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The role of South Africa's state-owned development finance institutions in building a democratic developmental state

William Gumede, Melissa Govender and Kamo Motshidi 2011

Published by
Development Planning Division
Development Bank of Southern Africa
PO Box 1234
Halfway House 1685
South Africa

Telephone: +27 11 313 3048 / 313 3474
Telefax: +27 11 206 3048 / 206 3474
Email: lyns@dbsa.org / rosen@dbsa.org

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Abbreviations

ADB	Asian Development Bank
AsgiSA	Accelerated and Shared Growth Initiative for South Africa
BNDES	Brazilian Development Bank
BRICS	Brazil, Russia, India, China and South Africa
CDB	China Development Bank
DBJ	Development Bank of Japan
DBSA	Development Bank of Southern Africa
DFI	development finance institution
DMIC	Delhi-Mumbai Industrial Corridor
EBRD	European Bank for Reconstruction and Development
FINEP	Brazilian Innovation Agency
FMO	Netherlands Development Finance Company
GDP	gross domestic product
GEAR	Growth, Employment and Redistribution
IBK	Industrial Bank of Korea
ICT	information and communications technology
IDBI	Industrial Development Bank of India Limited
IDC	Industrial Development Corporation
IT	information technology
JBIC	Japan Bank for International Cooperation
KDB	Korea Development Bank
Nafin	Nacional Financiera
PAISS	Joint Plan to Support Industrial Technological Innovation in the Sugar-based Energy and Chemical Sectors
PIC	Public Investment Commission
RDP	Reconstruction and Development Programme
SME	small and medium enterprise
SMME	small, medium and microenterprise
SOE	state-owned enterprise

1. Introduction

South Africa's New Growth Path, released by Minister Ebrahim Patel on 23 November 2010,[1] highlights the crucial role of state-owned development finance institutions (DFIs) in creating jobs, raising shared economic growth and enabling pro-poor expansion of infrastructure. The contribution of DFIs has been under the spotlight after the recent global financial crisis, which led to stunted economic growth, heavy job losses and factory closures. There has also been renewed public pressure for increased service delivery, as well as the constant urgent imperative to accelerate equitable economic development.

In many economically strong and socially equitable states, DFIs have acted as catalysts for accelerated industrialisation, economic growth and human resource development. Examples include the Western European democratic welfare states, such as Germany and Sweden, or the first-generation East Asian developmental states, such as Japan, Singapore and South Korea. New-generation developmental states, such as China and Turkey, and democratic developmental states, such as India and Brazil, have shown that DFIs can play a crucial role in transforming the economy. In all of these success stories, the intervention of DFIs was usually 'game-changing', in that it dramatically scaled up the growth paths of these economies.

South Africa urgently needs to accelerate its industrial development and economic growth rates and expand its human resources capabilities. This is necessary not only to address the crippling economic and human development inequalities left by apartheid, but also to match the country's rapidly growing BRICS partners – Brazil, Russia, India and China. South Africa also has to compete with other emerging markets, while catching up with the established industrial powers of the West.

A number of reports have concluded that South African DFIs have yet to realise their full development potential (ANC, 2007; National Treasury, 2008). Unless they do so soon, they will be unable to act as catalysts in the industrialisation, growth and human development needed to scale up South Africa's growth path dramatically. This working paper aims to identify what South African DFIs could do in this regard, by looking at lessons from successful DFI catalysts in other developmental states. *Crucially, in all these successful economic transformations, the state provided the leadership, the long-term vision and the political will for the DFIs and state-owned enterprises (SOEs) to be game changers.*

2. The mandate of development finance institutions

Traditionally, development finance can be defined as the provision of finance to those projects, economic sectors or sections of the population that are not well served by the financial system as a whole (UN, 2005:11). In contrast to public finance, which funds

1 www.info.gov.za/view/DownloadFileAction?id=135748

non-revenue-generating public goods, development finance focuses on the provision of public goods on which full or partial cost recovery is possible. Development finance thus seeks to address financial market failures, and so complements both government resources and market financing.

According to the United Nations (UN, 2005:14), DFIs play at least five crucial roles in terms of addressing market failures. Their roles are as follows:

- Appraise the economic and social development impact of projects seeking financing;
- Accompany investors in the long run through long-term loans;
- Offer technical assistance to sectors essential to growth;
- Attract investors by facilitating financing operations; and
- Alleviate the negative impact of financial crises through countercyclical financing by offering loans, even during downturns, and pooling efforts with regional financing institutions.

