

**PROGRAMMATIC PROCUREMENT: A POLITICAL ECONOMY REVIEW OF
THE TRANSNET FREIGHT RAIL COMPETITIVE SUPPLIER DEVELOPMENT
PROGRAMME.**

By

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In partial fulfilment of the Master of Commerce, at the University of the Witwatersrand,
Johannesburg.

Word Count: 17 890.

DECLARATION

I declare that this thesis is my own unaided work. It is submitted for the degree of Master of Commerce at the School of Economics and Business Sciences, Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or to any other university.

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AYABONGA CAWE

ACKNOWLEDGEMENTS

This study would have not been possible where it not for the generosity of the Department of Trade and Industry, the Public Affairs Research Institute and Economic Research Southern Africa. Their grants and other forms of assistance and support have allowed me to undertake this work, and I hope this work bears testament to the commitment of these organisations to finding long lasting solutions to the socio-economic challenges faced by South Africa.

I would also wish to thank my two patient and committed supervisors, Nicolas Pons-Vignon of the Corporate Strategy and Industrial Development (CSID) research programme at Wits University and Sarah Meny-Gilbert from the Public Affairs Research Institute. I also wish to thank my interview respondents who were generous with their time and insights which formed an integral part of this study.

Lastly I wish to dedicate this study, to my parents, Mzwabantu and Ntomboxolo, whose encouragement and support, I will always treasure. I certainly hope that this study is a small reflection of the efforts and sacrifices that you have made for your children to achieve what they have. May your children shine on humanity's stage and make their contribution as you have always wished.

TABLE OF CONTENTS

1. Introduction	
2. Transnet and the Competitive Supplier Development Programme(CSDP)	
2.1 A Brief History of Transnet Freight Rail.....	
2.2 Supplier Development: From NIPP to CSDP.....	
2.3 The South African supplier industry.....	
3. The South African Legislative and Policy Framework on Public Procurement	
3.1 Procurement as a system.....	
3.2 The Legislative and Policy Framework.....	
3.3 The PFMA and other oversight issues.....	
3.4 The DTI Rolling Stock designation.....	
3.5 National Treasury Instruction Notes on Rolling Stock Procurement.....	
4. Empirical Analysis of Primary Research.	
4.1 Research Findings and Primary Insights.....	
4.2 Tensions between Transnet's own manufacturing capability and other industry players.....	
4.2.1 Issues around the competitive climate (or lack thereof) in the local supplier industry.....	
4.3 Internal and external tensions around the developmental state.....	
5. Recommendations based on Research Findings.	
5.1 Governance Agencies.....	
5.2 Firm Structures	
5.2.1 Challenges in the local supplier industry-global OEM nexus.....	
5.2.2 Firm Structure Recommendations.....	
5.3 Towards a growth-enhancing political settlement	
5.3.1 The organisation of the ruling coalition in the CSDP.....	
5.3.2 The new political settlement: a developmental evaluation methodology?	
5.3.3 Programmatic vs. Transactional Procurement: a new praxis?.....	
5.3.4 Parting reflections.....	
6. Concluding Remarks.....	

A Political Economy Review of the Transnet Freight Rail Competitive Supplier Development Programme.

7. Annex:

Bibliography.....

Table of Figures

Figure 1.1 South African Manufacturing Value Added (MVA) 2002-2011.

Figure 1.2 South Africa Trade Balance 2001-2013

Figure 2.1 South African Capital Formation as a component of GDP 1988-2011.

Figure 2.2 South African GDP growth rates between 1988-2011

Figure 2.3 NIPP to the CSDP

Figure 2.4 Union Carriage and Wagon Production figures 1960-2012

Figure 2.5 The CSDP strategic approach

Figure 3.1 The evaluation of the bidding process.

Figure 3.2 The designation thresholds set by the DTI for the rolling stock sector

Figure 3.3 A list of designated rolling stock components.

List of Tables

Table 3.1 Primary and secondary objectives of Public Procurement according to the South African constitution

Table 4.1 A few successful CSDP transactions

Table 5.1 Transnet Internal Stakeholder Management.

LIST OF ABBREVIATIONS AND ACRONYMS

ANC	African National Congress
BBBEE	Broad-Based Black Economic Empowerment
BEE	Black Economic Empowerment
BU	Business Unit
CPO	Chief Procurement Officer
CSDP	Competitive Supplier Development Programme
CSIR	Council for Scientific and Industrial Research
DPE	Department of Public Enterprises
DST	Department of Science and Technology.
DTI	Department of Trade and Industry
EXCO	Executive Committee
GDP	Gross Domestic Product
GEAR	Growth Employment and Redistribution Macroeconomic Framework
IDC	Industrial Development Corporation
IPAP	Industrial Policy Action Plan
MDS	Market Demand Strategy
MEC	Minerals Energy Complex
NIPF	National Industrial Policy Framework
NIPP	National Industrial Participation Programme
NPM	New Public Management
OEM	Original Equipment Manufacturer
OPCO	Operations Committee
PPPFA	Preferential Procurement Policy Framework Act
SD	Supplier Development
SOE	State Owned Enterprises
TFR	Transnet Freight Rail
TRE	Transnet Rail Engineering
UCW	Union Carriage and Wagon

CHAPTER 1: INTRODUCTION.

1.1 Background

Procurement policies in a country like South Africa have been targeted as a vehicle to achieve a range of social objectives. Public procurement allows the government to combine two functions, that of a purchaser in the market, and at the same time regulating the market through the use of its purchasing power to achieve social justice (McCrudden, 2004).

This study aims to analyse some of the dynamics underpinning the use of public procurement as an instrument for industrial development. This will be done by looking at the case of Transnet Freight Rail's (TFR) locomotive stock renewal programme. The R35 billion programme, as part of Transnet's R300 billion recapitalisation programme is part of an ambitious seven-year strategy to boost rail capacity, and it has suffered several delays as a result of a fight between the Department of Public Enterprises (DPE), Transnet and the National Treasury over the evaluation criteria for the multibillion rand bids. These delays have serious implications for the country's rail capacity which has not received significant investment in the past two decades. The lack of investment in rail capacity has constrained the country's ability to benefit from the resource boom of the early 2000s (Nicholson, 2012).

Moreover this programme forms part of the government's R 4 trillion infrastructure roll-out plan led by the Presidential Infrastructure Co-ordinating Commission, which is aimed at unlocking employment and growth in the South African economy. The DTI has seen the reindustrialisation of the South African economy, in particular the resuscitation of the manufacturing sector, as a key to tackling persistent unemployment. In this regard, the DTI as part of the many iterations of the Industrial Policy Action Plan (IPAP) identified the procurement of rolling stock as one of the designated areas for localisation.

Therefore, Transnet's Competitive Supplier Development Programme (CSDP) which Transnet argue, lies at the heart of the request for the relaxation of evaluation criteria must be seen in the same light. The delay on the part of TFR and the DPE is largely informed by the need to incorporate supplier development provisions into the evaluation criteria. In particular, the two institutions aim to draw out more socio-economic benefits for the local supplier industry in the state-owned enterprises' capital expenditure programme.

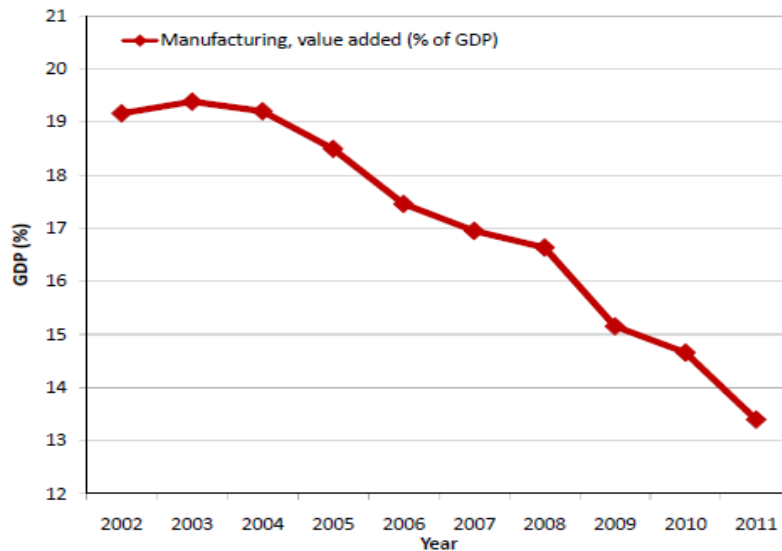
The CSDP, fully aware of the manufacturing capacity and expertise lost as a result of decades of underinvestment, aims to ‘localise the supply chain of imported manufactured goods or imported services to a reasonable level while promoting local industries and South Africa as an off-shore site of choice for OEM’s and multinationals procurements personnel’ (Transnet, Transnet Supplier Development Plan , 2008, p. 5). Moreover the CSDP aims to ‘increase economic growth, employment creation, skills development and broad-based black economic empowerment (BBBEE)’ (Transnet, Transnet Supplier Development Plan , 2008, p. 6). The study therefore aims to interrogate the effectiveness of the CSDP in terms of providing the adequate incentives to encourage learning and industrial upgrading in the local supplier industry. Additionally the study needs to assess the CSDP’s proposed measures that would assess the success or failure of the programme in delivering on some of its aims and objectives. The study aims to use the delay in the multibillion rand bid as a justification for assessing the potency of the assertions that the CSDP will bring both the commercial and socio-economic gains envisaged by the DPE and TFR. By doing this the study aims to illuminate the state-private sector relations that underpin large-scale public capital spending in South Africa ,and how the state’s regulations and policies alters the behaviour of other social actors, in particular local industrial interests.

1.2 Overview of the Literature

Manufacturing as an engine of development.

Manufacturing as Nicolas Kaldor (1978) argued, has special properties which make it an important sector in any nation’s attempt to achieve economic development. The characteristics of manufacturing that make it an engine for growth and development are its dynamic economies of scale, strong backward and forward linkages with other sectors of the local economy, strong properties of learning by doing, innovation and technological progress (Tregenna, 2011). An added feature of manufacturing, is its ability to deal with balance of payments challenges, which normally beset developing economies like South Africa, as **Figure 1.2** indicates.

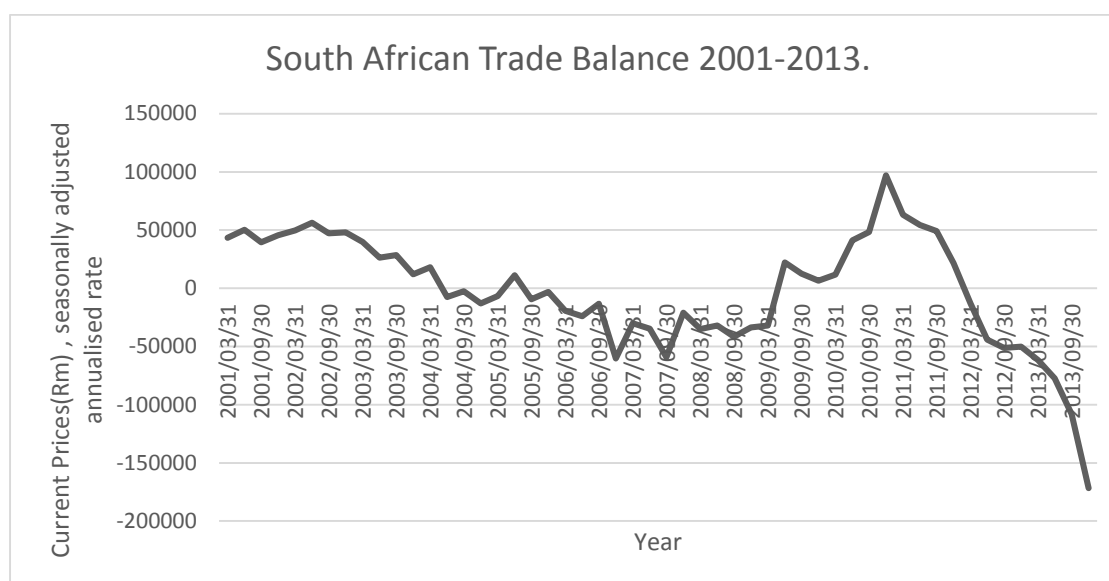
Figure 1.1 South African Manufacturing Value Added (MVA) 2002-2011.



(Source: Quantec EasyData, 2013).

These balance of payments challenges make it difficult for South African importers of consumer and capital goods, to procure these goods, as a lack of tradable exports (of which manufacturing is often a significant part) leads to a weakening currency, which makes these imports much more expensive. This has implications for inflation and domestic prices, and ultimately the quality of life, of those, whose consumption rests on imported goods.

Figure 1.2 South African Trade Balance 2001-2013.



(Source: Quantec EasyData, 2013).

In particular, as it relates to Transnet's supply chain and capital goods manufacturing in particular, Walker (2006) argues that there are various reasons why the development and growth of the local capital goods and service sector should be promoted and developed in the case of South Africa. Firstly, the developmental aspect of capital goods manufacturing lies in the 'know-how' embedded in the final manufactured product. This intangible 'know-how' created in the product development process provides the opportunity for application and transfer of the acquired knowledge into other related and unrelated, but technologically similar, activities along the value chain (Walker, 2006) (Amsden, 2001). This process facilitates the emergence of new high tech industries, thus further spurring on the virtuous cycle of innovation which lies at the basis of development (Schumpeter, 1934).

Secondly a vibrant local capital goods industry provides a competitive edge to the industries which buy its output as inputs. The productivity improvements associated with competitive suppliers, not only improve output, but an innovative supplier industry also gives the underlying industries downstream, the necessary cost-savings to commission new plants and/or projects with significant employment and output gains (Walker, 2006). This can only be possible through technological progress in the manufacturing processes of the supplier industries. The flourishing of such a virtuous innovative environment in South Africa has been stalled by a low level of SOE investment and anaemic levels of capital formation in South Africa generally (see Figure 2.1). Similarly, Tregenna observes that, decreases in the rate of capital formation lead to a decline in the share of manufacturing, since a

disproportionately large share of capital investment expenditure is dedicated to manufacturing (Tregenna, 2011).

Lastly, and more importantly, manufacturing has large employment multipliers. Walker argues that although capital goods manufacturing requires advanced skills and technology, the manufacturing of machinery and other activities incidental to capital goods manufacturing such as component manufacture and fabrication further down the supply chain are labour intensive (Walker, 2006). Walker goes on further to argue, that while competitively priced inputs, a skilled workforce and reliable services are important factors at firm level, the success of the sector is determined by the strength and stability of local demand, and the ability of the local supplier industry to meet the end-user's requirements in a competitive and cost effective manner (Walker, 2006)

Industrialisation and Deindustrialisation.

