for the consolidation of efforts to strengthen long-term economic policy-making, planning, and coordination that has the support of wider society.

2. Coordination and Integration of Long-term Development Programmes and Financing Mechanisms

DFIs are critical in the search for systematic approaches to long-term planning and the search for sustainable financing mechanisms. All successful developmental states have channeled resources for development through DFIs. Although at the 2003 Growth and Development Summit business, labour, government, and community organisations agreed to target five per cent of investible funds into developmental areas and activities, there is wide scope to improve the development and employment yields of DFIs. In part, this commitment has not been met because of policy disagreements about appropriate instruments that combine prudent investment policy with development goals. In mid-20101, the IDC sought to overcome the policy paralysis about financing by issuing a R2-billion development bond; the bond was priced at highly beneficial rates; the funding that the IDC provided using the bond would fund businesses with labor-intensive operations that will create and save jobs. An equally vital contribution of DFIs to the developmental state is through the financing of public enterprises. South Africa is increasingly turning to DFIs to fund public sector infrastructural expansion programmes of SOEs such as Eskom, Transnet, and Airport Company South Africa (ACSA). All these enterprises have approached DBSA to help in financing their investments to increase capacity in renewable energy, rail, ports, and airport infrastructure. In 2009, the Transnet management announced plans to spend about R93 billion in the next five years on infrastructure development and called upon the DBSA to be involved in financing some of these projects. ACSA has also indicated a preference for DFIs because they have a long-term perspective. Apart from investment in sectors such as spatial planning, energy, transport, and water security where long-term perspectives are important, DFIs

[53] "Patel's Brief Cuts across Departments," *Business Report*, March 5, 2010; and "Ministries 'Must Work Together'," *Business Report*, June 10, 2009.

are important in helping SOEs in monitoring the development process across the medium-term budget cycles.

3. Promoting and Leveraging Private Sector activities

Traditionally, DFIs have mobilized and leveraged finance to support investment programmes that "crowd-in" the private sector and provide economic returns in the longer-term. In this respect, DFIs pave the way for private sector investment, creating a symbiotic relationship between public and private investment. In South Africa where investment capital faces severe constraints, DFIs have played catalytic roles through their collaboration with private sector investors to share financial risk while fostering the common good and maximizing social outcomes. In future, a strategic partnership between DFIs and banks and capital market funds are going to be key to leveraging development finance. Almost all the DFIs have established partnerships with the private sector actors from both the first and second economies. Since the inception of the BEE program, the government through DFIs has increasing relied on the private sector to help finance the programme on the premise that without a real partnership" with the private sector, little progress would be realized. Similarly, the NHFC, DBSA, and IDC have leveraged local banking institutions for strategic partnerships in meeting their development mandates.[54]

4. Integration of New Actors and Sectors into the Formal Economy

In bridging the divide between the first and second economies, DFIs are the key actors in the integration of new actors and sectors into the formal economy whether they be small scale farmers, homeowners, or SMMEs. Through financing small and medium-size enterprises, supporting micro loans to companies, often viewed as too risky by private sources of financing, DFIs target neglected areas, both in geographical and industrial terms. In the long term, however, DFI investments are only supposed to pave the way for private capital markets to meet the needs of underserved areas. In the housing and housing sectors, initiatives such as Breaking New Ground and have provided bridging finance that has contributed to bringing new taxpayers on economic board, broadening the tax bases of local and national government. Similarly, given widespread recognition that finance remained a serious challenge in stimulating investment in SMMEs, the IDC launched a strategy in 2009 that sees the importance of exploiting the immense opportunities for SMMEs in all industries, including manufacturing, tourism and agriculture. Moreover, with estimates that reveal that the SMME sector has potential to contribute up to 60 per cent of GDP and reduce unemployment by 5 per cent if more financial resources and support are channeled to the sector, the IDC approach is to aggressively assist and develop SMMEs, including funding those with viable business plans, providing technical support, and training for potential entrepreneurs.