The idea is that DFIs mobilise financial resources for developmental purposes through investing in markets deemed too risky for the private sector to enter alone, but which are essential for the growth of the broader economy (see, for example, Smallridge & De Olloqui, 2011). DFIs do so in partnership with the private sector, but initially carry most of the risk. Thus, they initiate sustainable development by supporting opportunities that are not addressed by the market, and by providing risk capital to companies and individuals in partnership with the private sector (Khadiagala, 2011). Once these markets are developed, the DFIs gradually withdraw and focus on developing other underdeveloped markets.

However, DFIs are now generally expected to address broader development policy objectives. These include addressing market failures, such as private sector development, employment creation, income redistribution, import substitution, the development of poor groups or regions, as well as developing new industrial sectors or boosting weak ones (UN, 2005). In fact, it can be argued that the role of DFIs in developing countries has gone beyond addressing market failure to, more broadly, addressing development failure as such (Gumede, 2008 & 2011).

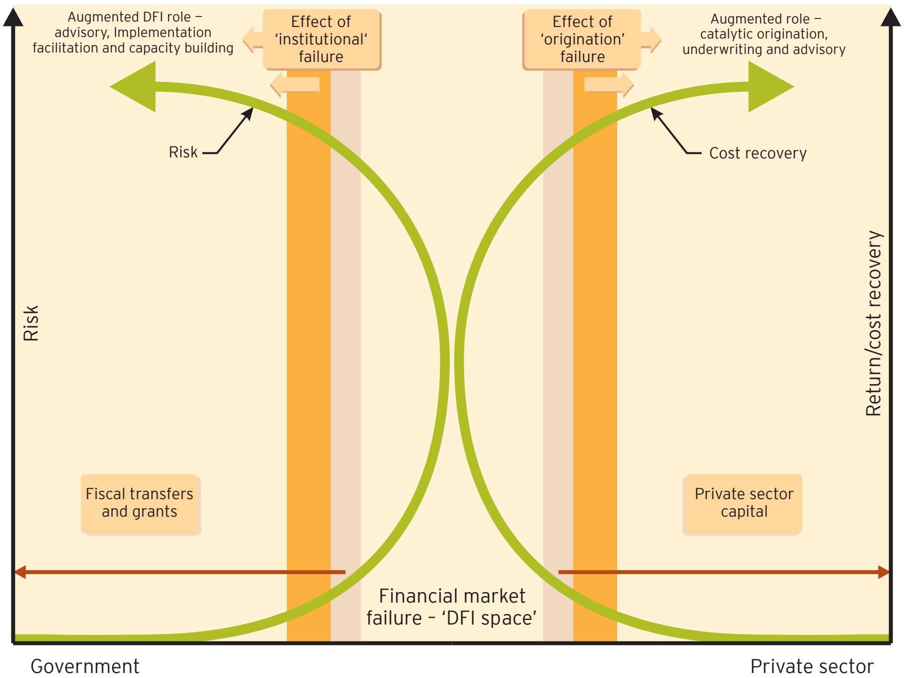
Development failure constitutes several key components of different types of failure (Scott, 2008; Gumede, 2008 & 2011):

- *Institutional failure* occurs when organisations do not implement the services for which they are responsible.
- *Capacity failure* is generally due to a lack of appropriate skills in the public institutions managing development.
- *Origination failure* arises when the public and market players fail to originate innovative ideas for development or to fashion an appropriate development vision, and are generally risk averse.

- *Information failure* exists when there is failure to overcome information asymmetry between the role players in development, which is necessary for coordinating investment between the private and public sectors.
- *Failure to facilitate strategic partnerships* means failure to establish a development partnership for growth between the public and private sectors.

The diagram below explains the impact of the development failures listed above on the financial lending model.

Figure 1: Key failures affecting development processes – cues for strategic intervention?



Note: Adapted by Scott (2008), this is an expansion on a 1998 diagram by BM Jackson, depicting the concept of financial market failure and the location of the intermediation gap, which defines a role for development finance.

3. The role of DFIs in successful developmental states

Successful DFIs do two things well: first, they perform their jobs as development finance institutions well, in that they finance development projects effectively. Second, they also play important roles, whether as facilitators, arrangers, ideas banks or financiers, in the broader industrialisation and economic development strategies of their countries. In some developing countries, including South Africa, DFIs may perform well in providing development finance, but be less effective in helping to fashion broader national development strategies and objectives.

The DFIs that have been most successful often go beyond what is expected of them and provide game-changing interventions that alter the growth trajectory of their countries.

Successful DFIs have accelerated industrialisation, economic growth and human development. The question South Africa's DFIs now face is: what kind of intervention will be 'game-changing' and irrevocably improve the country's transformation path?

