Developmental State Construction and Strategic Regionalism: The Continental Reach of South Africa's Development Finance Institutions

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Abstract

South African development finance institutions (DFIs) have extensive portfolios of projects they finance, with a remit that reaches beyond the domestic scene. Indeed, these DFIs are a product of history and have evolved to correspond to the country's postapartheid dispensation. In the past, South African DFIs were used to reinforce the political ideology of apartheid and its policy of separate development. Postapartheid DFI mandates have however changed significantly. They are not just instruments of the state's developmental agenda at the domestic level, but those also active in the region. We characterise this interlinkage of domestic developmentalism and regional orientation as strategic regionalism. The major focus of this article is to survey the role of South African DFIs in the African continent while also critically reviewing their relationship with the state's developmental paradigm and regional strategy.

Policy Implications

- Unforeseen fiscal challenges within South Africa might make it unsustainable in the medium to long term for government to capitalise the Development Bank of Southern Africa (DBSA). If it is to be a credible agency that has a wider reach in the continent, DBSA will need to be fully self-sufficient. This may mean it deepens partnerships with external sources, including tapping into sovereign wealth funds and other nontraditional financiers.
- There seems to be a degree of uncertainty about the future strategic direction of the Industrial Development Corporation (IDC). The government ministry under which the IDC falls is seen as highly controlling yet it lacks sectoral depth and possesses limited expertise on external economic relations. Better conceptual clarity is required as to how government positions the IDC as an effective DFI both domestically and regionally.
- South Africa's DFIs may generate negative perceptions in the region for historical reasons, in particular the legacy of apartheid, as well as resentment towards an economic powerhouse that is seen as increasing its dominance in the region. Because they do not have ownership of the DBSA, other countries in the region may even view it purely as a South African DFI rather than a regional (Southern African) vehicle for growth and development.
- There is a need for better clarity regarding the areas of impact that DFIs are expected to prioritise. There is, on the one hand, a push by the government to make them instruments for accelerating large-scale infrastructure development within South Africa by supporting the work of state-owned enterprises (SOEs) and to direct the DFIs' resources towards supporting industrial policy objectives. On the other hand, they are expected to be pivots that transform the African continent structurally. The opaque mandates may render them less agile in competing with external players such as China and India that are closing in on Africa's infrastructure space. Lack of sharp clarity on mandates, policy coherence from the government and better coordination between South African DFIs, SOEs and relevant government departments could create a competitive disadvantage for South Africa's DFIs in the continent relative to external actors.

South Africa has a diverse range of development finance institutions (DFIs) with different organisational structures and operational mandates. They also differ in the weight of their financial resources and the nature and scale of the projects they finance. There is, however, a common thread that defines them: they have assumed some centrality in South Africa's 'developmental state' objectives, particularly since 1994. In this article, we look at the external role of South Africa's two main development finance institutions, the Development Bank of Southern Africa (DBSA) and the Industrial Development Corporation (IDC) as illustrative cases of strategic developmentalism. Both entities are among the more strategic vehicles used by the South African government to promote itself as a developmental state that plays an active developmental and commercial role in the sub region and the African continent as a whole. This developmental positioning is contestable.

According to Pempel (1999), developmental states 'define their missions primarily in terms of long-term national economic enhancement' and 'they actively and regularly intervene in economic activities with the goal of improving the international competitiveness of their domestic economies' (p. 139). While the debates on the merits of South Africa as a developmental state (or not) are outside of the scope of this article, our broad observation is that the country is far from exhibiting characteristics similar to those that were present in most of the Asian countries that transformed themselves from economic backwardness to prosperity. Insufficient bureaucratic depth and weak convergence between the state and the broad array of societal interests undermines any claim to a developmental state character. Moreover, South Africa's conception of its developmental paradigm largely lacks coherence despite the evolving mandates of its DFIs.

Both the DBSA and the IDC have domestic and external mandates, which have changed over time since these two entities were formed in 1983 and 1940, respectively. Their objectives have changed similarly under the political guidance of various postapartheid administrations in South Africa. Some of the key signifiers of the postapartheid government's development programme to which the DFIs are expected to respond include: improving the overall performance of the economy to stimulate growth to reach the 5 per cent threshold; facilitating job creation; increasing public investment in infrastructure; achieving equity objectives; and providing more support to economic sectors that are prioritised by the state (Department of Trade and Industry, 2007; Economic Development Department, 2010; National Planning Commission, 2011).