[54] "State Depends on Private Sector to Finance Empowerment," *Business Report*, April 10, 2003.

In addition, although 75 per cent of IDC funding for SMMEs has been concentrated in Gauteng, KwaZulu-Natal and Western Cape, there are plans to target SMMEs in underserved provinces.[55]

5. Avenues of External Resource Mobilization and Partnerships

In the face of dwindling investment from local sources, DFIs serve as a one of the key avenues for mobilisation of external revenues. Over the years, South Africa's DFIs such as the DBSA have developed strategic partnerships with other international DFIs and funding agencies; the new DFIs such as NHFC are now only starting to tap into international sources of finance. Armed with high domestic and foreign currency credit ratings from Fitch IBCA, Moody's, and the Standard & Poor, the DBSA has been able to raise funds more cheaply, increasing its offshore portfolio to about 40 per cent.[56] Most of the DBSA's international credit lines come from the African Development Bank (AfDB), the European Investment Bank (EIB), the Japan Bank for International Co-operation, Nordic Investment Bank, and the French development agency, the Agence Francaise de Développement (AFD).[57] Through these partnerships, international actors have contributed to addressing the fundamental deficit in infrastructure in South Africa and many parts of Africa that limits access to basic services. Likewise, local institutions such as ACSA have leveraged these linkages to raise funds; in October 2010, ACSA announced plans to raise about R3 billion of the R5.5 billion from the DBSA, the AFD, AfDB. The latter has also co-funded the NHFC's project, International Housing Solutions (HIS) in Protea Glen, Soweto, and, in collaboration with the ABSA bank and the DBSA, invested in affordable housing, infrastructure projects and municipal services.[58]

6. Contributing to Institutional Capacity of the State through Training and Good Corporate Governance Practices

DFIs are critical in creating islands of efficiency, probity, and integrity that can then be replicated across all state institutions. Apart from the Land Bank that has faced severe governance problems including corruption and wanton misuse of public resources, most of the DFIs have had better stellar records of public resource management and strong corporate governance practices. As they have balanced the imperatives of profitability and social goals, DFIs have been forced to adopt managerial practices and standards that emphasize corporate governance and sound investment strategies. In this regard, DFIs have served to highlight the value of depoliticized bureaucratic

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[55] "Small Firms can Double their Input to GDP," *Business Report*, July 8, 2009.

[56] "DBSA Chair has R700bn Piggy Bank in his Sights," *Business Report*, July 6, 2010; The National Treasury, *Options Facing Development Finance Institutions: The case of the DBSA*, May 11, 2010.

[57] "EIB and DBSA to Fund Programme," *Business Report*, March 18, 2010; and "DBSA gets $100m to improve SADC infrastructure," *Business Report*, September 17, 2003.

[58] "AFD to Sign new Deals Worth R3.5 Billion," *Engineering News*, November 23, 2009; "ABSA, DBSA sign Deal to Fund Cheap Houses," *Business Report*, January 27, 2008.

institutions for efficient management and service delivery. The future of the democratic development state hinges on the enshrining the ethos and values of competence and efficiency that underpin DFIs. More directly, the mandates of accelerated skills training that DFIs are performing will become even more important to the success of their development objectives and capacity building in general.

7. KEY TOP TEN DECISIONS REQUIRED

1. Better Alignment with Government Policy

Alignment of DFI mandates with government policies hinges on the participation of DFIs in the articulation of these policies. In the past, only a few of the DFIs have had a major role in policy formulation; these roles, therefore, need to be broadened.

2. Institutional Coordination

Pending the creation of new coordination mechanisms such as the DFI Council, these institutions should explore more avenues for collaboration to reduce duplication of efforts and competitive mandates. Creating synergies around policy conception and implementation should not come at the expense of institutional autonomy; neither should it occasion bureaucratic turf wars. For instance, the DBSA and NHFC have collaborated to finance efforts to ease the housing backlog across the country. Such collaboration could be envisaged between the IDC and Land Bank to boost job-creation in rural communities.