The following examples illustrate selected interventions by DFIs in successful developmental states, which have fundamentally altered the growth paths of these countries. By examining the concrete steps such DFIs have taken to accelerate their countries' growth trajectories, inferences can be drawn as to how DFIs can ensure they meet their developmental mandate. The lessons to be learnt from these case studies will be discussed in the final section.

3.1 DFIs provide countercyclical lending

The Brazilian Development Bank (BNDES) exemplifies the vital catalyst role a DFI can play through countercyclical lending. BNDES has used this tool to great effect, not only to overcome the impact of the 2008–2009 global financial crisis but also to use the response to the crisis to turn around the country's economy. The Bank's countercyclical lending was aimed at creating new jobs; protecting existing jobs; expanding infrastructure, especially in underdeveloped areas; and building new industries. BNDES dramatically upgraded its credit lines, providing loans to finance private and public enterprises. These loans were mainly for infrastructure and long-term investment, but also funded regional development and circulating capital for small and medium enterprises (SMEs). BNDES loans are funded by indirect tax on goods and services. The loans are provided at subsidised rates that partly compensate for Brazil's excessively high interest rates. This credit facility reached 3.3% of the gross domestic product (GDP) during the peak of the global financial crisis and helped many firms to meet their need for circulating capital. The lack of private sector loans therefore did not affect Brazilian producers as much as it did producers in most other developing countries.

In the midst of the credit crunch caused by the global financial crisis, the Asian Development Bank (ADB) also applied countercyclical lending. It set up a US$3 billion fund to help member countries ramp up the fiscal spending needed to overcome the global economic crisis and sustain longer-term growth. Export-dependent Asia has been negatively affected by the decreasing demand for its goods, primarily from the United States and Europe. Moreover, with the global downturn deeper and longer than anticipated, economies in the region are likely to come under increased pressure. The ADB's Countercyclical Support Facility provides short-term loans faster and more cheaply than its existing special programme loan facilities (ADB, 2009).

3.2 DFIs provide an enabling environment for enterprise and industry

In Mexico, the development bank Nacional Financiera (Nafin), one of six Mexican DFIs, focuses on financing small, risky businesses at the start of the supply chain. It offers online factoring services to small, medium and microenterprise (SMME) suppliers. The programme

Cadenas Productivas (productive chains) works by leveraging the 'chains' that exist between big buyers and small suppliers. The big buyers are large, creditworthy firms with low credit risk, whereas the suppliers are typically small, risky firms that cannot access financing from the formal banking sector. The programme allows these small suppliers to use their receivables from big buyers to acquire working capital financing, thereby effectively transferring their credit risk to their high-quality customers in order to access additional – and cheaper – financing.

As of May 2009, the programme comprised 455 large buyers (about 51% in the private sector), more than 80 000 SMEs and about 20 domestic lenders, including banks and independent finance companies. Nafin has extended over US$60 billion in financing since the programme's inception in September 2001. The bank has also brokered over eight million transactions, of which 98% have been by SMEs, at a rate of about 4000 operations a day (World Bank, 2010).

3.3 DFIs identify and develop strategic and longer-term profitable sectors and steer long-term industrialisation

Many successful states have managed to diversify and upgrade their industrial base in the long term. Whether in developmental or democratic welfare states, DFIs have played a critical role in identifying potential future strategic sectors. They have steered long-term industrialisation by developing either new sectors or infrastructure generally.

Some countries have used proceeds from one dominant sector that may be nearing depletion to develop other, new sectors (Chang, 1998). Both Finland and Sweden developed new communications industries by leveraging the proceeds from other dominant resource sectors. Finland, for example, upgraded its pulp and paper industry to a papermaking machine industry. Sweden diversified from steel production into a formidable engineering sector. Other countries have built on natural resource endowments to upgrade and diversify into related industries. Norway, for example, has used a natural resource – oil – as a springboard for diversifying into related new industries (Chang, 1998).

Some of the new-generation developmental states have purposefully identified and developed new sectors with the potential for long-term industrialisation. In these states, DFIs have played important roles as financiers, partners, advisers, implementers and integrators (Scott, 2008:6). The Industrial Development Bank of India Limited (IDBI), for example, has been at the forefront of providing finance for industrial development in India. It has helped to identify the long-term growth potential of the country's information technology (IT) industry. The Indian government set up a national taskforce in 1998 to study the development of the IT industry and other priority sectors, with the goal of increasing their contribution to GDP (World Bank, 2010). As part of a drive to accelerate the information and communications technology (ICT) sector, support to institutions was established and managed; subsidised services were provided according to the strict framework set by the national strategy; human resources training and development were accelerated; and the cooperation of SMEs with larger research and cluster initiatives was promoted. New processes and products were designed, and businesses were trained by way of demonstration, participation and extension of technology. The IDBI was closely involved in all these activities.