However, the relationship between the DFIs and the government ministries under which they fall is not without its own discontents. While there is a fair degree of convergence regarding the pursuit of developmental objectives at the domestic level – especially those related to job creation and equity objectives – there are somewhat conflicting paradigms within the state, as well as between the state and the IDC in particular, regarding the precise objectives for external engagements. The IDC has for many years maintained an arms-length relationship with the state, something that has been changing in recent years. The DBSA, on the other hand, falls under the technocratic guidance of the National Treasury. Both DFIs have boards that, although approved by the relevant ministers, are expected to operate independently and conform to the country's corporate governance and regulatory frameworks.

Rationale and context for South Africa's development activism in the region

South Africa's apartheid regime adopted a strategy of aggressive intervention in the economy through DFIs in order to promote the development of Afrikaner capital. The objective was to industrialise itself through import-substitution industrialisation and, later, to build a cushion against international isolation. Achieving self-sufficiency while also pursuing the strategy of separate development among the different race groups in the country was uppermost in the government's calculation (see Lipton, 1986; Murray, 1999; Fine and Rustomjee, 1996). For the apartheid state, DFIs working 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, to the fortification of the economy against the effects of sanctions. In the postapartheid era, DFIs have increasingly carved a niche in financing development objectives to correct the inequities bequeathed by apartheid (Khadiagala, 2011, p. 6).

Therefore, South Africa's regional strategy takes its cue from the government's 'developmental' priorities, but with an awareness of the need to play a positive role in developing the broader Southern African Development Community (SADC) region and the continent. This is a thinking that is also crystallised in the country's foreign-policy strategic plans. South Africa's commitments in SADC, at least rhetorically, were evident at the cusp of democratic transition in 1994. The African National Congress (ANC), which is now the ruling party, then asserted that: 'in the long run, sustainable development in South Africa requires sustainable reconstruction and development in Southern Africa as a whole' (African National Congress, 1994, p. 119). Accordingly, the role of South Africa's DFIs post1994 should be seen, to a considerable extent, as deployment in the service of this objective.

One of the pillars of South Africa's foreign policy is what government refers to as a 'commitment to economic development through regional integration and

development in the Southern African Development Community and the Southern Africa Customs Union' (Department of Foreign Affairs, 2004, p. 18). South Africa's developmental credentials have not as yet gained currency among its counterparts in the region, some of whom still see the country as driven by the sole ambition of extending its economic dominance.

The appearance of a benign posture in foreign policy towards the region is largely informed by South Africa's own history of destabilisation in Southern Africa, and by the urge to be recognised as an African country after many years of isolation. Under apartheid, the South African government embarked on a systematic destabilisation campaign targeting specific countries that it deemed hostile and accused of harbouring armed militias of the ANC during the liberation struggle.

Countries such as Lesotho, Mozambique and Angola, which offered refuge to the ANC and were seen as launching pads for its armed wing, were particularly targeted by the apartheid government. As a consequence, these countries were faced with severe military harassment from the South African government. This military incursion by the South African Defence Force into neighbouring countries intensified between 1979 and 1983 (Davies and O'Meara, 1985). Economic coercion in the form of restrictions on the movement of goods and the disruption of infrastructure were some of the actions wrought by the apartheid government.

It is estimated that between 1980 and 1988, the total regional cost of South Africa's destabilisation in the region amounted to US$6 billion, measured in GDP losses, with about a million deaths and millions displaced (Ostergaard, 1990, p. 51; Lee, 2003, p. 46). This is said to have been about three times the gross external resource inflows in the form of grants, soft loans, export credits and commercial loans over a nine-year period (Hanlon, 1986; Ostergaard, 1990). For Angola alone, the cost of South Africa's aggression is estimated at US$1 billion in infrastructure disruptions and loss of economic opportunities (Davies and O'Meara, 1985). The systematic destruction of transport routes to Beira and Ncala in Mozambique forced countries to rely on South Africa for transit of goods, with the resulting net loss to Mozambique of about US$1.5 million in transit traffic revenue (Davis and O'Meara, 1985, p. 54). Essentially, South Africa restricted these countries' economic potential, and constrained their options for infrastructure development.

The twin pillars of developmentalism and strategic regionalism

South Africa's regional strategy post1990 shifted the tone substantially and placed emphasis on 'stabilising' the domestic economy and facilitating regional economic development as a stepping stone to deeper and more beneficial global integration. Beyond fulfilling its historic obligation and projecting itself as a benign development partner, South Africa sees the region in a mercantilist sense as a market that would absorb its products. It also sees it as a fertile avenue for South African corporates to expand their footprints. This could be characterised as a form of strategic regionalism. As Gamble and Payne (2004) point out, regionalist projects can be driven by a 'strategic trade view' (p. 52) that aims at creating competitive conditions for externally oriented regional firms (especially those from major countries). DFIs are thus seen in instrumental terms to fulfil South Africa's pursuit of strategic regionalism.