Many scholars, have written about industrialisation. A recurring theme amongst many of these writers, is the representation of industrialisation as a transition from an agrarian system of production and exchange, towards an industrial economy characterised by innovation and technological process. The West Indian scholar, W.A Lewis, was one of the first scholars from a developing country, to write of the experience of industrialisation from that vantage point. Using data on long-term demographic trends he argued that as land resources and the primary sector would reach their capacity point due to larger populations, non-agricultural opportunities had to be created in the manufacturing sector (Lewis, 1953). This population problem was earlier highlighted by British economist and scholar, Thomas Malthus, who argued that population growth would quickly outstrip the existing stock factors of production such as land, and this presented a long term limit on human progress. Lewis' argument on the role of manufacturing in absorbing surplus labour from the countryside supports the emphasis placed by Kaldor on manufacturing as an engine of growth and industrialisation. In particular, many of these scholars highlighted the importance of state investment.

Rosenstein-Rodan (1943) argued, assuming the indivisibility of demand, savings supply and an indivisible production function, that a 'big push', in the form of large investments is integral in pursuit of economic development. More importantly, Rosenstein-Rodan argued that economies of scale and thus industrial progress, could only be achieved with investments

in social overhead capital. Social overhead capital refers to investment in basic infrastructure such as power, telecommunications and transport networks, which are needed before any accompanying private sector industrial investment is made. Rosenstein-Rodan argued that such investments needed to be made in one fell swoop, in order to ‘crowd-in’ private sector investment. This ‘crowding-in’ thesis is also shared by Lewis in his essays on Caribbean Industrialisation, and outlines the thinking which informed much state development thinking in most of the 20th century.

Neoclassical analyses on economic and industrial growth, focus on the market or sphere of exchange whilst assuming that the price mechanism is the best allocator of resources. The neoclassical tradition, which favours neither industrialisation nor state intervention in the economy, argues that countries all lie on the same production function and should simply settle on the appropriate level of their capital/labour intensity according to their factor price ratios and areas of comparative advantage (Jayanthakumaran, 2000). Neoclassical analysis here, are compared with the protectionist ‘infant industry’ industrialisation model, and other import substituting models which in essence ,according to neoclassical theory, interfere with the ‘perfect’ functioning of the market. Erik Reinert (2012) argues, that neoclassical theory represents a return to the colonial postulates of David Ricardo, which argues that what a nation produces , be it industrial technology or subsistence agriculture, do not matter. Furthermore, the theory assumes full employment of resources (which is seldom the case in developing countries), and the perfect mobility of factors of production between countries. The neoclassical analysis also views state intervention, as inefficient and market distorting. However, recent developments in neoclassical literature on development highlight the importance of market failures in undermining the classical trade postulates put forward by Ricardo. Justin Lin argues that, having taken into account the reality of market failures in undermining the ‘perfect’ assumptions made by the neoclassical tradition, there is scope for state intervention aimed at removing binding constraints to facilitate private sector market entry into industries where there is a comparative advantage (Lin, 2011). Lin draws a distinction between two kinds of state intervention, firstly policies that facilitate structural change by overcoming information, co-ordination and externality challenges, and secondly policies that protect some selected firms and industries that defy comparative advantage, as determined by the existing endowment structure. Lin favours the former, and is very critical of the latter, in a sense making a case for industrial policy that is in line with the Ricardian trade theory discussed above.

Fine and Rustomjee (1997) outline the particular experience of state-led industrialisation in South Africa's economic history. It is an industrial strategy, captured in the term the minerals-energy complex (MEC), and built around an import substituting model. This industrialisation effort, particularly during the Apartheid years, was characterised by heavy tariffs, preferential purchasing and the creation and backing of 'national winners', who in many instances comprised of state owned enterprises (SOEs) (Barnes, Kaplinsky and Morris, 2003). The South African experience of industrialisation in the post-war period, rather than being marked by a shift from primary economic activity to secondary manufacturing, has been about the creation of a state sector around heavy industry, rather than being linked to a strategy of diversification away from primary activity in mining and agriculture. This analysis of industrialisation contends that South African industrial progress in most of the 20th century has not signalled a departure from, but active and supplementary support of, the economy's primary extractive sectors in particular.

Deindustrialisation refers to declines in the share of manufacturing in employment and output. This is depicted graphically in **Figure 1.1** which illustrates the South African situation between 2002 and 2011. Tregenna (2011) analyses the question of deindustrialisation by decomposing changes in the level and share of manufacturing employment. The results of the study indicate, that in most developed countries a decline in manufacturing employment is normally associated with rising productivity

Deindustrialisation usually occurs at higher per capita incomes as the surplus labour from manufacturing is absorbed into the services industry. Tregenna then argues that deindustrialisation in developing countries like South Africa is premature as it occurs at low per capita incomes. Moreover, in line with earlier thinking, Tregenna argues that these decreases in manufacturing are as a result of a decline in overall capital formation, of which manufacturing expenditure accounts for a significant portion (Tregenna, 2011). Beyond being a problem of anaemic levels of investment, Tregenna points to the fact that deindustrialisation in developing countries is a problem associated with policy shifts towards trade and financial liberalisation rather than the maturation of their economic or productive structures. As a result of these challenges, it becomes difficult for local manufacturers to build up lost production capability because of the following micro-level factors inter alia;

- Loss of market share
- Fixed capital

- Loss of networks in input sourcing and output markets
- Skills
- Tacit knowledge and other institutional qualities that are built over time (Tregenna, 2011).

Alice Amsden also notes that domestic efforts aimed at industrialisation or reindustrialisation need to focus on transforming formally acquired knowledge into tacit knowledge through, ‘learning by doing’ as opposed to a theoretical understanding of how industrial capabilities can be improved (Amsden, 2001). This however, becomes difficult in a context where such capabilities have been lost, or need to be acquired from scratch, and the state is required to facilitate such learning by providing the enabling conditions for this to occur.

Difficulties emerge, in an international market structure that has been dominated by low-cost producers in labour intensive sectors, making re-entry or re-industrialisation difficult (Tregenna, 2011). Policy intervention may be able to reverse premature deindustrialisation, and if developing countries wish to pursue industrialisation in the 21st century, it cannot be business as usual, and targeted and effective industrial policies are required to stem the further decline of local industry.

State-led development: The particular role of state owned enterprises.

The first theoretical contribution outlining the rationale for the existence of any kind of firm, both public and private, came from Ronald Coase’s seminal 1937 contribution, *The Nature of the Firm*. In it Coase poses two important questions; why and under what conditions do firms emerge. Conventional economic theory suggests that, under efficient market conditions, economic agents will find it easier to contract for the goods and services they need with price as the co-ordinating mechanism, as opposed to setting up a hierarchical co-ordinating structure for contracting and exchange purposes. Coase argues that there is a cost to using the price mechanism. More succinctly, Coase argues that there are costs to transacting which are not factored into the market price of goods and services, such as search and information costs, bargaining and decision costs and policing and enforcement costs (Coase, 1937). These costs which are not included in the price, may lead to the under-provision of goods and services at market prices, and ultimately market failure. Firms then emerge, with entrepreneurs or government (in the case of public entities) playing a co-ordinating influence, and reducing transaction costs.

In particular, as it relates to state owned enterprises as firm structures, Ha Joon Chang (2007) provides a summary of the theoretical justifications for the emergence of state owned firms. Chang argues that there are three main reasons for the creation of state owned enterprises; natural monopoly, capital market failure, externalities and equity considerations.

Firstly, a natural monopoly occurs in an industry where it is most efficient (involving the lowest long run average cost) for production to be concentrated in a single firm. This tends to be the case in industries where capital costs are a significant component of initial start-up costs. This creates large economies of scale in relation to the size of the market, creating significant barriers to entry for potential market entrants

Secondly, in capital markets private sector investors may be reluctant to invest in industries with high risk and long term structures to realise the return on the investment. As a result, sectors such as rolling stock, would suffer from under-investment if capital markets were the only means to finance capital investment.

Thirdly, private sector investors are not incentivised to invest in industries where the investment confers benefits on other parties free of charge. This is the commonly known, ‘free-rider’ problem in economics. Infrastructure, as a public good, faces the ‘free-rider’ problem, and as such it is more optimal for the state, or institutions under it, to provide such infrastructure.

Lastly, conventional investors and firms, driven by the profit motive, in sectors that provide basic goods and services may refuse to serve less profitable clients or customer segments, such as the poor, or people living in remote areas. Moreover, the free market, as something that has become a somewhat ahistorical construct, may fail to take into account historical inequities and disparities in access to power, wealth and income. Public policy then needs to take into account such historical inheritances, with the aim to redress some of these historical wrongs.

Public Procurement as an Industrial Policy instrument

Industrial policy according to Chang is policy pursued by the state, and/or its institutions with the aim of positively affecting the performance of industry (Chang H.-J. , 1998). Industrial

policy is commonly divided into three categories in the literature; horizontal policies which influence each industry, vertical policies that target specific sectors and the structural, which are aimed at promoting a structural shift in economic activity (Fine B. , 1997). The use of procurement to alter economic relations can be seen as a structural policy intervention in two ways. Firstly, in the sense that it aims to alter the South African industrial landscape through institutionally mediated actions aimed at improving the competitiveness and overall performance of local industry. Evans, quoted in Kattel and Lember (2010), seems to hold a similar view when he argues that, ‘if developing countries used public procurement only for increasing cost-effectiveness through the creation of a level playing field, these countries would voluntarily give up on using one of the most powerful demand-side innovation policy tools to promote innovation, industrial development, competitiveness and economic growth’ (Kattel & Lember, 2010, p. 386).

Moreover, the point of articulating public procurement as part of an industrial policy lies in, as Lee notes, ‘providing new conditions for capital accumulation by readjusting economic relations’ (Lee, 2013, p. 63) Secondly, readjustment of economic relations through industrial policy in South Africa occurs amidst much discussion on fashioning the South African state as a ‘developmental state’. The notion of a developmental state refers to the phenomenon of state-led industrialisation that characterised the 20th century East Asian development experience. Freund(2006) drawing on the work of Evans(1995) argues that the model developmental state is one where bureaucratic apparatuses are embedded in social ties that bind the state to other non-state societal actors and provides institutionalised channels for the negotiation and renegotiation of goals and policies (Freund, 2006). Therefore the use of procurement as industrial policy aimed at improving local manufacturing capabilities needs to be assessed on the basis of the social ties it engenders between the state and local suppliers and the institutional mechanisms that mediate this relationship in pursuit of commonly defined goals and policies.

An inquiry of this kind would never be complete without understanding the particular interests and forces that are to emerge from the process. Lee argues that, ‘the way in which underlying economic agents with different economic interests are linked to each other needs to be at the heart of any analysis of industrial policy’ (Lee, 2013, p. 63). In particular, as it relates to procurement, there is a need to analyse the relations between different political and

economic interests that stand to have their conditions of accumulation altered by the purchasing decisions of state owned enterprises.

Policy Governance: Rent management and economic development.

Khan defines an economic rent as excess incomes which should not occur in the presence of efficient markets (Khan M. , 2000). The treatment of rents in the neoclassical literature suggests that state policy-induced rents may create incentives to direct resources away from more useful and socially beneficial uses towards rent-seeking behaviour in pursuit of excess returns. Many scholars have identified rents as non-compensated transfers, between different economic agents, facilitated by access to political power (Krueger 1974, Buchanan 1983). Krueger (1974) developed a model of competitive rent-seeking in a case where rents originate from quantitative restrictions on trade, such as embargoes, quotas and restrictive licensing. These restrictions on economic activity give rise to various forms of rents and people then compete for these rents. Competitive rent-seeking in this analysis, results in divergence between private and social costs of certain economic activities (Krueger, 1974). Buchanan (1983) arguing from the same intellectual tradition, observes that inefficiencies emerge from non-compensated transfers of valued rights and privileges among certain groups. Buchanan argued that rents and rent-seeking behaviour erode economic value. Murphy, Shleifer and Vishny (1993) argue that rent-seeking exhibits two features which makes it detrimental to growth and economic development. Firstly, rent-seeking behaviour exhibits increasing returns, in the sense that an increase in rent-seeking behaviour leads to more rent-seeking relative to productive activity. Secondly, rent-seeking is likely to hurt innovative activities, and since innovation drives development (see Schumpeter 1934), then rent-seeking is harmful for development (Murphy, Shleifer, & Vishny, 1993).

At the edges of the neoclassical tradition, North, Wallis and Weingast (2006) argue that conventional rent-seeking models fail because they posit the existence of a 'normal' stable state as a given in the development process. These models fail to explain the state, how it gains instruments of coercion, how it survives and how it enforces decisions particularly the rights and privileges extended to various groups in society (North, Wallis, & Weingast, 2006). North et al. argue that the state's foremost task is ensuring its own survival, and thus its activities will be aimed at establishing its power over society and the provision of rents and public goods. A *natural state* according to North et al. is a specific way of organising political and economic systems, such that economic rents created by limited entry are

available to secure commitments to stability and peace from politically powerful groups. Potential political rivals in a natural state will have a disincentive to fight when their economic rents are dependent on the existence of the state and social order. In a sense, this kind of analysis, posits that rents in limited entry societies (most developing countries) serve the function of ensuring stability and peace. As a result they can lead to development if they entrench peace, stability and the necessary conditions required for accumulation.

A distinction is made in the literature, by Khan and others, between inefficient growth-retarding and productive, 'learning' rents. As Khan argues there may be scope for certain kinds of rents to play an essential role in growth and development. As Khan observes, 'The identification of some rents as efficient challenges the policy rule-of-thumb of the liberal market model which says that the removal of institutions and rights which protect rents is always desirable' (Khan M. , 2000, p. 1). To accelerate industrial and technological learning, conditional policy-induced rents may be created to allow producers in the learning sectors to catch up and become globally competitive (Khan M. , 2000). This is an argument which is different to an analysis that assumes all rents are bad and that policy should be geared towards their eradication.

Industrial Upgrading and Learning.

There is an important link between the learning described by Khan(2010) and the upgrading of industrial capabilities. Industrial upgrading refers to how firms advance their position through the different stages of the global value chain towards participating in higher value adding activities. If we accept that the key to competitiveness is the success of the learning process where industry is able to use the latest technology efficiently to increase productivity and achieve the cost advantages associated with economies of scale, then the process of industrial upgrading is intimately tied to the learning process. Khan (2010) argues that the process of upgrading involves three related issues. Firstly the achievement of minimum quality that allows entry into globally competitive production for a variety of products. Secondly investments in manufacturing and productive capabilities and spreading these across the working population and lastly moving up the quality ladder in terms of a firm's product offering (Khan M. , 2010)

Governance Agencies, Firm Structures and Political Settlements.

Khan argues that old import-substitution inspired industrial policies failed because they could not ensure effort, and that the effectiveness of industrial policy interventions rests on a range of institutionally defined variables. Furthermore, the effectiveness of these interventions depends on the ‘interaction and appropriateness of three other sets of variables; the *governance agencies* implicitly responsible for enforcing the terms of the instrument, the *firm structures* describing the internal hierarchies of firms, their relationship with the state and the markets they operate in and the broadly defined *political settlement* that describes the relevant distribution of power between different agents involved in the learning and financing process’ (Khan M. , 2010, p. 1). Moreover Khan defines governance agencies as important tools of enforcing the obligations placed on different actors by a policy instrument. This presupposes, for the purposes of effective policy implementation, that these agencies will have the capacity to monitor and enforce agreed upon obligations, and expectations. Furthermore, the analysis argues that some kind of relationship should exist between the governance agencies, and powerful commercial and political interests that stand to gain from policy.