In Brazil, BNDES has been heavily involved in financing the industrialisation of the economy to such an extent that, since 1950, not a single major undertaking involving private Brazilian capital has come about without BNDES support. Lately, the Brazilian government has identified renewable energy as a strategic growth sector, and BNDES has been a trailblazer in green economy initiatives by financing renewable energy programmes (NewNet, 2011). As the world's largest sugarcane producer, Brazil has the largest and most successful ethanol industry in the world, producing ethanol from home-grown sugarcane (Trusted Sources, 2009). BNDES has contributed greatly to this sector and has also partnered with Petrobras, the oil SOE, in building the country's sugar-based ethanol industry. BNDES loans are channelled into PAISS, the government's Joint Plan to Support Industrial Technological Innovation in the Sugar-based Energy and Chemical Sectors (Forbes, 2011). PAISS finances the production of biofuels from sugarcane biomass and ethanol. BNDES has further committed to providing additional financing, ranging from US$19 billion to US$22 billion, to fund growth in this sector up to 2014. This financial support amounts to approximately two-thirds of the industry's annual output (Riveras & Winter, 2011). BNDES has also offered US$1 billion (which almost matches America's budget for renewable energy research) to the Brazilian Innovation Agency (FINEP) to fund research and development into second-generation ethanol.

In identifying companies and projects to receive funding, BNDES pools existing companies in the sector and focuses on specific projects that advance ethanol biofuels, a process it refers to as 'consolidation in the ethanol sector' (BNDES, 2010). An example is the merger of two key companies in this industry, ETH Bioenergia and its rival Brenco, in a move supported by the government to prioritise the biofuels industry. BNDESPar will have a 16% stake in the merged companies. BNDES is the main financier and investor in the ethanol sector and supports relevant technological initiatives (BNDES, 2010). Research and development funded by BNDES have enhanced the processes involved in advancing Brazil's biofuel industry, which has also expanded into production using other natural resources.

The Korea Development Bank (KDB) and the Industrial Bank of Korea (IBK) have also played important roles in identifying new strategic industries. Once a new company starts production of a strategic product, the government places orders for the product and simultaneously restricts imports in order to protect the domestic market. The government has been quick to provide the private sector with credit, foreign exchange and subsidies. So-called policy loans are set at low rates of interest and are financed by development banks, using soft repayment terms. The development banks usually take equity in the new companies, but large private banks have also been compelled to make a proportion of their loan book available for these loans. Investment is financed by banks, with the government using finance from taxation, fiscal policy, tariffs and judicious foreign borrowing.

The Industrial Development Corporation (IDC), an integral South African DFI established in 1940, was instrumental in setting up companies such as Sasol, Foskor and Soekor. These companies were formed to create domestic industries that would supply goods likely to be unavailable from foreign sources because of World War II (Verhoef, 2010), as well as the international isolation of South Africa on account of its apartheid policy. In 1950, the IDC recognised the long-term value of commercialising coal-to-liquid technology and helped finance the establishment of Sasol, currently South Africa's leading chemical and liquid fuel company.

3.4 DFIs help expand infrastructure development

The positive effects of infrastructure on economic development are captured in the thesis of Albert Otto Hirschman (1958), who proposed the idea of 'social overhead capital' of the public sector (public investment in roads, energy, etc.), which supplements 'direct productive capital' of the private sector (factories, machinery, etc.). Hirschman argued that once social capital is invested, the 'quantity of public service which can be supplied by social capital often exceeds the quantity of demand, since social capital possesses economies of scale in most cases'. Such demand in infrastructure can only be revealed once the infrastructure is actually complete, and demand in this context therefore excludes potential demand (Yoshida, 2000:63).

This means that the invested social capital can provide the private sector with less expensive services and intermediate goods, and so raise the productivity of private sector capital. 'Social capital acts as a pump priming for expanded private sector investment, and in contrast, social capital relatively becomes lacking along with the expansion of private capital and productive activities. When this happens, the private sector's indirect production costs gradually increase and private sector capital input declines' (Yoshida, 2000:63). At this stage, the demand for social capital investment rises again and investment is boosted, with public and private sector investments balancing each other out. Most of the successful post-World War II developmental and democratic welfare states used infrastructure spending to boost economic growth, create jobs and develop underdeveloped areas. The rebuilding of infrastructure was the key difference in the recovery of Europe under the United States' Marshall Plan on the one hand, and that of Japan, South Korea, Taiwan and other East Asian countries on the other hand, who received aid from the United States and the World Bank after World War II (Yoshida, 2000:64).