Of course, at the domestic level, the South African government views its DFIs as instruments with the objectives of: improving the quality of life of the citizens; enhancing public service delivery; increasing economic growth; improving infrastructure; and creating jobs. According to the Presidential Review on State-owned Entities (2012), these objectives are a central plank of a 'developmental state'. This repositioning of DFIs and state-owned enterprises (SOEs) does not necessarily imply coherence in government's core thinking about what it aims to achieve overall, but it is at least indicative of the general impulse of the country's development strategy. Strategic regionalism is a pillar whose ultimate utility is to promote the country's developmental objectives, for example by creating favourable conditions for cross-border commercial flows.

Since 2010, the IDC has been recalibrated to work within the political strictures of a government ministry, the Economic Development Department (EDD), which, along with the Department of Trade and Industry (DTI), drives the state's interventionist agenda. Accordingly, job creation has become the central aim in the IDC's core mandate, a shift from defining its development mandate in broad generalities and merely parlaying its investments for the purpose of realising high returns.

Further, the IDC is also expected to fulfil some of the goals set out in the New Growth Path (NGP) – a developmental strategy that is a brainchild of the EDD. The NGP was adopted as the centrepiece of government's development strategy in 2010, and is the defining kernel of South Africa's developmental state vision along with attendant policy instruments such as the industrial policy framework crafted by the DTI. There is no sense of central coordination of these plans. Instead, they compete for attention.

Underscoring the importance of the twin pillars of domestic development drive and regional strategy, the South African finance minister Pravin Gordhan identified economic competitiveness as one of the imperatives of government in his 2013 budget speech; in particular, he

stressed 'the need to invest in infrastructure, raise productivity, to diversify our economy, to create jobs and raise living standards' (Gordhan, 2013a). Furthermore, Gordhan (2013a) pointed out: 'Africa is our home, and it is our future. It is a market of over one billion people and it is growing rapidly'. He particularly highlighted the fact that the African continent accounts for roughly 18 per cent of South Africa's total exports, and nearly 25 per cent of its manufactured exports. While observers have often criticised South Africa's economic dominance in the region, Gordhan has hailed South Africa's investments in the African continent as 'mutually beneficial, as they support development in those countries, and also generate tax revenue, dividends and jobs both abroad as well as in South Africa'.

The DBSA in Southern Africa

The DBSA was established in 1983 to perform an economic development function within the constitutional dispensation of the time. Its developmental role under a democratic government became more enhanced, especially with the promulgation of the 1997 Development Bank of Southern Africa Act, which aligns its mandate to a new constitutional and economic dispensation. According to the National Treasury, the role of the DBSA is to promote 'socioeconomic development and growth within South Africa and in the Southern African region', and its primary purpose is to contribute towards sustainable economic development and growth, human resource development and institutional capacity building through tapping into public- and private-sector resources locally and abroad (National Treasury, 2012, p. 12).

The DBSA is regarded by government as a centre of excellence on infrastructure development in markets beyond the subregion. It raises its funding from domestic and international capital markets, and also receives allocations from the National Treasury. The funding model employed by the institution is made up of a mix of internally generated sources and borrowing from international and domestic capital markets, supplemented by credit lines from supranational and bilateral development finance institutions and commercial banks.

The DBSA also receives funding from external sources include from the Agence Française de Développement (AFD), the European Investment Bank, the German Kreditanstalt für Wiederaufbau (KfW), the Department for International Development (DFID) of the UK and the Japan International Cooperation Agency (JICA). More recently, the DBSA has signed a financing agreement with the EU to the tune of 100 million euros to support project preparation and fund infrastructure investment for the next three financial years from 2014.

There has been debate on the exact provision for local company participation in these arrangements. This is best summed up in a joint EU-DBSA statement on the funding model of the projects to be supported. The statement pointed out that funding would be 'directly linked to the priorities of the South African government, EU-SA priorities for cooperation, and the regional infrastructure strategy of the Southern African Development Community (SADC)'.

The main point to highlight is that projects are negotiated on a case-by-case basis, but would ordinarily be linked to DBSA objectives and interests. The loans are mainly granted to sovereigns. The legal structure of loan deals is particularly governed by the Public Finance Management Act (2012). It is important to highlight that while the bank has to align its policies and procedures with the government's code of good practice for broad-based black economic empowerment (BBBEE) in all its partnerships, for international DFI arrangements the policy is discretionary.