In terms of firm structures, Khan argues that the degree to which learning and effort will occur depends on the internal organisation of firms and the structure of the market these firms operate in (Khan M. , 2010). What also becomes important, particularly in the South African case, is the structure of the historical and present relationship between firms targeted through policy and the existing government.

With regard to the political settlements, Khan argues that the distribution of organisational and bargaining power between different social groups in society, is important to the effective implementation of industrial policy. Moreover, in the South African context, the distribution and dynamics of power within the ruling coalition become very important, as will be shown in the study (North, Wallis, & Weingast, 2006). .

1.3 Gaps in the Literature

The global economy, post the 2007-8 financial crisis, is certainly a different place, insofar as thinking around economic policy and the role and character of the state, and how it intervenes in the economy. The need for industrialisation in developing economies like South Africa goes without saying. Faced with unemployment at crisis levels, the state has had to intervene

decisively, or at least draft policy that makes provision for such. This has only been possible, as a result of a global economy that is more receptive to state intervention in the economy. The study, presents interesting insights into how the state uses instruments, such as policy, at its disposal to effect meaningful socio-economic change.

Having analysed the role of a state in pursuit of a Rosenstein-Rodan inspired 'Big Push', the management of relevant rents and of the relationships that underlie a policy instrument, becomes important. To outline the nature of the state's role in altering relations in the marketplace in favour of particular, often patriotic, outcomes is one of the main aims of this study. How the state structures and manages the relationships lies at the core of the CSDP as a policy instrument, and will have an impact on its developmental outcomes, or lack thereof.

Institutions are there to serve certain societal needs and concerns, the review of the literature for instance, outlined the needs and concerns that led to the emergence of state owned enterprises as a specific form of enterprise or commercial entity. The study needs to analyse in the South African context the added political economy needs and concerns that give rise to an instrument such as the CSDP. One may argue that these needs and concerns are the deindustrialisation that South Africa has experienced, and its attendant job losses, the destruction of industrial capabilities and the outdated and dysfunctional rail infrastructure in South Africa and the need to transform the racial profile of the industrial classes in South Africa, and create new interests in the previously disadvantaged segments of South African society. The latter has brought about a need for investment, and the former raises the concern of how policy can be geared towards leveraging investment for reindustrialisation and ultimately domestic economic development. In this context, this study fills an important gap in the literature in how the state intervenes using procurement and capital spending in pursuit of development, its role and the nature of its involvement.

These are concerns which are not unique to South Africa, but however they have an important bearing on whether the South African state is able to use large capital spending on infrastructure to effect socio-economic changes in the form of employment, and the development of local enterprises.

1.4 Research Method and Summary of Empirical Work.

The study employed an inductive qualitative method. The primary research was conducted through semi-structured interviews with personnel in the relevant and affected institutions. The people interviewed were the following;

- **Dr Edwin Ritchken**, Advisor: Special Projects, Department of Public Enterprises
- **Steve Jardine**, Chief Executive Officer, Sustainium Growth and Transformation Services and,
- **Garry Pita**, Executive, Supplier Development, Transnet Group.

The study also consulted different secondary data sources, such as news reports, interviews, research reports, academic papers and other relevant data sources. The study analysed the insights gained from the different data sources, through the framework proposed by Khan(2008), which argues that successful and enabling industrial policy, rests on the interaction of governance agencies, firm structures and political settlements in a given and specific country context. The study employs this framework in analysing the data sources, and also in providing recommendations in the concluding chapter.

CHAPTER 2

TRANSNET AND THE COMPETITIVE SUPPLIER DEVELOPMENT PROGRAMME (CSDP).

2.1 A Brief History of Transnet Freight Rail

The origins of the company now known as Transnet SOC Ltd can be traced back to 1853, when the Cape Town Railway and Dock Company was formed (Transnet, 2009). Five years later, the building of the first railway started through the signing of an agreement between the Cape Town Railway and Dock Company and the Government of the Cape of Good Hope. The railway network expanded quickly, catalysed by the discovery of diamonds in Kimberley in 1866, such that by 1910 the year the Union of South Africa was formed, the different railway authorities under the erstwhile governments of Natal, Transvaal and the Cape, came together to form the South African Railways and Harbours (SAR&H) (Transnet, 2009). By 1930 the SAR&H had opened up at network of mainline passenger and freight rail services.

In 1981 the government decided to restructure SAR&H into distinct business lines, and this process ultimately led to SAR&H becoming a state enterprise known as the South African Transport Services (SATS). Less than ten years later, on 1 April 1990 SATS was incorporated as Transnet Ltd with the government as the sole shareholder (Transnet, 2009). Transnet Freight Rail (TFR) then went on to become one of the major and more prominent divisions of Transnet. In 1997 Transnet transferred its rail commuter assets into a division known as MetroRail. In its current form, Transnet has the following divisions;

- Transnet National Ports Authority
- Transnet Port Terminals
- Transnet Engineering
- Transnet Pipelines
- Transnet Freight Rail

Transnet Freight Rail as the largest division within Transnet now operates three major freight divisions namely its General Freight Business (GFB), Orex and its COALink. TFR also

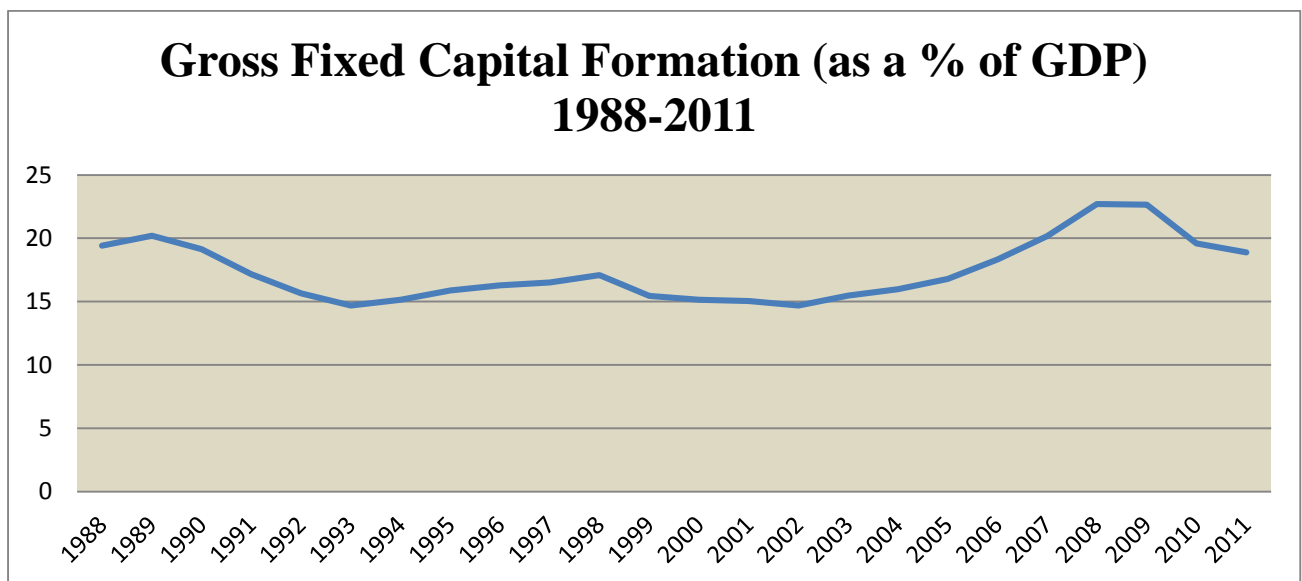
manages the mainline passenger services (known as ‘Shosholoza Meyl’) and the luxury Blue Train (Transnet, 2009). TFR fashions itself as a world class heavy haul freight business. Its core business is in providing freight logistics solutions for customers in the mining sector and in heavy and light manufacturing. TFR’s fleet provides logistic support in the automotive, agriculture, energy, chemicals and metals sectors inter alia.

The division enjoys an extensive rail network across South Africa, which is linked to other rail networks in Sub Saharan Africa. Moreover, TFR’s footprint on the continent is immense, and its infrastructure represents 80% of Africa’s entire rail infrastructure (Transnet, 2009). In the medium to long term, TFR has outlined its strategic intent, which will guide its operations going forward, as the following;

- Enabling economic growth
- Facilitating trade growth by improving South Africa’s competitiveness in its tradable sectors
- Reducing the cost of doing business by transferring traffic from road to rail and,
- Skills development.

The areas outlined in TFR’s strategic intent are an indication of some of the economic challenges that the company aims to address, and also an indication of some of the political economy issues that have plagued the rail sector over the past 25 years. Two related issues are of particular interest and deserve mention. Firstly there have been significantly low levels of fixed investment in the South African economy over this period, and this has been one of the causes of the low levels of economic growth the country has experienced over a long period. Transnet therefore sees itself, through its investment activity and operations, contributing to economic growth and stemming this trend of low investment. Secondly, if one looks at Figure 2.1 then we get an indication, when we compare it to Figure 2.2 that even in periods of relatively strong economic growth, there hasn’t been a concomitant rise in fixed capital formation.

Figure 2.1 South African Capital Formation as a component of Gross Domestic Product (GDP) 1988-2011.



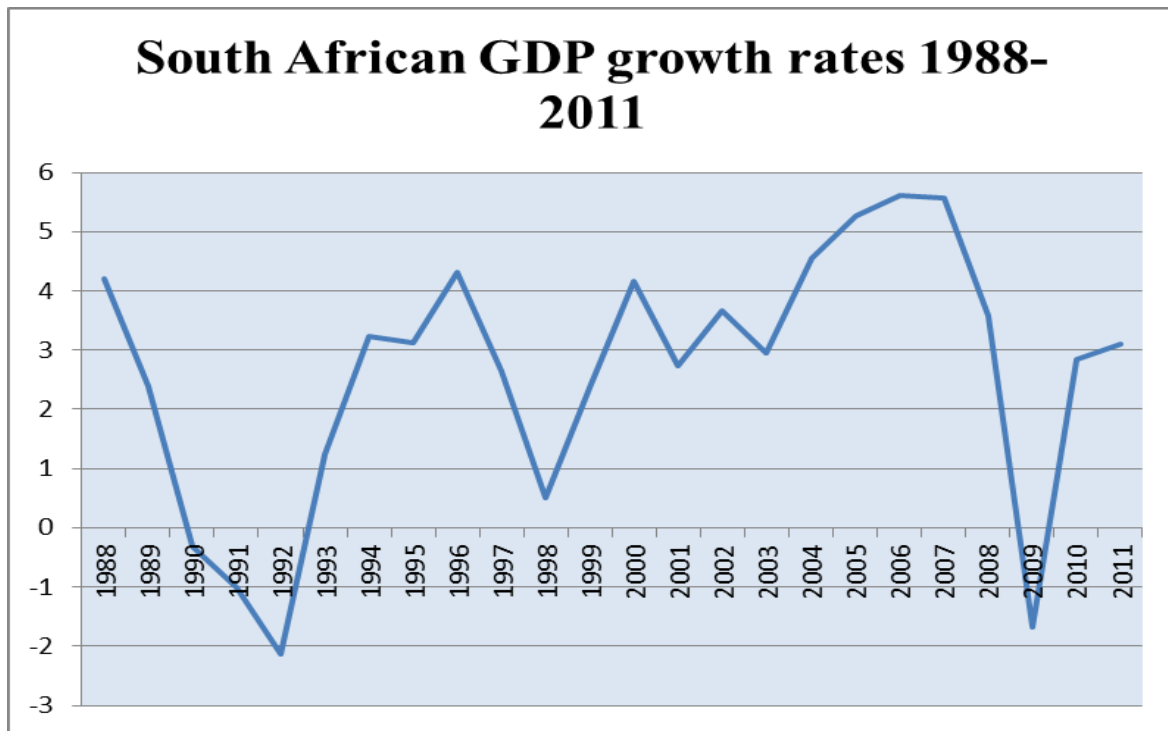
(Source: World Bank National Accounts Data, and OECD National Accounts Data, 2013).

Transnet Freight Rail, as a business whose main operations include a coal and iron-ore export line, has missed out on the resource boom of the early 2000s, as a result of ageing assets and operational inefficiencies associated with such an old fleet. These two issues point towards the urgency with which Transnet has had to commit capital, towards the renewal of their rolling stock. From the 2005/6 to the 2008/9 financial year, Transnet spent R53, 4 billion towards capital investment, and this jumped to an expected 80, 5 billion between 2009/10 and 2013/4, 32 % of which will go to rolling stock (Transnet, 2009). These massive surges in capital investment indicate the urgency with which Transnet aims to remedy the close to three decades of underinvestment that have been a focal part of the state-owned enterprises' recent past.

Transnet has committed, as part of its market demand strategy (MDS), to an investment of R300 billion, to ensure that they increase cargo volumes from 200 million to 350 million tons by 2019. Almost 70% of the approved capital expenditure will go to Transnet Freight Rail, for the expansion of rail infrastructure, which includes rolling stock (Transnet, 2009). The 1064 locomotives in question form part of this expenditure. More importantly this expenditure, through the leveraging of the large procurement that forms part of it, aims to build manufacturing capabilities in the local supplier industry. In large part due to the

underinvestment outlined above, many suppliers to the rail industry have lost key manufacturing capabilities.

Figure 2.2 South African GDP growth rates between 1988 and 2011



(Source: World Bank National Accounts Data, 2012).

The competitive supplier development programme (CSDP) is seen as an important part of how Transnet aims to leverage this intended large capital spending for the benefit of the country. The socio-economic multipliers of this spending, in the form of export capabilities for suppliers, employment and improving South Africa's industrial base are what the CSDP aims to realise (Transnet, 2008). Moreover the CSDP also aims to reduce the capital leakage associated with large scale infrastructure spending through building competitive and sustainable local supplier industries.