In successful developmental states, infrastructure development goes beyond building transportation routes, for example, and is seen as a tool for long-term economic investment that is integral to a country's industrialisation. Infrastructure investment has the ability to stimulate demand in other economic activities (the so-called flow effect) and boost demand in other sectors (through the multiplier effect and the stock or production effect).

It brings new stock, which indirectly reduces the production costs of the private sector and hence increases productivity. Smart investment in infrastructure (Yoshida, 2000:79) can close the income gap and reduce poverty within and between countries, because poor areas and countries 'have a better chance of generating higher economic activities when infrastructure is available' (Abidin, 2010). Infrastructure projects have proportionally large multiplier effects, which can dramatically raise income. However, for infrastructure development measures in underdeveloped regions to be effective, they must be linked to 'other regional economic stimulus measures [to] complement the infrastructure investment and generate synergistic effects' (Yoshida, 2000:86).

This comprehensive approach to infrastructure development is often missing in less successful developing countries in Africa and elsewhere. The idea is that the investment in infrastructure will attract private sector investment and production based on the comparative advantages of the region with its new infrastructure. Thus, the infrastructure will 'yield indirect production effects through provision of adequate infrastructure services as intermediate inputs' (Yoshida, 2000:86).

In Japan, since World War II, the priority fields of infrastructure development were carefully planned in order to eliminate regional income disparities, and were adapted accordingly as the socioeconomic structures were transformed (Yoshida, 2000:72). There was a flexible demarcation of roles between the private and public sectors (DFIs and SOEs) in driving infrastructure development, with the emphasis on a partnership between the two sectors in pursuit of national developmental goals. Where the private sector had the capacity, for example, to roll out the trunk networks of national railways, it led the initiative with strong support from the government through DFIs and SOEs (Yoshida, 2000:85–6). Clearly, in a developing country, 'if a market is immature with little hope of the efficient participation of private sector resources and when the availability of infrastructure services are limited', public interventions are absolutely necessary (Yoshida, 2000:86). The emphasis is on providing universal and equal access to services. Generally, in cases where the public sector has driven the infrastructure development, once these infrastructure markets have been developed, private sector competition can gradually be introduced.

In East Asia, most of the fiscal stimulus packages to counter the effects of the global financial crisis have consisted of large investments in infrastructure, such as roads, ports, rail networks and basic needs, which included more efficient energy supplies, reliable water supply and sustainable environmental management (Abidin, 2010:1). The infrastructure spending has focused on boosting economically depressed and underdeveloped regions, either linking them to growth areas or turning them into growth areas that will become new markets for goods and services. In the process, employment opportunities were created. In all of these programmes, DFIs have played important roles both within countries and across regions.

In successful developmental states, DFIs are also at the centre of integrated planning for infrastructure. The role of an integrator is particularly important, 'mobilising and linking stakeholders, resources and initiatives' (Scott, 2008:6) and facilitating the integration of infrastructure development into broader economic development. DFIs do so by being the integrating connection in the infrastructure delivery system, linking different initiatives, resources, stakeholders and decision-makers in both the public and private sectors. In most unsuccessful developmental states, especially in Africa, infrastructure development has rarely been integrated into broader economic development. It often occurs on a standalone basis.

The Development Bank of Japan Inc. (DBJ) and the Japan Bank for International Cooperation (JBIC) are examples of DFIs that have effectively served as financier, adviser, partner, implementer and integrator in infrastructure delivery. They have played a significant part in facilitating the integration of infrastructure planning both in Japan and in the wider East Asian region. A case in point is the creation of the Delhi-Mumbai Industrial Corridor (DMIC). In this regional project, worth an estimated US$90 billion, the DBJ is performing the fivefold role, particularly that of integrator. This project will create seven cities along the DMIC, aimed at becoming manufacturing hubs that will contribute to India's economic growth and development (Construction update.com, 2011).

3.5 DFIs promote and support their countries' national interests in the international arena

China has demonstrated how it uses DFIs to promote Chinese businesses and its national interests. During 2009/10, the state-owned China Development Bank (CDB) and the Export-Import Bank of the Republic of China lent at least US$110 billion to governments and companies in developing countries, which is more than the World Bank lent in the same period. China's large-scale financial assistance to Africa, Latin America and Southeast Asia has been motivated primarily by a strategic aspiration to secure and transport natural resources, be they iron, coal, steel or oil.