Regional support

Considering Southern Africa's vulnerability to exogenous shocks and the reality of a lack of organisational capacities in the SADC region, the DBSA's role in supporting investment shortfalls and project bankability has been vital. As of August 2013, the DBSA's regional project portfolio as managed by its International Finance Unit covered all 15 SADC member states: Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe. The Corporate Finance Unit and the Project Finance and International Investment Finance units provide products and services across South Africa and Southern Africa. The bank has a country-based engagement policy that is divided into three categories:[1]

1. Low-income and postconflict countries: this includes the DRC, Angola, Zimbabwe and Madagascar, and projects are aimed at maximising strategic development in those countries;
2. Countries with strong bilateral and multicountry projects: Botswana, Mozambique, Lesotho, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe; and
3. Countries with acceleration opportunities: Namibia, Lesotho, Zambia and Botswana.

Resources for regional projects are mostly mobilised through strategic partnerships with various regional and international partners. The South African government also considers requirements for the recapitalisation of the DBSA to help it manage its liquidity risk. An example of this is the recommendation in 2012 by the minister of finance to parliament that an amendment to the DBSA Act be made to increase its capital from the current US $480 million to US$2 billion (Development Bank of Southern Africa, 2012). In 2012 the Treasury recapitalised

the DBSA with US$240 million, a significant component of which was allocated for local socioeconomic development. In 2013, there was a further capital injection to the tune of US$790 million to last until March 2016. This was meant to bolster municipal lending, capacitate the infrastructure plans of SOEs and replenish the DBSA's regional lending activities (Development Bank of Southern Africa, 2013, p. 3). In addition, over the past two years, the DBSA has also received roughly US$2.9billion in loan guarantees from the National Treasury (National Treasury, 2014, p. 77).

Loan portfolio

In 2011–12, the DBSA approved projects to the value of US$2.48 billion. Of this disbursement, 61 per cent was for South-African-based projects, of which 44.4 per cent went to energy, 25.7 per cent to entrepreneurial and manufacturing activities and 11.6 per cent to communication infrastructure. This declined somewhat in 2012–13, with the DBSA making total disbursement of US$920 million to support infrastructure projects in South Africa and the SADC region. Of this total, 81 per cent was related to projects in South Africa and 19 per cent in the rest of the SADC. The DBSA is an active player in South Africa's renewable energy programme, and helps to offer equity financing to black entrepreneurs who want to participate in this programme. On power projects broadly, the DBSA has disbursed R5.6 billion in the past two years, with US $17.2 million earmarked for enterprises owned by black economic players.

The DBSA's exposure remains well diversified across a broad spectrum of sectors. The major sectors are energy, transportation, information and communications technology, and roads and drainage infrastructures. Moreover, it has expanded its sectoral partnerships and collaborates with other development finance institutions such as the IDC and the Public Investment Corporation, as well as with other SOEs. The National Treasury encourages the DBSA to cofinance infrastructure projects with the private sector.

In the 2011–12 financial year DBSA development finance support outside South Africa totalled US$380 million, increasing to US$580 million in the current period. In Angola, Mozambique and Zambia project approval amounted to US$290 million, with most of this directed at energy and transport sectors (Development Bank of Southern Africa, 2013, p. 20). Support also included a loan for the Kilwa Energy Project in Tanzania, a US$110 million loan for Banco BAI in Angola and a US$79 million senior debt facility signed for the expansion of the Nova Cimangola Cement Plant in Angola.

The Nova Cimangola project is considered the DBSA's largest commitment to Angola to date. The DBSA plays a lead role through its spatial development initiative unit in driving the Angola–Namibia–South Africa infrastructure development corridor with the main aim of improving Angola's infrastructure and increasing commercial activities between these three countries.

This project was agreed upon during President Zuma's much-publicised state visit to Angola in August 2009. This was a significant gesture, and the one that seems appropriate in light of South Africa's role in the destruction of Angola's infrastructure during apartheid. The minister of finance, Pravin Gordhan, noted recently during his medium-term budget speech before parliament that the DBSA provided almost US$150 million for road projects in Angola in 2013, and made commitments to fund US$300 million to energy projects in Tanzania and the DRC (Gordhan, 2013b).