2.2 Supplier Development: From NIPP to CSDP

The origins of the competitive supplier development programme (CSDP) can be traced back to the cabinet adoption of the National Industrial Policy Framework (NIPF) in January 2007. The NIPF outlined the government's approach to industrial policy, and was followed, in the same spirit, by the respective iterations of the Industrial Policy Action Plan (IPAP). The IPAP

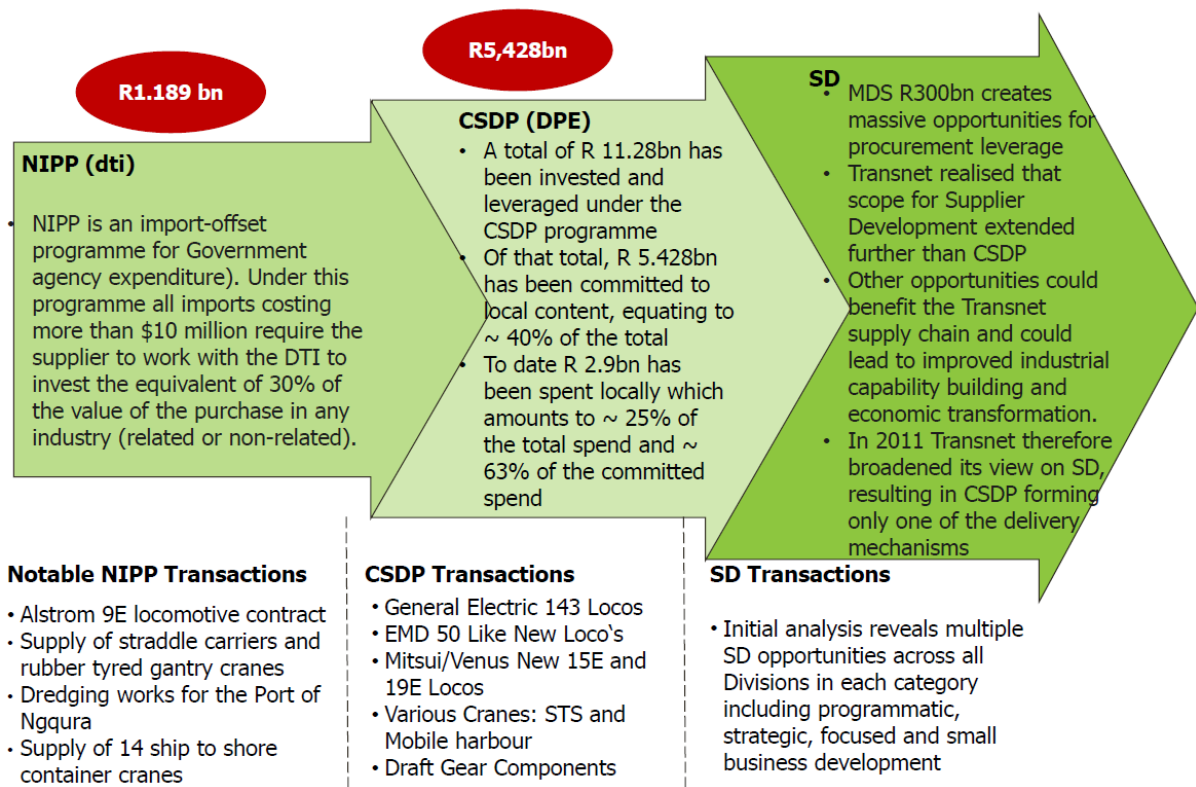
consists of direct and transversal interventions aimed at improving the competitiveness of the local industrial sector. The IPAP identifies the following as the key structural challenges facing the South African economy;

- Imbalances in South Africa's current growth path
- Declining share of manufacturing in the country's output
- Unemployment
- Low relative profitability of manufacturing
- Cost and allocation of capital
- Failure to leverage procurement (Transnet, 2009)

The last challenge, directly relates to the intended use of supplier development provisions in state owned enterprise (SOE) procurement. The IPAP outlines key sectors for support that directly affect Transnet, namely; capital equipment and component manufacturing. Seen from this perspective, the CSDP is an important part of the government's efforts at industrialising the South African economy (Transnet, 2008). The CSDP replaced the National Industrial Participation Programme (NIPP), which was an import offset programme run by the Department of Trade and Industry (DTI). **Figure 2.1** illustrates the shift from the NIPP to the CSDP. Under NIPP programme, all imports greater than US \$10 million, the supplier would have to work with the DTI to invest the equivalent of 30% of the import value in a non-related industry (Mohamed, Gwanoya, & Mfongeh, 2010).

The DPE received cabinet approval for the CSDP in 2007. The CSDP sought to develop a system where foreign OEMs that win contracts to build major infrastructure on behalf of the government and its institutions, would be required to have a significant amount of local content. As part of this programme, SOEs had to submit their CSDP plans to support local second and third tier suppliers, to the DPE (Mohamed, Gwanoya, & Mfongeh, 2010). The Department of Public Enterprises (DPE) as the state institution that established the CSDP, envisaged that the program would, *'involve procuring in such a way as to increase the competitiveness, capacity and capability of the local supply base, where there are comparative advantages and potential competitive advantages of local supply'* (Transnet, 2008, p. 6). Then Transnet Group Chief Executive, Maria Ramos formally approached the DPE, notifying the Department that the state owned enterprise wished to participate in the CSDP, which meant that Transnet suppliers of imported manufactured goods and services were no longer required to be part of the NIPP.

Figure 2.3 NIPP to the CSDP.



(Source: Transnet 2012).

The CSDP involved both supply and demand-side measures. On the demand side, the DPE which initiated the CSDP is responsible for approving the supplier development plans of state owned enterprises, and on the supply-side the DTI provides incentives and support for the local supplier base, and the Department of Science and Technology (DST) aims to close any technological and specification gaps that may exist (Transnet, 2009). A distinction needs to be made between the CSDP and Transnet's enterprise development initiatives as part of their supplier development Centre of Excellence (COE) and the CSDP. The focus of enterprise development is on investing resources into small micro and new suppliers who currently, or through extensive development, provide goods and services to Transnet. The CSDP, on the other hand, involves the localisation of Transnet's supply chain through encouraging foreign direct investment from international suppliers into local businesses so that these firms can expand their capacity to not only supply the state owned entity's supply chain, but also export as well (Transnet, 2009). Moreover, the latter programme uses government's procurement spend to *indirectly* influence the development of competitive local suppliers.

The shift from the NIPP to the CSDP had important implications for Transnet's business model. Firstly it meant that instead of investment in non-related industry to offset manufactured imports as was the case in the NIPP, the introduction of the CSDP involved a shift in focus towards the enterprises whose viability and longevity is directly determined by the demand and investment behaviour of Transnet and its suppliers. Secondly one of the overarching aims of the CSDP was to improve the profitability of the SOE as a result of cost-savings from sourcing from innovative, responsive and more-competitive suppliers (Transnet, 2008). This coupled with improved lead times would see an improvement in the cost structure of Transnet. Thirdly procuring capital goods and related manufactures from the domestic market would ensure that Transnet and its preferred suppliers in many instances would effectively protect themselves from adverse exchange rate fluctuations which could lead to cost and time overruns. All these benefits, added to increased employment and output, would bode well for the socio-economic contribution that state owned enterprises are expected to make in South Africa.

2.2 The South African supplier industry

As this study directly focuses on TFR and the procurement of 1064 locomotives, which has come to be known as the 'ten sixty four' contract, the discussion on the local supplier industry, and its state, will focus on suppliers in one particular area of Transnet's operations; rolling stock. Suppliers in the rolling stock industries consist of tier-1, tier-2 and tier-3 suppliers. Tier-1 suppliers are those who manufacture wagons, and are direct suppliers of 'fit-for-purpose' equipment (systems and subsystems) (Transnet, 2009). The biggest tier-1 supplier is Transnet Rail Engineering (TRE), which is responsible for the manufacture and repair of rolling stock. Other tier-1 suppliers, most of which are multinationals are; General Electric (GE), General Motors (GM), Alstom, EMD, Mitsui and Siemens.

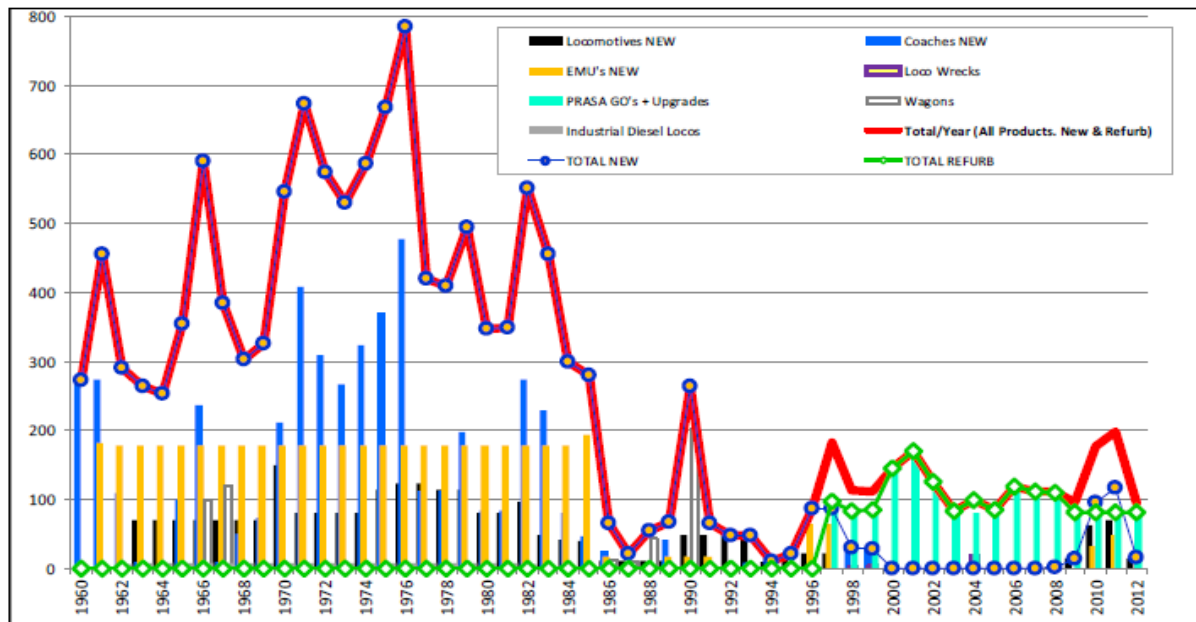
Tier-2 suppliers are manufacturers of assemblies and sub-assemblies or key maintenance and testing services. Companies that fall under this category include; Union Carriage and Wagon, Siemens, DCD-Dorbyl (whose subsidiaries include the rolling stock divisions of Metpro and Ringrollers), Scaw metals and Surtees (Transnet, 2009). All of these firms, except for Metpro which is based in Rosslyn, Pretoria, are located in Gauteng's East Rand. Tier-3 suppliers provide components for original equipment manufacturers (OEMs) such as the tier-1 firms mentioned above. However, it is important to note, that Transnet's tier-3 suppliers, are tier-2 suppliers to the OEMs. Therefore, the CSDP will be implemented, through a direct

contractual relationship with multinational OEMs (Transnet's first tier suppliers), who as part of the bidding process, will have provided localisation and supplier development plans. These OEMs will be accepting contractual localisation obligations to extend their supply chains to local suppliers in South Africa (Transnet, 2008). These OEMs will then retain control and management over their supply chains, both locally and internationally. Thus, Transnet's tier-2 assemblers and sub-assemblers, become tier 1 suppliers to the OEMs. It is clear, from **Figure 2.4** that there has been a significant decline in output, and thus employment, in the local supplier industry over the past four decades. The illustration, by depicting the rail units built and refurbished by one of the local suppliers, Union Carriage and Wagon, indicates the need for investment to re-energise this industrial sector.

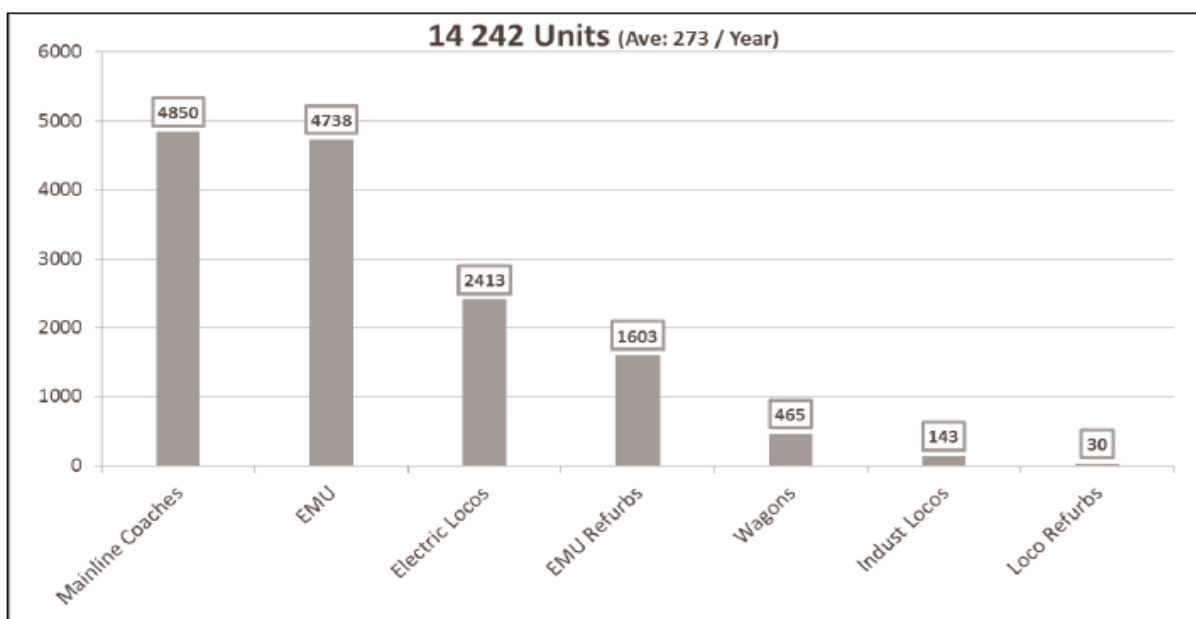
Furthermore, Transnet, provides enterprise development and preferential procurement support to bolster local supplier relationships. Transnet, having struck the CSDP agreement with the OEM as its tier-1 supplier, then provides support to the OEM's tier-1 and tier-2 suppliers, which are engaged in the manufacture of subassemblies and components for the OEMs respectively (Transnet, 2008). Transnet's CSDP strategic approach is to engage tier-1 suppliers, and to influence them to engage tier-1 and tier-2 suppliers. Figure 3.2 indicates how Transnet's approach is envisaged to work. This process starts from when the request for proposals begins in the bidding process, and continues with Transnet lobbying the OEM's buyers to promote local suppliers as an attractive alternative source of supply, and advising OEM's, interestingly, on the suitability of TRE(Transnet Rail Engineering) and other local suppliers as manufacturers of rolling stock components

Figure 2.4 Union Carriage and Wagon (UCW) Production 1960-2012.