As China extends its economic and political reach across various regions, its DFIs, businesses and SOEs are constantly able 'to influence economic policies in other countries to protect investments made by Chinese firms and to ensure that loans extended by Chinese banks are repaid' (Downs, 2011). For example, the CDB has played an active role in ensuring that the US$20.6 billion extended to Venezuela would be secured by the delivery of Venezuelan oil to the China National Petroleum Corporation.

The Chinese government has made effective use of its DFIs, business community and SOEs as a diplomatic arm in extending its economic power. For example, the US$5 billion China-Africa Development Fund, established in 2007 by the CDB to finance infrastructure, industrial and agricultural projects, also includes 'financing (concessional loans), grants, debt cancellations, and economic investments' (Lum et al., 2009). The primary mineral resources that China gains from these countries are oil and gold.

In an analysis by Erica Downs (cited in Lum et al., 2009), the CDB's 'cross-border deals provide Beijing with financial leverage over distressed borrowers to advance other Chinese interests'. This, according to Downs, is evident in the way the CDB uses its loans to promote other foreign policy objectives, such as supporting the international use of Chinese currency. China has therefore been very strategic in positioning itself as a source of finance for developing countries. Because of the CDB's involvement in Chinese international relations and cooperation, the government can now greatly influence the economic policies of those nations in which it has vested interests. Through agreements entered into between China and these states, the CDB has been at the forefront of advancing China's diplomatic agenda.

In Japan, the DBJ is commissioned to steer the country's economic development. Since its inception in 1951, the focus of the Bank has been on infrastructural and industrial development. The Japanese government and the DBJ have used the country's DFIs to increase exports to the region, thereby benefiting Japanese business. Since 1995, countries in the region have tended to obtain more of their technology licences from Japan than from anywhere else. In addition, all of them rely heavily on the technology embodied in machinery and equipment imported from Japan to run their manufacturing industries. Between 1992 and 1995, Japanese multinational corporations, supported by the Japanese government and the DBJ, transferred more than US$35 billion in foreign direct investment into Asia. Japanese banks also played a leading role as suppliers of capital to the region – in 1995 alone, they provided about US$9 billion in yen loans to countries in Asia (Hatch, 1998).

3.6 DFIs play a part in institutional capacity building

Given the extensive resources, both financial and human, at the disposal of DFIs, they are crucial in addressing capacity failure in public institutions that manage development. DFIs in developing countries have a critical role in boosting capacity in the broader public sector. Furthermore, DFIs are tasked with creating new markets and, given the general lack of skills in developing countries, they will also need to be involved in building the capacity of their clients – from project preparation to, in some cases, implementation.

DFIs in industrial countries, such as the Netherlands Development Finance Company (FMO) and the European Bank for Reconstruction and Development (EBRD), provide capacity to their project finance clients as a matter of course (Te Velde & Warner, 2007). They also offer capacity development support to the public institutions managing development. In South Africa, scaling up the role of DFIs in the economic development process will mean that these institutions will also have to scale up their capacity development initiatives to clients, as well as the broader public sector, to mitigate the increasing risks.

The Development Bank of Southern Africa (DBSA) provides targeted skills development at municipal level through programmes, such as Siyenza Manje, that strengthen local governance, infrastructure delivery and financial management. Siyenza Manje involves the deployment in municipalities of young professionals (it also sends in senior professionals/experts and twins them with young professional) in finance, engineering, project management and town planning, with a view to transferring skills and implementing projects. Having worked closely with municipalities, it was clear to the DBSA that incapacitated municipalities perform poorly. It therefore created the Vulindlela Academy to offer specialised and focused training and capacity development in the fields of infrastructure development and poverty alleviation. Its primary focus is on reducing capacity deficiencies in local government. This kind of initiative for addressing institutional failures will have to be scaled up dramatically, given the deep-seated institutional and capacity failures of institutions that are mandated to deliver public services, infrastructure and economic development in South Africa.

3.7 DFIs provide leadership in development coalitions

At the heart of most successful developmental states has been a cooperative partnership between DFIs and SOEs on the one hand, and between DFIs and the private financial sector on the other. It is essential to coordinate the application of private and public sources of finance in strategic investments, in order to achieve the country's development goals, promote structural change in the economy, and put the country firmly on a new growth path. For this to happen, there needs to be an enabling environment for both DFIs and private sector financial entities to support such strategic investments. DFIs are crucial in fostering such an enabling environment and in coordinating the process of establishing public-private partnerships for development or growth.