The DBSA has also made commitments to the reconstruction of Zimbabwe by finalising disbursements of R464 million on the R1.4 billion loan to the Zimbabwe National Road Administration (Zinara). This is reported to be the DBSA's biggest commitment to Zimbabwe thus far. The DBSA also disbursed R1.3 billion to the National Road Fund Agency in Zambia for the rehabilitation of five priority roads along the North–South corridor, an infrastructure passage that encompasses East, Central and Southern Africa.

For cross-border infrastructure projects the DBSA's decisions take into account business criteria, particularly the bankability and attractiveness of projects. It also considers the 'strategic' importance of the projects, which could be interpreted to mean anything from realising major development spinoffs from large-scale and potentially profitable development projects to cross-border characteristics and linkages to industrialisation, to political preference for projects – especially where the South African government has made commitments to regional institutions. While the DBSA is ambitious about its involvement in the African continent, the agency will need to negotiate its role and effectiveness carefully given its ponderous mandate that straddles both the domestic and the regional spheres.

The expansive reach of the IDC

The IDC was established under the Industrial Development Act No. 22 of 1940. Its main purpose was to industrialise South Africa. In the past, it helped to pioneer the development of the synthetic fuels and chemicals industries in South Africa. It became one of the cornerstones of state-driven economic development during the apartheid years, extending support to Afrikaner businessmen and acting as a counter to what was at the time seen as the dominance of Anglo-Saxon capital (Feinstein, 2005, p. 75). The IDC's importance became even more salient

as South Africa began to experience economic isolation and was forced to become inward-looking in its development approach.

An important change came in the form of the expansion of the IDC's mandate by the Industrial Development Act of 1997, which served to widen its ambit. The new mandate enabled the IDC to extend to the rest of Southern Africa, allowing it to finance cross-border industrial development initiatives in the Southern African region and to promote the expansion of South African firms in this regard. This was done mainly to encourage regional economic integration and to support the growth of new markets for South Africa.

The IDC's mandate was further expanded by another amendment in 2001, which extended the geographical area that it could invest in to include the rest of the African continent. In short, the IDC is a key industrial development actor in the country and has the dual role of being both a financing institution and a development agency. The IDC's support role is varied, and includes both finance and nonfinance mechanisms. The main activities include providing development finance in the form of general debt, quasi-equity, equity and export–import finance (Industrial Development Corporation, 2012, p. 5). Because it is a developmental finance institution, its debt offering is on concessional terms and on a case-by-case basis.

The IDC has supported 41 projects across 17 African countries, approving around US$2 billion in funding between 2001 and 2010 (Industrial Development Corporation, 2012). Most economic activities are centred on the IDC's traditional areas of mining and tourism, although it has started to expand into industrial infrastructure, green industries and agro-processing sectors. One of the first and most successful ventures for IDC was the Mozambique Aluminium Smelter (Mozal) and the smaller Mozambique Cotton Textile Company (Mocotex).

The Mozal project was one of the IDC's first major ventures into cross-border investment. Despite successes in the continent and the increase in the number of projects it finances, the IDC's investments in other countries are still very small in comparison to the weight of its financing within South Africa: new investments in the African continent accounted for a mere 4 per cent of total portfolio financed in 2010–11. This is understandable given that the IDC's primary mandate is to support the industrial development of South Africa, especially in view of the low growth rates and high levels of unemployment within the country.

The IDC makes no requirements for the projects it finances outside South Africa to work with South African businesses. There is a broadly stated goal that IDC funding should make some contribution back in South Africa. However, depending on the type of project, there is a requirement for the participation of black persons or women as a precondition for support to South-African-based projects.

There is enormous pressure from government, in particular the economic development ministry, on the IDC to justify its financing in the African continent on the basis of the contribution this makes to job creation in South Africa, and its impact on growth. This pressure comes in various forms, including during mandated presentations before the parliament's portfolio committee on economic development, as well as during the minister's consultations with the leadership of the institution.

The job-creation link of these DFIs is also a core issue for government, where the last administration's five-year term also had difficulty in making DFIs drivers of job creation. Both DFIs have no objective criteria against which developmental outcomes can be measured in a robust manner. This then makes it difficult to undertake an accurate evaluation that directly links jobs or certain developmental outcomes to the initiatives of these two institutions. In this respect the government seems to be at odds with itself, especially since it has also set out an objective of increasing investment in infrastructure and building up supply-side capacities in the continent as a defining factor for integration and development. The DBSA faces the same conundrum, but to a lesser extent than the IDC.

Notes

The authors would like to thank Nokubulela Vuyo Lindani for research assistance.

1. See DBSA International Finance Information Brochure.

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