Units built / refurbished by UCW 1960 -2012

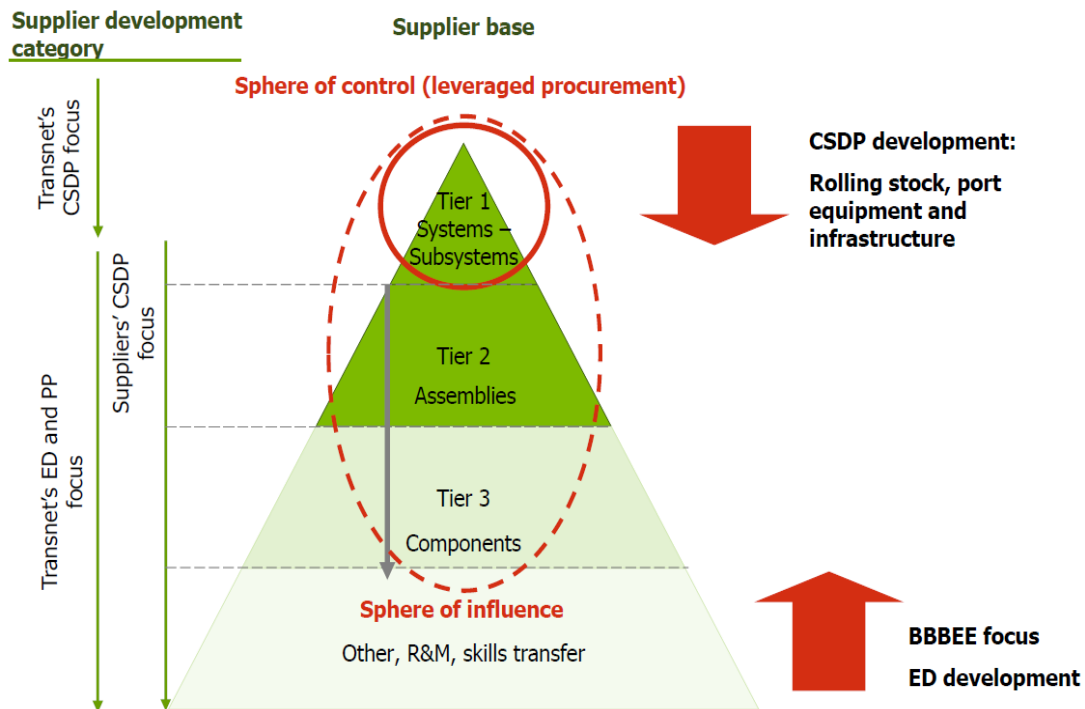


Rolling Stock produced 1960 - 2012



(Source: Union Carriage and Wagon Company Profile, 2013).

Figure 2.5 The CSDP strategic approach.



The conflict and delays over evaluation criteria, not only point to a breakdown in this institutionally mediated interaction model, but also indicates a fundamental divergence of views about how to achieve industrialisation and economic growth. The following chapter discusses some of the legislation and policy on public procurement, which to a large extent, lies at the centre of the differences between the different state institutions.

CHAPTER 3

THE SOUTH AFRICAN LEGISLATIVE AND POLICY FRAMEWORK ON PUBLIC PROCUREMENT.

3.1 Procurement as a system

Watermeyer (2011) defines a system as ‘an established way of doing things and provides order and a platform for the methodical planning of a way of proceeding’ (p.1). Systems are underpinned by *processes*, *procedures* and *methods*. Processes are a logically related set of actions carried out in a manner that leads to the completion of a major deliverable or the achievement of a particular milestone (Watermeyer, 2011). Procedures refer the formal steps that need to be taken in the performance of a certain task, and methods are a collection of rules that are documented and ordered in a systematic manner. Procurement procedures, as important as they may be, do not adequately allow one to problematize the location of state purchasing decisions as an instrument that seeks to deal with social and economic realities and exigencies. As Mohamed and Gwanoya et al note;

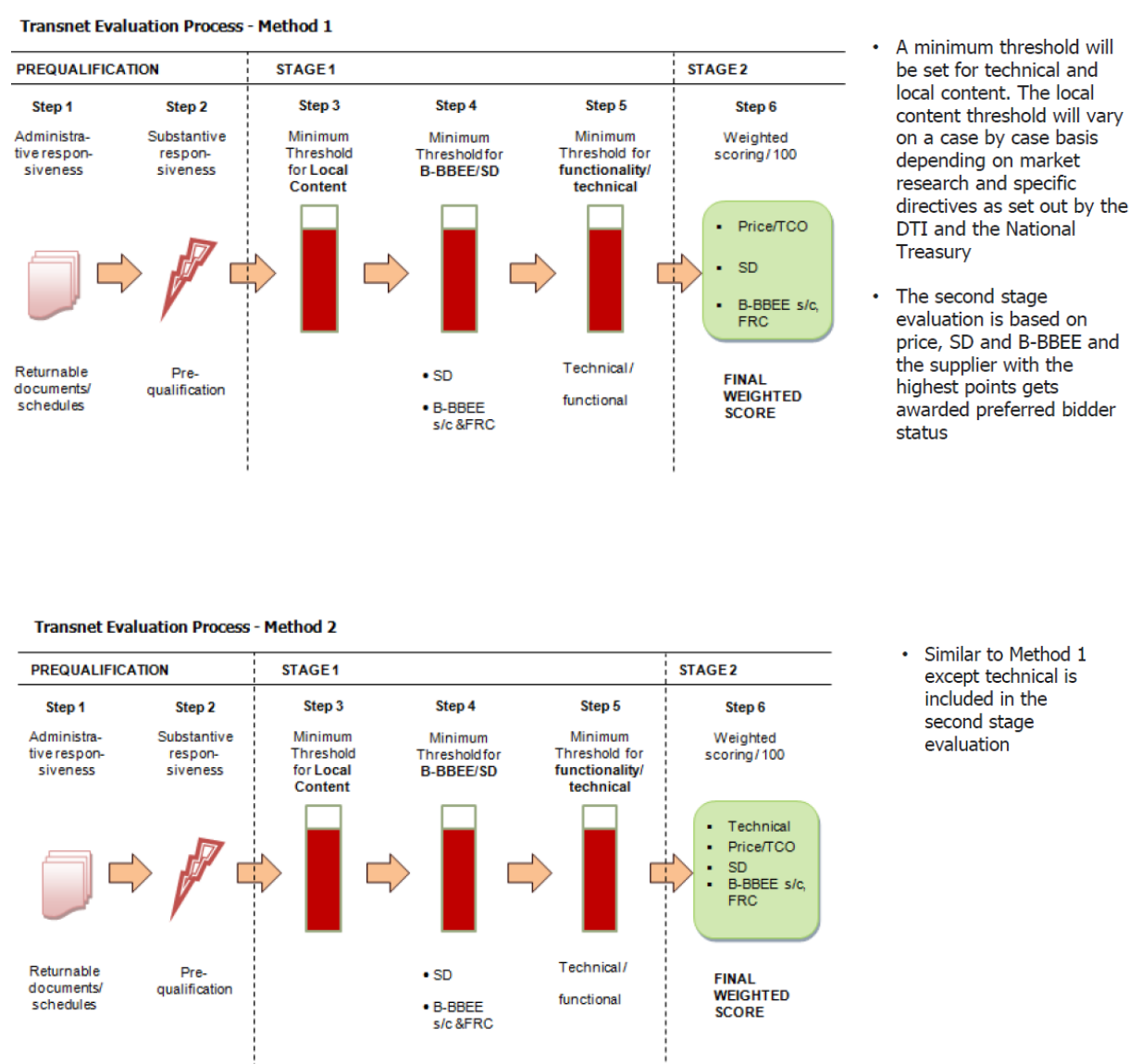
‘Procurement is much more than a process or procedure. It is a fundamental and integrated part of the governance and public financial management system’ (Mohamed, Gwanoya, & Mfongeh, 2010, p. 5)

Viewing procurement as an integral part of a governance system allows us to analyse it in its totality, and view its constituent elements through the prism of the *governance agencies*, *firm structures* and *political settlements* nexus outlined above, and the interaction between these elements. The importance of procurement as a system tends to be obscured by the fact that it happens in a decentralised fashion across the state. Although the state in its entirety is not the focus of this study, however procurement as viewed in the public discourse contributes to our day-to-day understanding of government purchasing and its potential or lack thereof as a tool of social and economic reform. The fragmented story of state purchasing indicates how the thinking aligned with New Public Management (NPM) school of thought has become commonplace in the discourses on the state in South Africa.

In the 1990s public policy implementation became associated with decentralisation and market-like discipline, as exemplified by the New Public Management (NPM) reforms. The Apartheid government had historically been comfortable with state induced rents managed centrally through the Tender Boards, albeit for the exclusive benefit of the white minority. The reform of the public procurement system in the late 1990s and early 2000s, was shaped

by NPM values. These values are, inter alia, cost effectiveness, transparency and enhanced competition (Kattel & Lember, 2010). A major factor shaping this shift, was a sense that the Apartheid procurement system was a highly centralised, cumbersome, inefficient and a constraint to development. These are the NPM values that inform the PPFA, and its insistence on competitive bidding processes free of rent-seeking. The CSDP, in so far as it represents a shift away from these values, is a policy-induced rent, that aims to privilege local supplier concerns above any other supplier firms outside of South Africa. **Figure 3.1** illustrates the evaluation of the bidding process, taking into account the SOE's CSDP.

Figure 3.1 The evaluation of the bidding process.



The figure illustrates the two evaluations that occur. The first evaluation focuses technical aspects and functionality of the tender bid. The second evaluation concerns supplier

development provisions, broad-based black economic empowerment (B-BEE) and price considerations. This is a departure from the normal procurement evaluation criteria, which have price and functionality as the overriding considerations.

This departure presents interesting insights that challenge the conventional praxis of public procurement. As Dr Edwin Ritchken, Strategy Advisor at the DPE, pointed out, an assessment of the CSDP is an assessment of a new way of procuring. In a sense, the CSDP introduces the question of how change is managed within state institutions in order to build the capabilities required in a developmental agenda (Ritchken, 2013). With added evaluation objectives, management of key supply chain functions became more cumbersome. As Dr Ritchken pointed out, *‘The hardest part of the CSDP was in getting middle management to spiritually embrace something that made their work harder’* (Ritchken, 2013).

The procedures and methods used to carry out public procurement, informed by policy and legislation, leading to the award of a contract to a preferred bidder need to be clearly defined, in order to establish the basis of the contract entered into with successful bidders. The procedures and methods, used to guide the procuring entity in implementing the procurement process are as important as what is being procured, particularly in a developing country context like South Africa, where these have to be constantly in conversation with the nation’s other social and economic policy considerations.

3.2 The Legislative and Policy Framework

The Constitution of the Republic of South Africa (Act 108 of 1996) provides the fundamental framework outlining how public procurement should be carried out in South Africa. Section 217 of the Constitution establishes the primary and secondary objectives of public procurement in South Africa. **Table 3.1** depicts the primary and secondary objectives of public procurement as outlined in the Constitution.

Objective		Reference
Primary	Procurement system needs to be fair, equitable, transparent, competitive and cost effective	Section 217(1)
Secondary	Procurement policy may provide for: a) Categories of preference in the allocation of	Section 217(2)

	contracts; and b) The protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination	
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(Source: Watermeyer, 2011)

The Constitution makes the following provision; that national legislation must prescribe framework within which the objectives outlined in Section 217 can be implemented, in the form of a policy framework. The Preferential Procurement Policy Framework Act, 2000(Act 5 of 2000), known as the ‘PPPFA’ from here onwards was promulgated in response to this constitutional imperative.

The main aim of the act was to ensure the participation of historically disadvantaged individuals (HDI) and small medium and micro enterprises (SMMEs). The legislation makes provision in Section 2(1) for organs of state to implement a preferential procurement policy that favours the groups mentioned above (Mohamed, Gwanoya, & Mfongeh, 2010). The Preferential Procurement Regulations were then promulgated in 2001 following the passing of the act in 2000, to give effect to the provisions of the Act. The bid evaluation system envisaged in the regulations aims to preference to all tenders to HDIs and SMMEs, but in addition awards points for *inter alia*;

- The promotion of South African owned enterprises
- The promotion of export oriented production to create jobs
- The intensification of labour intensive production (Mohamed, Gwanoya, & Mfongeh, 2010)

There is a ‘spanner in the works’ however, as SOEs, which are defined as organs of state by section 239 of the Constitution, are not regarded as organs of state for the purposes of the Act, and by extension the regulations. This means that they are not subject to the provisions outlined in the Act, however they remain under other legislation which assigns a fiscal oversight role to the National Treasury and the Companies Act 71 of 2008. The legislation, which we will concern ourselves with, which makes provision for this National Treasury oversight role is the Public Finance Management Act of 1999, known as the ‘PFMA’ hereafter.

4.3 The Public Finance Management Act (PFMA) and other oversight issues

The PFMA regulates the financial management of national and provincial governments. However, it also recognises state owned commercial entities as outlined in s239 of the Constitution. Section 1 of the PFMA defines an SOE, which it refers to as a, ‘national government business enterprise’, to be an entity which;

- (a) Is a juristic person under the ownership and control of the national executive
- (b) Has been assigned financial and operational authority to carry on a business activity;
- (c) As its principal business, provides goods or services in accordance with ordinary business principles
- (d) Is financed fully or substantially from sources other than
 - (i) The National Revenue Fund; or
 - (ii) By way of a tax, levy or other statutory money (PRC, 2011).

The National Treasury, is assigned the oversight role over the PFMA as it applies to SOEs.

4.4 Department of Trade and Industry Rolling Stock Designation

The Preferential Procurement Regulations of 2011, pertaining to the PPPFA, make provision for the DTI to designate sectors in line with national development and industrial policies for local production (Treasury, 2012). Regulation 9(1) prescribes that in the award of bids where local production and content is of critical importance, such bids need to be advertised with a specific condition that only locally produced services, works or locally produced manufactures, with a stipulated minimum threshold for local content and production will be considered.

Figure 3.2 The designation thresholds that the DTI has set for the rolling stock industry.

Classes of Rail Rolling Stock	Stipulated minimum threshold
Diesel locomotives	55%
Electric locomotives	60%
Electric Multiple Units (EMU)	65%
Wagons	80%

(Source: National Treasury, 2012).

In order to ensure that localisation will be achieved in the intended manufacturing activities, the following components, in **Figure 3.3** have also been designated and need to be included in bid invitations and, as Garry Pita, Executive: Supplier Development at Transnet indicated, they also need to be clearly outlined in the request for proposal (RFP).

A Political Economy Review of the Transnet Freight Rail Competitive Supplier Development Programme.

No	Component/Activity	% local content (3-5 years)	% local content (6 and above)
1	Assembly of locomotives and EMU	100%	100%
2	Car body: <ul style="list-style-type: none"> - Car body shell - Door system - Windows - Seats (for coach interior) - Lighting - Grab pillars and rails - Interior gladding - Cable and wire - Safety equipment - Pipe works and ducts 	100%	100%
3	Bogie: <ul style="list-style-type: none"> - Bogie frame - Motor suspension unit - Wheel sets and wheel components - Axle and axle boxes - Bearings - Bolster 	100%	100%
4	Coupling equipment <ul style="list-style-type: none"> - Coupler body - Coupler hook - Yoke - Pin - Draft-gear 	100%	100%
5	Suspension <ul style="list-style-type: none"> - Shock absorbers and dampers - Springs 	100%	100%
6	Heat, Ventilation and Air Conditioning <ul style="list-style-type: none"> - Fabrication - Power Coating - Heat Exchangers 	60%	70%

	<ul style="list-style-type: none"> - Fans - Compressors - Refrigeration components - Electrical components - Fasteners - Insulation and liners 		
7	Braking system	70%	80%
8	Alternators	90%	100%
9	Traction motors	65%	80%
10	Electric systems	80%	90%

Figure 3.3 List of designated rolling stock components.

(Source: National Treasury, 2012).