Korea's KBD and IBK, Japan's DBJ and JBIC, India's IDBI and Brazil's BNDES are clear examples of how DFIs take the lead in joining together public and private sector partners for development, whether for developing specific sectors of the economy, for infrastructure development or for long-term industrialisation. Indeed, these DFIs highlight how the private and public sectors can work together to address developmental challenges where the DFIs provide the facilitating leadership (UN, 2005:14).

3.8 DFIs serve as model corporate citizens

As part of their leadership role, DFIs in South Africa can serve as model corporate citizens and persuade the private sector to follow suit (Heath & Norman, 2004). They can, for example, provide better training opportunities for their employees, as skills development does not feature highly in the private sector. DFIs could employ more women, disabled persons and people from historically disadvantaged communities, where private sector companies do so reluctantly. Furthermore, DFIs could open up their supply chain to SMEs and provide them with greater procurement opportunities. In order to perform their leadership role with integrity, DFIs will have to be transparent and professional, and adhere to good corporate governance. Unless they do so, they will not have the credibility to lead the private sector to pool financial and other resources for development purposes.

4. Conclusion and recommendations

Successful DFIs do two things well: they effectively finance development projects, and they play an important part in the industrialisation and economic development strategies of their countries by extending their roles to include facilitation, organisation and idea generation. These successful DFIs have the ability to start game-changing initiatives that alter a country's national industrialisation, development and growth path. The examples cited above have shown some of these initiatives in successful developmental and other states. For South Africa to scale up its growth path dramatically will demand game-changing initiatives from its DFIs to address development failure.

The question is: which key factors may prevent South Africa's DFIs from effectively embarking on such significant initiatives? DFIs need to do the following in order to carry out their developmental mandate:

1. *Clarify the governance environment and rationalise some DFIs.* The mandates, functions and structures of DFIs should be reviewed in keeping with the changing demands on DFIs and the new requirement for DFIs to align themselves with national imperatives. Furthermore, their roles, functions and relationships with shareholders and oversight bodies will have to be refined. This will include reviewing the overarching policy and framework legislation, as well as strengthening oversight and corporate governance. The model of South Africa's DFIs is that of a diversified mix of specialised and niche-market national, provincial and municipal institutions. DFIs should be rationalised vertically and horizontally across the national and provincial spheres and, if necessary, some provincial and municipal DFIs may have to be merged. Many provincial and municipal DFIs have performed poorly on the enterprise finance side, and have failed to secure private finance and reinvigorate rural and/or underdeveloped regional economies.

2. *Align DFIs more tightly with broader national economic policy.* Most South African DFIs are not aligned with broader national economic policies, specifically national, sectoral, institutional and supply chain programmes. There should be particular emphasis on putting DFIs (in tandem with SOEs) at the centre of long-term development planning. However, note that, since 1994, there has not always been clarity on the role of DFIs in economic policy. Important policy frameworks, such as the Reconstruction and Development Programme (RDP), the Growth, Employment and Redistribution (GEAR) strategy and the Accelerated and Shared Growth Initiative for South Africa (AsgiSA), sent confusing and sometimes contradictory policy signals about the role of DFIs. The New Growth Path is much clearer. However, DFIs may have to be more proactive and provide the policy ideas for their roles with regard to the New Growth Path and the creation of a dynamic, democratic developmental state.

3. *Coordinate DFI activities.* More effective coordinating mechanisms for DFIs are needed to create coherence and better synergy between the activities of different DFIs. There should also be closer collaboration between national and provincial DFIs, especially where functions tend to overlap. The DFI Forum is an example of the kind of body

needed to coordinate DFI activities and avoid duplication and competition over scarce resources. Greater DFI collaboration on projects is urgently needed, such as that between the DBSA and the National Housing Finance Council on finance models for low-cost housing. As different DFIs currently report to different national departments, regular and formalised interaction between different national departments and their DFIs will help to improve coordination. The combined supply and procurement chains of both DFIs and SOEs should also be used more effectively to develop new markets, expand economic sectors and stimulate job creation.

4. *Ensure greater coordination between DFIs and SOEs.* There should be better coordination and alignment between DFIs and SOEs, and a greater effort to ensure that their investment activities are complementary. Such interaction should be formalised. Already, DFIs are increasingly funding the infrastructure programmes of SOEs, for example, the DBSA's involvement in Transnet's R93 billion infrastructure expenditure. Coordination should also take place at the level of the shareholder departments of DFIs and SOEs in order to maximise development impact.

5. *Boost DFI capacity to enhance development impact.* The capacity of DFIs will have to be enhanced considerably, which includes securing the best talent available, no matter the colour, political faction or ethnicity; and improving corporate governance, risk management capacity, the effectiveness of boards, and the capacity of shareholder departments overseeing the DFIs.