3. Check the Proliferation of Financial Instruments

Institutional coordination across the DFIs is one way of reducing the multiplication of competitive financing instruments that have bedeviled, for instance, Khula. Where there are meagre financial resources to meet growing needs, the best approach is not to thinly spread them across agencies and thereby increasing administrative costs. DFI that can deliver services with reduced administrative costs are key to building the developmental state. Proposals for the amalgamation of Khula and the Small Enterprise Development Agency (SEDA) into an SMME development bank are driven by the fact that opportunities for sustainable SMME development have been lost by the failure of the two institutions to effectively work in partnership.

4. Reduce Dependence on Financial Markets and Broaden Resource Base

Although strategic partnerships with private banks and capital market funds have enabled DFIs to leverage development finance, dependence on these resources may be risky in the long run. This means that diversification of financing base is central to their sustainability. It is the responsibility of the government to enable the development finance system to gain a greater independence from private capital for long-term development projects.

5. Routine and Rationalized Engagement with the SOEs

DFIs have engaged the wide array of SOEs about financing of projects, but this should be more routine and rationalized. Often these two sets of institutions should be seen to play complementary rather than competitive goals in setting the pace of the developmental state. As DFIs compete with new external factors such as China and India in financing development projects, these engagements will become even more urgent and relevant.

6. Improving Access to Target Communities

Access to recipients and target communities remains a formidable obstacle in measuring the contribution of DFIs to creating quality and sustainable livelihoods. DFIs need to set annual and measurable targets in their areas of investment. The NGP's job-creation targets, for instance, provide a template that could be replicated by the DFIs in their various domains.

7. Broadening Local and External Linkages and Partnerships

The private sector and international DFIs are key allies that DFIs have engaged over the years. Broadening these linkages may be one way that DFIs share financial risks while maintaining their commitments to social mandates. The bulk of the private sector in South Africa has bought into the overall developmental objectives of inclusive economic growth, hence the importance of frontal approaches by the DFI to tap into their resources.

8. Better Managerial Accountability and Corporate Governance

DFIs need to demonstrate that there are leaders in integrity, professionalism, and accountability. Although the problems that have confronted the Land Bank in the past have illustrated the impact of poor governance and mismanagement in public institutions, other DFIs such as the IDC and Khula have faced instances whereby opportunistic individuals have hijacked public resources for narrow gains.[59]

9. Promote Cooperation with African DFIs

The IDC and DBSA have developed some working relations with African DFIs primarily because of their investments in Africa. But the rest of South African FDIs have not systematically engaged with Africa, including the Association of African Development Finance Institutions (AADFI about sharing ideas, best practices, and partnerships in development projects.

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[59] "Investigation Points to R3m Fraud Network at Khula," *Business Report*, April 9, 2002; and "Department Defends IDC over Mzigate," *Business Report*, July 19, 2003.

10. Supporting Regional Integration

As the NGP acknowledges, domestic job creation is intimately linked with regional integration. DBSA has played a dominant role in disbursing investments for infrastructure in the SADC region and beyond, but other DFIs need to follow the same path. For instance, in light of the growing global food demand and Africa's fertile agricultural land, the Land Bank needs to adopt a proactive agricultural investment policy in Africa.

8. CONCLUSION

DFIs are essential to democratic development states, permitting state intervention in the economy to reconcile the objectives of growth and equity. With the demise of authoritarian variants of developmental states, the dominant trend is for states to engage a wide array of other actors, particularly the private sector and civil society, to forge compromises about these objectives. In democratic developmental states, policymaking, for the most part, needs to reflect the intricate integration of the state and market. For this reason, DFIs are handmaidens of the state for the pursuit of long-term development; they are also critical interlocutors engaged in momentous questions about resource control and distribution. In South Africa, DFIs have gradually overcome the transitional teething problems of redefining their roles in the post-apartheid era. The transition problems have been difficult because of the overwhelming resource constraints, the enormity of inequities, and policy divisions about the state's role in the economy. These problems are, however, lessening with growing consensus on long-term development goals.