4.5 National Treasury Instruction Notes on Rolling Stock Procurement

The purpose of the Treasury's instruction note is to regulate the environment within which accounting officers and accounting authorities may procure rail rolling stock, which has been designated for local production and content. The instruction note also serves to outline the evaluation process for rolling stock tender bids. A two stage process may be followed in evaluating the bids received for each contract.

- (i) Evaluation in terms of the stipulated minimum threshold for local content and production

A bidder's commitment to local content needs to be outlined in the Declaration Certificate for Local Content, which should accompany the relevant bid documents. The declaration made by the bidder in the declaration certificate needs to be in line with the designations set out by the DTI for the bid to be successful. Where the bid is for more than one product, local content percentages need to be outlined for each product (Treasury, 2012).

Accounting officers and supply chain officials at the SOE need to ensure that the relevant documentation regarding local content is submitted as part of the bid documentation. A bidder who fails to do this may be disqualified from the tender process. Lastly, the DTI has a right, as and when it is necessary, to request auditors certificates indicating the authenticity of the local content declarations (Treasury, 2012).

(ii) Evaluation in terms of the 90/10 and 80/20 preference points systems.

In the second stage of the evaluation process, only bids that have achieved the minimum threshold can be evaluated further. At this stage, the bids are evaluated according to the 80/20 and 90/20 principle outlined in the Preferential Procurement Regulations of 2011. The evaluation criteria outlines that, for all contracts below R10 million the 80\20 rule is to be applied. For all contracts above R10 million, the 90\10 principle is applied. The evaluation criteria, according to the Preferential Procurement Policy Framework Act (PPPFA), provides a 90% weighting to price considerations and a 10% consideration to Broad-Based Black Economic Empowerment (BBBEE) and other social considerations like enterprise development, local supplier development, job creation and skills transfer (Treasury, 2012). SOE accounting officers and authorities also need to ensure that procurement processes for rolling stock and related components take into account benchmark prices, value for money and economies of scale (Treasury, 2012).

CHAPTER 4





EMPIRICAL ANALYSIS OF THE PRIMARY RESEARCH.

This section aims to understand the insights gained from the semi-structured interviews with respondents, by looking at what new empirical and primary experiences, outside of the literature emerge. These insights will allow the study to add to the body of knowledge on the use of public procurement to achieve the aims of industrialising developing economies such as South Africa. This section is divided into three parts. The first part presents some initial research findings and primary insights. The second part deals with the concerns expressed by the local supplier industry, about the role of TRE in the CSDP. Thirdly a discussion is presented on the contestations within and outside the ruling coalition around how the ANC government fashions itself as a developmental state.

4. 1 Research Findings and Primary Insights

Transnet has managed to extract supplier development value through the Competitive Supplier Development Programme (CSDP) since 2008. The advent of the CSDP has placed contractual obligations on OEMs to develop the local supplier industry. The total contractual committed value has been in excess of R14 billion (Chokoe & Pita, 2013). **Table 4.1** outlines some of the transactions and contractual agreements which are set to alter the conditions of accumulation for local suppliers. More importantly, the CSDP has sought to assist the growth of small supplier firms in areas that were historically dominated by a few white core suppliers. The answer to the above question needs to outline new areas of investment and the development of new productive capabilities where such didn't exist, or where these had previously been underdeveloped. Contractually, General Electric, Gijima and EMD inter alia (see Table 5.1) have made investments or signalled commitments to invest in plant and equipment, local manufacturing, skills transfer and the procurement of local parts and components in order to fulfil their localisation obligations.

Table 4.1 A few successful CSDP transactions.

Contract	Supplier Development Commitment (%)	Progress to date
<p>General Electric 100 X locomotives</p> 	54% of contract value	<p>Of the total supplier development commitment value, 78% has been spent locally. The spend allocation is on job creation and preservation, skills development and localisation. A large percentage of the commitment is invested in local manufacturing of locomotives. A number of local suppliers are being developed to source and provide locomotive parts and components.</p> <p>General Electric has another contract for supplying 43 additional locomotives. The supplier development commitment is 65% of the contract value in this one. In this new contract, only 4%.</p>
<p>Gijima Heavy Machine 8 X Reachstackers</p> 	60% of contract value	<p>To date, a supplier development commitment value of 66% has been realised of the total committed. This value is allocated to skills development, investment in plant and localisation</p>
<p>EMD – 50 X Like New EMD</p> 	67% of contract value	<p>100% of the supplier development value has been allocated to localisation. 40% of the parts used for the build of the locomotives were sourced locally.</p> <p>Other achievement includes:</p> <ul style="list-style-type: none"> • Assist maintenance facility processes upgrade • Up-skill and employment of local employees • Improve Transnet Engineering Centre of Excellence for • EMD accreditation application • Procurement of local parts and components • Classroom and on-the-job training
<p>Liebherr – 6 X Mobile Harbour Cranes</p> 	23% of contract value	<p>The contract is still new and no supplier development value has been realised as yet. The commitment is focused on investment in plant, skills development and a large allocation for localisation.</p>

(Source: Transnet, 2013)

4.2. Tension between Transnet's own manufacturing capability and other industry players

It hasn't been plain sailing, however, as far as the impact on the local supplier industry, of these investment commitments is concerned. Steve Jardine is the Chief Executive Officer

(CEO) of Sustainium Growth and Transformation Services. Sustainium offers industry clustering and supplier development facilitation services to SOEs, global OEMs and the local supplier industry. Mr Jardine has supply chain and leadership experience in the rail rolling stock and automotive sectors. Steve had the following to say, about the investment of global OEMs in the local supplier industry;

‘In terms of the relationship between Transnet, the OEM and the local supplier industry, from a supplier perspective there are real concerns. When an OEM comes into the country they only have a discussion with Transnet Rail Engineering (in discharging their localisation initiatives) and no one else. The responsibility lies with the OEM to come and speak to the local industry’ (Jardine, 2013).

Steve Jardine argued that local content designation and the investment obligations this places on successful bidders, will not have any force or effect to protect and develop the local supplier industry (Jardine, 2013). Jardine’s sentiments are largely supported by the concerns, shared by Edwin Ritchken as well, around the role of other Transnet Group subsidiaries in the CSDP, particularly Transnet Rail Engineering. The role of Transnet Rail Engineering is a somewhat uncertain one. As a commercial entity Transnet’s rail engineering business serves the same function as firms in the local supplier industry, but however it has a special role in that it is an integral part of the Transnet Group.

Two of South Africa’s largest rail engineering firms, DCD Group and Union Carriage and Wagon, have raised concerns around the bias towards Transnet Rail Engineering in the award of contracts with global OEMs and public investments in plant upgrade (Smith, 2013). Both firms design and manufacture locomotives, wagons and coaches. They would be the typical kind of firms which would be intended to benefit from the Transnet supplier development programs. Global OEMs such as Alstom and General Electric, in their hopes to win tenders have been reluctant to contract, on a long term basis, with firms like DCD and without clarity on how much work would contractually be directed to Transnet Rail Engineering. The two firms have further argued that an impression has been created that all rolling stock would be manufactured within Transnet Rail Engineering’s control. One of the fault lines of the CSDP has been the inability of Transnet to clarify, at a supplier development policy level, the extent to which the private sector would be allowed to compete with Transnet Rail Engineering, in

light of some of the public investments which are being made in Transnet Freight Rail's sister company.

Rob King, Managing Director of DCD had this to say about the concerns of an inherent bias in the award of business in favour of Transnet Rail Engineering;

'What worries us in particular is that we have a supply chain in South Africa that may not be used in the tenders and it would seem there is new capacity being developed at Transnet Rail Engineering and I would question why we need that' (Smith, 2013)

DCD has been doing work with Eskom to supply local content to its build programme, this has included discussion on how DCD could participate in the planned nuclear power programme. This, Mr King argues, is at odds to the approach when it comes to rolling stock;

'It's like the government is schizophrenic, when it comes to trains we do one thing and when we do energy we engage differently' (Smith, 2013).

Mr King also highlighted the ideological differences embedded within the state, in its pursuit of industrial development;

'It's as if you have the National Development Plan going up against the developmental state. Up there are two different philosophies' (Smith, 2013).

DCD however, has made investments of its own, having launched the first R100m phase of a R240m investment to recapitalise its railway manufacturing plant in Boksburg on the 28th of November 2013. These investments, which introduce robotic technology aimed at boosting competitiveness, are set to expand DCD's rail manufacturing capacities ten-fold. In terms of job creation, DCD also committed to the creation of hundred new jobs by January 2014 (Allix, 2013). DCD's complaints about public investments in Transnet Rail Engineering reflect an important concern within the supplier industry about the future competitive environment within the rail industry. Is the CSDP set to boost Transnet Group's internal capacity at the expense of improving the capacity and economies of scale for other private sector local suppliers? Steve Jardine seems to think so;

‘Transnet Rail Engineering, before the tender had already been announced, came out saying that they would be assembling the locomotives. With such an environment, as an OEM who has to engage the local industry, they have no incentive to speak to anybody else. (What about open tender?) What is the role of Transnet? If Transnet is going to do everything, what about the local suppliers?’

4.2.1 Issues around the competitive climate (or lack thereof) in the local supplier industry.

Many in the local supplier industry in South Africa feel that public investments in internal capacity by Transnet may serve to give the SOE an unfair advantage, and local suppliers a disadvantage, in their relations with global rail manufacturers. Steve Jardine had this to say, of this perception;

‘Transnet’s investments in plant upgrade are using public money to improve internal capacity in order to exclude, in future, private sector local suppliers . ‘Why would I (as a global OEM) go and spend that money at UCW again?’ (Jardine, 2013).

What simply was a question around the government’s policy interventions aimed at incentivising OEM investment in the local supplier industry, reveals important tensions between the private sector and the state, but also within the state, around how industrialisation should be pursued. Transnet has argued in the following manner, in defence of the role of TRE;

‘It would be a critical error in judgment not to leverage Transnet’s current strength in maintenance and engineering. Transnet will need to place TRE at the centre of Transnet’s CSDP programme’ (Transnet, Transnet Supplier Development Plan , 2008, p. 46).

This divergence in approach raises interesting questions and insights into the private-sector led vs. state-led development approaches, and the roles of an intervening state as opposed to an enabling regulatory state far removed from commercial activities of its own.

This mirrors, sentiments expressed by what Dr Edwin Ritchken termed, '*a struggle for the soul of the state*', and this struggle is not waged by two distinct enemies, but is an ideological war contested around ideas of how to achieve industrialisation.

As it relates to the latter, the state institutions in question, the DPE and Transnet, need to manage a complex set of relationships with global OEMs and local suppliers. Moreover, the state needs to manage its own internal constituent elements, its departments and commercial enterprises, in order to leverage procurement for local industrial development.

4.3 Internal and external tensions around the developmental state

South Africa and the ANC in particular, has since President Thabo Mbeki's second term of office, and more emphatically since the Polokwane Conference in 2007 declared itself a developmental state. In the mould of the East Asian strong states, the South African government began to see its role as state that can facilitate the achievement of sustained economic growth, and maintain itself as a state on that basis. The central question then becomes; how does this self-styled developmental state manage its internal tensions, and external relationships fashioned by policy, to build industrial capability. Such industrial capability must be able to address urgent national concerns, such as unemployment and black economic empowerment.

Fine (2010) rejects the developmental state paradigm on analytical grounds. Fine observes that the paradigm, by drawing a distinction between state and market, does not appropriately identify underlying political and economic interests and how these are represented through the state and the market (Fine B. , 2010). Fine argues that for South African state, 'far from being a developmental state co-ordinating or even coercing private capital to commit to a concerted programme of industrial expansion and diversification, the interests of private capital have predominated over developmental goals' (Fine B. , 2010, p. 175). Fine further argues that an adherence, at a policy level to macroeconomic orthodoxy has prevailed at the expense of broader economic and social interventions. Even though, there has been strict following of orthodox macroeconomic principles by the state, there hasn't been wholesale privatisation of state owned entities, as the logical conclusion would suggest. The reasons for this, highlight an important historical and contemporary role envisaged by the state for its commercial enterprises. How this role is managed, in conjunction with other tensions will influence the performance of the CSDP towards its intended objectives.

Southall (2007) argues that the state sector has historically enjoyed a symbiotic relationship with private capital, and by not privatising the parastatals totally, this reflected the ANC government's, 'reluctance to cede ownership of strategic assets to forces which might prove beyond its control' (p. 204). Southall further argues that the ANC government's policy towards state owned entities started out as leftist, went right, and then returned to centre, in its approach to state involvement in the economy. In addition, parastatals have always been central to class and ethnic mobilisation, and just as the National Party had used them to promote the development of Afrikaner capital around the MEC, and the ANC continues to see them as key instruments for black economic empowerment, as Mr Malusi Gigaba, Minister of Public Enterprises notes in relation to Transnet's demand strategy;

'This presents an opportunity for black business to explore both downstream and upstream initiatives, high value-added goods and growth sectors in the infrastructure value chain like cement plants, stone mining and others' (<http://www.southafrica.info/business/trends/empowerment/infrastructure-240114.htm#> - accessed 25 February 2014.)

Southall argues that the government's approach to parastatals and its policy in that regard, is predicated on the use of the state to promote black ownership and control of the economy (Southall, 2007). The CSDP as part of the policy frameworks aimed at achieving that overarching objective faces many tensions, and contestations. The two central tensions that emerge from this chapter are as follows;

- a) The tension and difficulty within the ANC of creating a black industrial class that can develop fast enough, to be able to benefit from urgently required infrastructure investment in South Africa. What would be termed, a patriotic or developmental national bourgeoisie reflected across both the state and the market.
- b) The tension around which interests' state policy promotes, and the possibility of promoting established white interests in the rail sector, as opposed to creating new black industrial interests, through the CSDP and other industrial policy measures.

These tensions, and many others, will be assessed in the following chapter using the *governance agencies, firm structures and political settlement* approach proposed by Khan(2010).

CHAPTER 5

FURTHER INSIGHTS GAINED FROM RESEARCH FINDINGS

5.1 Governance Agencies

Lee (2013) argues that a successful industrial policy is defined by the extent to which it alters conditions of accumulation and the extent to which it enables new forms of accumulation to occur. Blankenburg and Khan (2009) raise the central concern that the 21st century conditions for industrial catch-up, learning and ultimately development, are different to those faced by earlier developers. Khan argues that, ‘non-market incentives are required for catching up, the effective implementation of such strategies typically also requires institutional systems of compulsion to supplement the discipline imposed by the market’ (Blankenburg & Khan, 2009, p. 2).

The mechanisms used in the CSDP require the co-ordination of different government departments, state owned enterprises and other private and public sector agencies. The co-ordination of these different institutions, with different focuses and institutional thinking on development issues, represent what Khan and Blankenburg define as the compatibility (or lack thereof) between the institutional compulsions and the organization and structure of political power in any society.

It is therefore important to analyse the governance agencies charged with managing a policy instrument such as the CSDP. **Table 5.1** illustrates the internal stakeholders that need to be managed.