6. *Scale up countercyclical funding significantly.* The countercyclical financing by Brazil's BNDES to overcome the effects of the global financial crisis should serve as an example for South African DFIs. What is needed is better coordination of countercyclical financing responses. For example, the DBSA, the IDC and the Public Investment Commission (PIC) should coordinate their approaches in order to kick-start the economy.

7 *Provide integrated planning for the complex 'delivery system' of infrastructure*. DFIs are well placed to be centres of integrated planning for infrastructure, as infrastructure will have to be delivered both within South Africa and in the wider region. In Africa, most of the post-colonial infrastructure development has not been integrated into broader economic development. This has also happened in post-apartheid South Africa. In many cases, infrastructure development has occurred on an isolated basis, depending largely on who financed it, whether foreign donors or emerging market investors, such as China. The physical location of the infrastructure is often also based on the financier's decision, either to curry political favour by constructing a football stadium or a road to an airport, or to facilitate exports from the financier's investment outlets in the recipient country. DFIs are ideally placed to serve as integrators, financiers, advisers, partners and implementers in infrastructure development. Much of South Africa's infrastructure development since 1994 has focused on overcoming backlogs left by the apartheid regime. These efforts have tended to centre on individual and isolated infrastructure projects, which have often been run by different state departments.

There has also been little focus on maintaining infrastructure. Yet, the key to successful infrastructure planning is seen to be the provision of infrastructure as an integrated and synchronised system, designed to change the pattern of overall development. This would shape society positively through providing economic opportunities in the long term. In South Africa, DFIs – in combination and coordination with SOEs – will have to synchronise the eradication of infrastructure backlogs, the maintenance of existing infrastructure, and the long-term provision of infrastructure as a complete functioning system.

8. *Lead the coordination and enhancement of the relationship between the private and public sectors.* In successful developmental states, a partnership exists between the public and private sectors in which resources, especially finances, are pooled for growth purposes. DFIs, uniquely nestled between the private and public sectors, yet forming part of the public sector, have an important catalytic role in creating a developmental partnership for growth between the public and private sectors. DFIs can do this, first, by fostering an enabling environment and, second, by starting the process of creating a cooperative developmental partnership between DFIs/SOEs and the private financial sector, with the aim of speedily reaching South Africa's developmental goals. The DFI Forum is particularly suitable for bringing DFIs and the private financial sector together to plan how to collaborate in mobilising private, public and development finance for growth. For DFIs to lead the private sector in pursuit of joint developmental partnerships for growth, they will have to be credible – being good corporate citizens will provide such credibility.

9. *Innovatively mobilise new sources of finance for development.* Given the increasingly limited resources available for development, DFIs will have to become more innovative in mobilising resources, both locally and internationally. It may mean that DFIs should consider tapping into off-balance-sheet and concessional finance. The government may also be expected to play a more active role in providing equity and guarantees, allowing for dividend retention, giving tax exemptions and scaling up transfers. An option is to allow strong DFIs to hold selective deposits, such as those from municipalities. Another option is to replicate the funding model of BNDES and better leverage the assets of the PIC to enhance a broader development impact.

10. *Assist with capacity building within the state.* Currently, the implementation capacities of many institutions in infrastructure service delivery and of important role players in economic development and public service delivery are limited. The provincial and local government level, where much of the planning, facilitation and accommodation of economic development and growth ultimately take place, is particularly vulnerable. Unless these shortcomings are overcome, it is unlikely that rapid progress will be made in meeting developmental goals and objectives. DFIs may have to scale up initiatives dramatically to address institutional failures within the state, particularly at provincial and local government level. Lessons in this regard can be learnt from examples such as the ADB's intervention in India. DFIs will have to operate better as think tanks,

ideas banks and knowledge banks. They will have to analyse the country's developmental needs intelligently and proactively design scenarios to address these. DFIs are the repository of extensive skills, resources and research capacity, which should be better utilised for broader strategic policy analysis.

11 *Promote regional integration.* DFIs are pivotally positioned to promote regional integration efforts, which are crucial to the economic prosperity of the continent. DFIs will also have to lead the process of creating a continent-wide free trade area. South African DFIs should be more proactive in integrating local finance, donor aid and finance from emerging market countries into more long-term, sustainable infrastructure development, industrialisation and development of poorer regions. In East Asia, a tightly integrated regional DFI network ensures capacity building within DFIs in the region. The DBJ is also involved in the institutional capacity building of DFIs in Japan's neighbouring countries. For example, it has set up development banks in Vietnam and other poor neighbours. South African DFIs may have to play a similar capacity building role in the southern African region.

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