Table 5.1 Internal Stakeholder Management

A. INTERNAL STAKEHOLDER	WHAT TRANSNET NEEDS
EXCO	<ul style="list-style-type: none"> • Support for supplier development in general and CSDP specifically • Approval of this Plan
BU OPCOs	<ul style="list-style-type: none"> • Support for supplier development in general and CSDP specifically • Timeous execution of approved business cases • Follow governance and procedure • Provide spend information quarterly
BU CPOs	<ul style="list-style-type: none"> • Identification and communication of opportunities • Timeous execution of approved business cases • Follow governance and procedure • Ensure appropriate staff attend training and are continually trained in Supplier Management / Development • Ensure that the structure supports continuous Supplier Development and Management

The table indicates the organisational support that a supplier development policy intervention such as the CSDP requires at executive committee, operations committee and chief procurement office level at all business units within the Transnet Group (Transnet, Transnet Supplier Development Plan , 2008). In terms of the external stakeholders which are integral to the success of the CSDP, there are a wide range of stakeholders which are involved in the management of the CSDP as a policy instrument. The Department of Trade and Industry (DTI). From when the DPE introduced the CSDP in 2008, it facilitated consultation between;

- Participating SOEs (including Transnet)
- Government institutions (DTI, DST, CSIR and the IDC)
- The local supplier industry represented by supplier industry associations

These consultations were carried out in order to understand industry perspectives on areas of competitive advantages and possible productivity improvement (Transnet, Transnet Supplier Development Plan , 2008).

The DPE in terms of the obligations placed by the CSDP is expected to fulfil the following roles. They are required to communicate successes of CSDP initiatives publicly and provide

assistance to participating SOEs as required, such as funding advice and access to benchmarking services (Transnet, Transnet Supplier Development Plan , 2008).

Additionally, the DPE has to facilitate the Supplier Benchmarking Forum between SOEs, government institutions and UNIDO as the benchmarking service provider and improve stakeholder engagement models to reach more local SOE tier-2 and tier-3 suppliers. Furthermore the DPE is expected to share the importance of a database of benchmarked tier-2 and tier-3 suppliers as a means for tendering global OEMs to propose participants for localising their supply chain (Transnet, Transnet Supplier Development Plan , 2008).

In essence, the envisaged role for the DPE in the CSDP is that of a co-ordinating and facilitating institution, as we shall see below, in practice this role is far less clear.

The DTI has the following roles and expectations assigned to it as part of the CSDP;

- Assist OEMs with registration and legal issues in setting up operations in South Africa
- Assist OEMs with customs and duties for SOE mega project imports
- Identify potential suppliers and industries based on DTI's industry
- Assist in leading and supporting trade delegations to OEM procurement personnel and lastly;
- Facilitate access to DTI incentives and support measures for local SOE tier-2 and tier-3 suppliers. (Transnet, Transnet Supplier Development Plan , 2008)

The DST and the CSIR are required to assist suppliers needing Research and Development on new technologies or in teaming up with OEM technologies. In terms of financing, the IDC is expected to provide development funding options as required by OEMs, and/or tier-2 and tier-3 suppliers. They are also expected to provide advice and/or assistance to Transnet Supply Chain officials on business case development of CSDP opportunities and due diligence of local suppliers requesting admittance into the CSDP on a case-by-case basis. Additionally, the IDC is expected to provide access to their market research, industry information and the relevant industry statistics.

Industry associations on the other hand, are expected to liaise with supplier development managers with respect to market dynamics and the dissemination of information. They are

also expected to provide sector information and review and accept supplier development plans.

5.2 Firm Structures

The intended objectives of the CSDP, such as employment creation, increases in manufacturing value added and ultimately the creation of new conditions of accumulation can only be made possible if local suppliers are able to form part of global OEM supply chains and service these supply chains even beyond the Transnet capital spend. An analysis of the firm structures of the firms wishing to enter the global OEM value chains and the global OEM's value chains themselves allows us to assess the possibility for local firms to enhance their position in global markets, one of the central aims of the CSDP.

Gereffi et al argue that two important features of the contemporary global economy are the globalization of production and trade (Gereffi, Humphrey, & Sturgeon, 2005). According to Gereffi et al, this globalization has had the following effects;

- Growth of industrial capabilities in developing countries
- Vertical disintegration of transnational corporations which are redefining their core competencies to focus on innovation, product strategy, marketing and other highest value-added segments of manufacturing. This has occurred while these firms have reduced their direct investment and ownership of non-core activities such as generic services and volume production (Gereffi, Humphrey, & Sturgeon, 2005, p. 79).

An analysis of global value chains, and the effect of their configuration on local manufacturing capabilities is important for two different, but interrelated reasons. The first being, that the ways in which global production and distribution systems are integrated and secondly the possibilities for firms in developing countries to enhance their position in global markets (Gereffi, Humphrey, & Sturgeon, 2005). The latter directly responds to the intended outcome of the CSDP, however an analysis of the diverse firm structures that will be affected by the CSDP is important to understand the possibilities for the local supplier industry to enhance its position in the global rolling stock market.

5.2.1 Challenges in the local supplier industry-global OEM nexus

As the OEMs are charged with capacitating the local industry, as part of the CSDP, it is important that one analyses the connection, or lack thereof between the local supplier

industry, and global OEMs. Insights from the semi-structured interviews conducted indicate that the relationship is seen from different vantage points depending on which side one stands. The success of the CSDP is dependent on the functional interaction between the firm structures in the OEMs and the local supplier industry. Edwin Ritchken, Strategy Advisor at the DPE, alluded to how unresponsive the local supplier industry was, in the face of large demand from the SOE's market demand strategy. This was a sentiment shared by independent development consultant, Greg Poisson argues that;

'..while it seems that foreign OEMs have accepted government's localisation initiatives and have competed to meet and exceed government requirements, the response from the local manufacturing sector, can at best be described as patchy' (Poisson, 2013).

Of the stakeholders one has spoken to, Steve Jardine shared the view together with Greg Poisson, that years of under-investment and uneven orders have led to a climate of uncertainty where local suppliers are afraid to commit any capital or other expenditure towards improving their productive capabilities. This has then left them in a state, where they are unable to respond to the conditions laid down by OEMs in their subcontracting requests (Jardine, 2013).

Poisson further argues that the local supplier industry assumes that it has no role to play in supplier development initiatives and that the onus is on the OEMs to meet all regulatory obligations relating to localisation, and simply hand-deliver work packages to the local industry (Poisson, 2013). This view is refuted by what Steve Jardine stated as the cause of underinvestment by the local industry; uncertainty. Jardine argued that uncertainty about getting the OEM contracts, or being overlooked by OEMs or even by having the supplier contracts given to Transnet Rail Engineering, has made the local industry, save for the DCD's of this world, quite nervous about investing in productive capacity in order to use large state spending in order to gain global competitiveness;

'In this environment, you don't know who the winners are going to be, and because the industry doesn't know who they are, they don't invest in the right capacity' (Jardine, 2013).

It is however, notably interesting that the local supplier industry and the global OEMs are not as homogenous or uniform, in their responsiveness or lack thereof to regulatory change, or OEM subcontracting requests. Steve Jardine, in responding to an enquiry about the nature of the relationship between the local supplier industry and global OEMs, said that a number of

OEMs bidding for Transnet work, have gone into the local supplier industry to look for the capacity, and where they have found that capacity they have contracted with those suppliers (Jardine, 2013). The question then becomes, is that enough to ensure investment, and how much investment is needed to make the global industry globally competitive, and who will be expected to make this investment and under what conditions?

One of the concerns expressed by the local industry, is the amount of time that the local industry has to make these investments and benefit from the spending, which has already come on board (Jardine, 2013). This mirrors, a similar concern, of how long it may take to build black industrialists, and whether or not these industrialists will be developed in time to benefit from the large capital spending. As the Executive for Supplier Development at the Transnet Group, Garry Pita observed, that the local industry in terms of some of the high value elements of rail value chains, has very little capability beyond, ‘fabrication, metal bashing and taking designs from other overseas entities and then doing the assembly’ (Pita, 2014). Unfortunately, assembly generally accounts for 15% at most of the total pricing of the final end product (Pita, 2014). This means that the current value addition that occurs in the local industry to rail products, is very low as a result of inadequate local capabilities, and this has meant that very few firms (especially of the smaller ones) have benefitted from large Transnet rolling stock contracts. This difficulty was also expressed by Dr Shawn Cunningham, a Post-Doctoral Fellow at the Vaal University of Technology and a Research Associate at the Institute for Economic Research on Innovation at Tshwane University of Technology;

‘Due to public procurement pressure, there simply is not enough time to develop local manufacturers. For this reason, a select group specialized and competent firms are being identified and drawn into local procurement initiatives, often giving up other business within local supply chains. Thus our local manufacturing sector is becoming more concentrated and more isolated from export markets to local markets’ (Cunningham, 2013)

If the industry will become more concentrated as a result of local procurement initiatives, then the CSDP needs to ensure that its methodology at an SOE level is robust enough to ensure that public procurement is not only benefitting established industries alone, but also expanding emerging firms and developing new ones, in this way, the program will have addressed Lee’s need for industrial policy to create conditions for new forces of accumulation to occur.

The analysis above indicates one central and overriding concern; that our local manufacturing capabilities are typically insignificant relative to what we demand in terms of public infrastructure, and this then makes space for global OEMs to bid for public infrastructure spending. Supplier development initiatives such as the CSDP, then play the role of ensuring that the global OEM contracts with the local industry, such that these firms also benefit from public spending. The sad state of the local supplier industry, which according to Steve Jardine, needs to organise itself, has meant that it has in large part missed out, and will continue to miss out from contracts related to public infrastructure projects.

5.3 Towards a growth and capabilities-enhancing political settlement?

In the first section of this chapter, one analysed the different governance agencies charged with the implementation of the CSDP. This section aims to illuminate the distribution of power and power relations that underpin large scale capital spending on infrastructure in South Africa. Khan defines a *political settlement* as the relationship between formal and non-formal institutions and the distribution of power in society. In particular, Khan analyses political settlements in developing countries through two dimensions, which this study employs; the organization of the ruling coalition and its relationship to the emerging productive sector. In the South African context, the latter can be seen as the 're-emerging' productive sector.

With the end-user in the CSDP value-chain being Transnet, one would assume that the SOE is the locus of power when it comes to the implementation of the CSDP as a way of procuring rolling stock. This kind of analysis masks the political economy relationships that make it difficult to identify the central organisation that yields power over the localisation instrument or procedure. Such an analysis would invariably ignore the power dynamics and relationships from both sides of the public-private sector divide. An important concern is the nature of the organisations charged with legislative and regulatory oversight over public procurement and the CSDP in particular, and the organisations which provide supply and demand-side support and the distribution of capacities, competencies and resources financial or otherwise, among the organisations involved in the CSDP, in both the private and the public sector. An analysis that addresses these concerns will illuminate the political settlement that the CSDP is embedded in, and in so doing plays an important role in illuminating the dense web of state-private sector relations that underpin large capital spending. This becomes more important if

one takes into account the prominent role placed on infrastructure spending (of which rolling stock is an integral part) in turning around South Africa's socio-economic fortunes.

5.3.1 The Organization of the Ruling Coalition in the CSDP

In terms of the governance of the CSDP, there are legislative and implementation concerns that underpin the policy instrument. There are clear oversight issues, largely as they relate to the rules, procedures and criteria governing the CSDP. The organization of the administrative and legislative functions of the state in South Africa has largely followed what can be termed as a neoliberal approach. The neo-liberal and NPM approach to state economic planning and governance since the early 1990's has continued to have an overriding impact on the organization of the state and its institutions. The idea behind the NPM influenced procurement reforms, was to decentralise procurement down to the departments and management level, and then hold accounting officers at that level, and even at municipal level responsible for spending and procurement decisions. These decisions would then be contrasted against the regulations issued by the National Treasury for compliance with the PPPFA and PFMA.

Pons-Vignon and Segatti, argue that the particular form that public reform has taken in South Africa post 1994, has continued to frame all forms of state intervention in the economy;

'The systematic overhaul of the Department of Finance, and its National Treasury division....is a critical bureaucratic process which not only determined the nature and longevity of the new macro-economic policy framework but also conditioned all other forms of state intervention' (Pons-Vignon & Segatti, 2013, p. 568)

Pons-Vignon and Segatti further argue that this public reform was underpinned by an increasingly overarching reach of the National Treasury in the affairs of other government institutions;

'combined with a broad public sector reform that soon moved from a developmentalist agenda to a more narrowly managerial one, this techno-structure and its increasing adherence to orthodox economics ensured a panoptical control over government activities at the service of fiscal restraint' (Pons-Vignon & Segatti, 2013, p. 569)

This has made the National Treasury, a unique organisation within the state bureaucracy in South Africa. It is an organisation whose oversight powers and financial control are immense.

Moreover, its personnel and organizational capacity, ‘exhibit levels of professionalism which are exceptionally high by national standards’ (Pons-Vignon & Segatti, 2013 , p. 569).

The National Treasury has the most important oversight function as the custodian of the PPPFA, and as such issues instruction notes on how public procurement in designated sectors should occur. Instruction notes serve the purpose of regulating the environment within which accounting officers and authorities may procure rolling stock which has been designated for local production and content (Treasury, 2012). Interviews with officials from the National Treasury were difficult, if not impossible, to come by due to busy schedules and one assumes, nervousness on the part of many of these officials to speak about, what is a sensitive issue. The lack of first-hand insights from these officials has limited and handicapped the study to some extent, in its attempted to illuminate the dense web of relations within the state and between the state and private commercial and industrial interests, as a sector of society.

Many of the respondents interviewed in this study, and those found in other sources, made reference to the seeming disconnect between the PPPFA, and the other pieces of legislation outlining the use of public procurement for industrial development. Garry Pita, responding to the apparent divergence in approach between the legislative and policy provisions around procurement by state owned companies;

‘Look, the fact is, and we are not going to lie about it, is that there is an element of disconnect between the PPPFA and all the other aspects that we are trying to achieve such as our supplier development objectives, job creation etc.’ (Pita, 2014)

Pita argued that the PPFA doesn’t allow the procurement process to extract more localisation and local content, than that outlined in the PPPFA.

‘The PPPFA doesn’t really allow you to go over and above that, it says that fifty percent local content, and let’s say for argument’s sake diesel locomotives are fifty percent and electric locomotives are sixty percent. I can get more than that so why is that the threshold? Why can’t it just be a minimum, and it will allow me to make a threshold that I believe goes to my market research, so that is one issue with the PPPFA’ (Pita, 2014)

Further, on the question of other equity objectives, such as broad-based black economic empowerment (BBBEE), Pita argued that the PPPFA legislation stands at odds with the methodology that Transnet aims to deploy, to draw out more developmental outcomes from its capital spend;

'The other issue is the 90/10, why is ten percent the maximum for BEE? If we are trying to create change within ownership within supplier development, within enterprise development in this country, then that is not really an incentive, in fact your larger traditional OEMs or white-owned businesses in South Africa that have had a lot of success in the past because of the previous regime, they might score badly then on BEE but beat other new entrants on price and that is not trying to achieve the objectives that the government is trying to achieve'

Reconciling the different pieces of legislation and the new methodologies adopted by the SOE, needs to be a priority if the CSDP is to succeed as a policy instrument. Pita highlighted the need for sustained dialogue between the different governance and oversight agencies over the CSDP, in order to ensure coherence in methodology and implementation.

6.3.2 The new political settlement: a developmental evaluation methodology?

Transnet has ventured, to renegotiate the basis of power in terms of state procurement and its envisaged methodology to achieve the socio-economic and industrial outcomes envisaged by the current government. That the government has prioritised infrastructure spending as a source of growth and employment in this decade and beyond, goes without saying. This has highlighted, as Garry Pita noted, the need to develop new methodologies to draw out industrial enablers and innovative forms of protection and encouragement for the local industry (Pita, 2014). In the process, these new methodologies have called in to question the adequacy or inadequacy of existing legislation and its implementation in the form of regulatory provisions issued by the institutions charged with custody and oversight over these pieces of legislation and policy. This search for new ways to carry out procurement, calls in to sharp focus, the need to align legislation with the need to rectify historic economic inequities in access to resources and industrial means of accumulation. In essence, legislation needs to be aligned to the need, to draw from Lee, to create the conditions for new 'black' economic forces to emerge, accompanied by new productive structures and forms of accumulation. Our 'big-push' needs to be premised on transforming a centuries-old landscape of accumulation, a tall order indeed.

Pita argues that the new methodology has aimed to create new economic forces of accumulation, particularly among the historically disadvantaged sections of the population, by allowing for Transnet to have greater power in the award of contracts to firms which take long term industrial development and transformation seriously;

‘..because we realised that there is an issue (with the CSDP and PPPFA), in the interim we have created a new methodology that aligns to trying to maximise the developmental objectives. So for example in our tenders we will do ninety ten, but we will have a supply development pre-qualification that says if you do not sign up to say that you are going to invest fifty percent contract value in all these supply development objectives, you do not even come past the gate to tender again’ (Pita, 2014).

This new methodology, has in a way created a new way of procuring in one significant way. It has created a differentiator that the PPPFA in no way makes provision for. In the sense that only firms which have met the supplier development objectives will be able to bid for Transnet contracts. Garry Pita notes, that in the previous system, one could not do this;

‘So I have got a pre-qualification and I have got a threshold for us to be able to allow tenders to either go in or out and if they can’t meet those objectives then they are out. The only problem with that is by me not putting them in evaluation and only having ninety ten and not having supplier development in the evaluation or a BEE additional, I can’t create a differentiator’

However, even in the face of such differentiation, the PPPFA due to its insistence on price competitiveness continues to make developmental procurement praxis difficult as Pita observes;

‘.....if you are tenderer A , I am tenderer B, and the pre-qualification is 45% and you can give me 80% and I as tenderer B can provide 46% and our prices are the same or lets say I am R1 cheaper, I will win but yet you would offer eighty percent in terms of supplier development which is far more beneficial for South Africa, the PPPFA doesn’t allow you to do that differentiator’ (Pita, 2014)

The case for legislative reform in order to align and improve the working of the government’s policy instruments is clear. There is a need for policy coherence across the government, in the instruments it uses, and the legislative provisions that regulate the use of those instruments. The public procurement legislation is but one of these pieces of legislation.

5.3.3 Programmatic vs. Transactional Procurement: a new praxis.

Transnet’s supply chain policy, commits itself to programmatic or strategic procurement, as opposed to transactional procurement (Transnet, Transnet Supplier Development Plan ,

2008). The study has already highlighted the need to build globally relevant capabilities in the local industry, in order to make it globally competitive. Transnet, in responding to the concern raised by the local supplier industry that there isn't enough time for the local industry to upscale and upskill itself to benefit from Transnet contracts, has articulated its aim of achieving a programmatic procurement regime. Pita notes in relation to the design capabilities that the local industry needs to develop;

' I think (the local supplier industry) has a long way to go in terms of their design capabilities, so that is why Transnet and Eskom are entering into much longer term contracts and RFPs to create programmatic change, as opposed to transactional procurement. It (the new method) is a programmatic procurement, a programme of a thousand locomotives, of a hundred and twenty five per year type of thing or two hundred a year which can create a stable pattern of demand so the South African supplier community can learn and grow with it so that by the end of it we must be good' (Pita, 2014)

This new programmatic approach, as opposed to a 'piecemeal type of procurement', is in clear conversation with the notions of creating an enabling environment for learning, as outlined by Khan (2010). Moreover, this long term view of leveraging purchases over a longer temporal horizon presents a new and interesting praxis of carrying out public procurement in pursuit of developmental industrial outcomes, and only time will tell whether this approach will be beneficial or detrimental, to the developmental project pursued by the self-styled developmental state in South Africa.

5.4 Parting Reflections

The interaction between governance agencies, firm structures and a broadly-defined political settlement underlying the CSDP as a state policy instrument, have provided interesting insights. Three main overriding insights emerge.

Firstly, when one looks at the intra-departmental tensions that the CSDP process has laid bare, one can clearly see that the current tensions around what Transnet wishes to do, with regard to using its spending as a means of industrial diversification and building a domestic, black industrial class, are a typical result of the kind of SOE that Transnet is. What is meant by this? Roger Southall in his discussion of the restructuring of South African SOEs, talks about how the ANC government's aspirations to become a developmental state have in the early years of the current dispensation had to stand up against a market-friendly restructuring

of SOEs and the need to racially transform the South African economy (Southall, 2007). There is a clear indication that Transnet has had since it started operating under that name, in 1989, to be a cost-cutting and highly bottom-line conscious organisation in pursuit of commercial profit as opposed to developmental goals. This coupled with later privatisation, albeit on a less than significant scale, has meant that Transnet has always had to be conscious and aware of its commercial imperatives and a regulatory environment which adhered to the fiscally conservative macroeconomic framework, GEAR, that South Africa had since adopted. There has been however, an added complexity, with the DPE from the time it was under Alec Erwin's stewardship, seeing the SOEs as important drivers of growth and development (Southall, 2007). This has also been complemented by the ANC government's need to deal with the growing impatience of the black majority at the pace of economic transformation, such that there was a shift in thinking towards using the state and its parastatals as key sites of transformation. As Southall notes, that the shift, 'reflecting government's growing disillusion with the capacity of the private sector to bridge the alarming gap between the 'two economies', indicated aspirations towards a much more stronger and interventionist state' (Southall, 2007 , p. 210). Therefore, as part of this shift, the state in framing parastatals as key sites of transformation, aimed to use two tools to achieve this, staffing and procurement. What this study, then posits as a tension, with regard to the latter, is the increasing frustration and acknowledgement within Transnet, that the regulatory environment may thwart their intentions of using parastatal procurement as a means of transforming the local economy, and creating new forces of accumulation among the previously disadvantaged. Moreover, what this tension between the imperatives of restructuring and transformation indicates, is a bigger tension at a policy and legislative level, and realised through intra-departmental tension between a more commercial versus a developmental view of the SOEs, and how the role and powers given to different departments play a role in managing, or failing to manage, the underlying ideological tensions. This represents a central tension and concern within the political settlement around the CSDP.

Secondly, what the analysis presented in the last two chapters indicates, is a deeply fragmented state, and this has in turn had a profound impact on how it relates to other sectors of society, in particular suppliers in the rail sector. It is however, a state that is fully aware of the need to create institutions vested with enough power to regulate and co-ordinate economic transactions and activities of state organs. The challenge in South Africa, then becomes the nature and orientation of the institutions charged with such regulatory and

oversight powers, and whether this complements the developmental aspirations of the government as a whole. The delay over the evaluation criteria for the ‘ten-sixty four’ contract, is seemingly an indication of how these tensions can play themselves out in a manner that stalls urgent investment, with significant implications for the domestic economy. More importantly, as the multi-layered relationships between the governance agencies represented in the preceding analysis indicates, the state in its economic functions is fragmented with the lion’s share of regulation and oversight occurring at the level of the National Treasury, with limited ability to co-ordinate or articulate a clear distribution of power between the different institutions that would manage the underlying tensions between existing policy and the developmental aims of the state.

Lastly, in avoiding the often misleading dichotomy between state and market, it is often useful, as Ben Fine notes, to identify the underlying economic and political interests and how these interests are represented through state and market. In the ANC government’s quest for economic transformation that can resolve the national question of race in South Africa there is a need to outline how certain interests within both the state and the market stand to benefit from state policy aimed at creating a black and patriotic industrial class that can benefit from large capital spending by the state. Southall observes, that as parastatals are defined as key sites of transformation this, ‘entailed that there would be winners and losers and implied that there would be struggles and controversies which would be disruptive to the smooth running of what were all highly complex organisations’ (Southall, 2007 , p. 210). There has been a heavy emphasis, on the part of Transnet as can be seen in the comments made by Garry Pita that historically disadvantaged interests need to be placed at the centre of the company’s large capital spending. There has been overriding tension however, around how the regulations and oversight framework on the one hand makes it difficult to draw out and leverage more opportunities for black owned businesses. There is a concern that the current framework, legislatively, may lead to the promotion of two particular interests, white established industrialists and TRE, at the expense of creating new commercial interests among the black majority. Whether Transnet wishes to use TRE as a means to internally leverage the capital spending of other Transnet subsidiaries, and directly influence transformation outcomes, is a moot point. However, it is clear, that there is a degree of mistrust or miscommunication between the local supplier industry and Transnet.

At a commercial level, there is the real difficulty which was presented in the preceding chapter, of developing a class of black industrialists soon enough, to benefit from the large spending which will be rolled out over the next decade. The fear and tension within the ANC, is around whether large capital spending of this nature may bolster established white industrial interests, with very little in terms of direct ties to the ruling ANC and whose long term interests in terms of national developmental aspirations around BEE, employment and investment may be different to those of the ruling coalition. As Steve Jardine notes,

‘the local supplier industry is inefficient, antiquated and stuck in a debt spiral, and BEE is the last thing on their minds’ (Jardine, 2013)

The resolution of all these tensions, as proposed by Transnet through programmatic as opposed to transactional procurement, may go a long way in ensuring that the market structure of the local supplier industry, is able to transform and reflect interests whose developmental orientation and objectives are in line with the transformation objectives of Transnet, and the ruling coalition as a whole. However, if the comment above, is anything to go by, then a more long term and institutionalised procurement schedule, such as that proposed by Transnet, will have to assist in altering the behaviour of the local supplier industry in two fundamental ways. The first of which, would require the local industry to prioritise BEE, in the form of ownership, and possible worker involvement in the management and operational activities of local supplier firms, the second would require significant investments in industrial capability and local synergies with other relevant local and preferably black industrial interests, will allow these firms to be responsive to the kind of SOE-private sector engagement required by the CSDP.

CHAPTER 6

CONCLUDING REMARKS

There have been notable success with regard to the CSDP, and these have been mentioned in the study. Moreover, the shift towards a programmatic procurement regime presents significant possibility for the state to leverage its own spending in a manner that it can enforce and monitor, for continuous improvement and innovation in the long term. The advent of the CSDP, as two of the interviewees from Transnet and the DPE noted, has created an acknowledgement of and sensitivity to the need to incorporate supplier and industrial development in the praxis of supply chain management. It is however, the challenges that this study has found notably important, and these require final mention here.

Firstly, it is clear that there is a contestation around how the state should intervene in the economy within the state, and how parastatals should be used to achieve this, and whether or not these parastatals should play a direct role in the market in competition with the very interests that the CSDP and Transnet's SD policy aim to develop and encourage. Moreover this reflects across the state and the market, contestations around a strictly balance-sheet focused view of SOEs as commercial enterprises that should be subject to the same competitive environment and conditions of accumulation as other actors in the rail sector when it comes to state contracts, as opposed to a more interventionist state, with enterprises that play a direct and 'developmental role in ensuring the achievement of socio-economic transformation objectives.

Secondly, there is an indication of a state that is fragmented in terms of its approach to industrial policy, and the use of the instruments at its disposal in that regard. What became clear early on, was that the state, in its functional roles was largely a site of contest between those who have had to oversee compliance to fiscal regulations tied to the overall state macroeconomic framework, and those who feel that the state needs to intervene more in pursuit of industrial and socio-economic transformation, over and above the bounds set by the macroeconomic policy framework. This has led to a situation where the National Treasury, plays a strong co-ordinating role of different state institutions due to its financial and policy oversight over public procurement, but very little co-ordination in terms of ensuring that the non-financial activities such as communication with different stakeholders, co-ordinated

planning of how related stated instruments can be used in tandem with the CSDP and other SD measures. Without internal coherence and a clearly co-ordinated means of creating functional and institutional links between the different government departments and instruments that the CSDP consists of, the programme is unlikely to succeed.

Lastly, as Lee notes, the state needs to alter the conditions of accumulation for underlying economic and political interests, but moreover it needs to create new economic interests. By fashioning itself as a developmental state, the state has identified the need to create the motive forces that will benefit from such a developmental and possibly interventionist stance. These interests have been clearly identified as the historically disadvantaged black majority, which needs to produce its own industrial class in the mould of the patriotic elites of the East Asian developmental states. In this regard, SOE procurement policy has for long been targeted as an important means of ensuring the upward class mobility and industrial success of this group of interests. Have these attempts been successful? The study clearly indicates that there has been minimal success in this regard. One of the reasons for this has been a challenge internal to the state. It is clear, that different state institutions hold different views, from those with an inherent nervousness about the possibilities of clientelist rent-seeking culture emerging within the state, to those who understand that the development of new productive forces seldom occurs in rent-free environments, there is a wide cross-section of thinking and schools of thought within the state. What seems to be emerging is a middle road that is becoming more attuned to policy which skews competitive norms in pursuit of domestic industrialisation in an economically unequal world. This will represent interesting possibilities for the development of a new thinking around industrialisation and re-industrialisation in emerging economies. However, at present, it is clear that there is a tension around whether or not programmes like the CSDP can churn out such an industrial class quickly enough to benefit from the large capital spending, and whether programmes such as the CSDP will serve to provide support to existing white industrial interests at the expense of creating a new class of industrial interests among the previously disadvantaged. It is interesting that the state has not found it difficult to provide support for white corporate interests, with minimal black ownership and representation, in other sectors such as telecommunications, mining and finance. One wonders whether this is the model envisaged by the state when it comes to the rail manufacturing sector.

This study, in analysing the Transnet's programme aimed at leveraging procurement, has sought to illuminate the fragmented nature of the state, and the character of its intended and actual relationship with private sector interests in South Africa. Moreover, it presents an analysis of a state enterprise charged with meeting socio-economic expectations, in an environment framed by a rather conservative macroeconomic framework. The contestations that emerge from such a policy environment, and how they play themselves out in the state and market, have important implications for public procurement praxis. In fashioning itself as a developmental state, the South African state has embarked on a process through measures such as the CSDP, aimed at forming a constellation of economic, political and ideological interests that can in complementary action ensure that developmental and transformational policy is actualised and reflected in outcomes and praxis. This will go a long way in making the developmental state aspirations of the ANC government seem somewhat realistic and realisable, however a lot more needs to be done.

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