



**STRUCTURAL TRANSFORMATION OF ECONOMIES:  
LESSONS FROM THE SOUTH**

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## **STRUCTURAL TRANSFORMATION OF ECONOMIES: LESSONS FROM THE SOUTH**

### **INTRODUCTION**

Within the developing world, governments and state institutions are formulating and implementing policies to assist with overcoming the challenges which hinder the successful economic and social development of these nations. South Africa is a good example for this process, as it has been, and still is, undergoing the processes of transformation which resulted from calls from international organizations to abolish the laws of apartheid. This led to the implementation of numerous structural adjustment programmes which required the complete overhaul of the economy, changing its nature and characteristics from one in which wealth was concentrated among a few and economic diversification practically non-existent, to one in which the state plays a direct role in the achievement of economic growth and social development, and the resulting benefits spread to all.

South African decision-makers have, since 1994, made numerous attempts to deal with the ongoing injustices inherited from the years of segregation and oppression, but these have resulted in a mixed bag of successes. This paper aims to analyze these policy measures, examining the realism of the stated objectives, assessing the resulting outcomes and identifying the shortcomings within them. Furthermore, the state cannot achieve all its goals unaided, and Development Finance Institutions (DFIs) are seen as an integral constituent to help achieve success in these programmes, most notably for their ability to forge ahead, achieving both efficiency and effectiveness in times of crisis.

The challenges and shortcomings resulting from the execution of these policies within the South African context and the success of the role played by DFIs, allows for the analysis of lessons learned in the last 15 years, so that it may be utilized in the decision-making and policy formulation processes in developing nations which seek to follow a similar route in the achievement of transformation.

### **BACKGROUND**

For decades, black South African citizens<sup>1</sup> suffered under the oppressive rule of Apartheid brought about by the enactment laws of 1948 which institutionalized and legalized racial discrimination. The system placed authority in the hands of the whites and sought to control the economic and social affairs of blacks, including their education, employment, and residential locations as settlements were allocated based on race, preventing people from different racial classes living side by side, denying black South Africans

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<sup>1</sup> The term 'black South Africans' as used in this paper, includes African, Coloured and Indian citizens

access to essential basic services such as water, sanitation, transport, communication and electricity. Municipal grounds; beaches, parks, hospitals and schools were declared to be ‘whites only’ areas and the Act of 1956 allowed for formal discrimination in employment. Education was governed by the Bantu Education Act, preventing black South Africans from receiving an education which would lead them to aspire to greater positions in society, rather providing them with skills which allowed them to labour under white employment only. Severe restrictions were placed on black business ownership, while ownership of immovable property by blacks was illegal, making farming and agriculture a white dominated sector.

Aside from the racially driven social injustices which resulted from apartheid, South Africa suffered economically as well. Economic growth and the successes achieved in areas of inflation, job creation, saving and investment during the early years of the apartheid era, was underpinned by the relative strength of the gold price, and the protectionist import substitution trade policies implemented, providing protection to the internationally uncompetitive manufacturing industry. The changes in policy governing the gold price, coupled with the liberalisation of international trade barriers, and the withdrawal of foreign firms due to pressure from international anti-apartheid movements, led to the low, and ultimately negative, economic growth of the late 1980s and early 1990s.

The 1994 national elections and the victory of the unity government, led by the African National Congress (ANC), saw the start of South Africa’s emergence from decades of oppression and discrimination under apartheid rule. However, while this attainment of democracy presented South Africa with the opportunity to restore the rights of the people, it also brought with it the daunting legacies of apartheid in the form of South Africa’s economic and diplomatic isolation from the rest of the world, as well as high levels of inequality, poverty, and economic stagnation.

The new ANC-led government faced a tough battle to mitigate these challenges and together with the formulation of the new interim constitution, protecting the right of all South African citizens, recognized the need that all-encompassing reforms be implemented at all levels of government. They have since formulated and adopted many policies to improve the quality of life of the people, promote economic and social transformation, address the challenges of racial inequality and unemployment, and simultaneously achieving the objectives of growth and efficient institutions. The following sections review these policies, the objectives and outcomes, while analyzing the challenges which hindered their effective implementation.

The five policies which are analyzed are the Reconstruction and Development Programme (RDP), the Growth, Employment and Redistribution Strategy (GEAR), the Accelerated and Shared Growth Initiative for South Africa (AsgiSA), the Medium-Term Strategic Framework (MTSF), and the New Growth Path of 2010.

### **Reconstruction and Development Programme - 1994**

In the run up to the 1994 elections, the tripartite alliance, comprising the ANC, the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP), formulated and released a social development policy document, the Reconstruction and Development Programme (RDP), which acted as its election manifesto. This framework, which clearly articulated the injustices suffered and set out the objectives and aspirations of the alliance, was aimed at addressing the many social challenges facing the country, while contributing to economic growth through the liberalisation and improved efficiency of the economy. It was built on the bottom up, grassroots approach to be owned and driven by communities and organisations, allowing beneficiaries to be involved in all levels of the decision making process.

‘The programme will meet basic needs and open up previously suppressed economic and human potential in urban and rural areas. This will increase output in all the sectors of the economy and by modernizing our infrastructure and human resource development we will also enhance export capacity’ (ANC 1994).

The need for the RDP was evident from the inequality and underdevelopment imposed on blacks, for while some citizens enjoyed a high standard of living, others were denied access to even the basics such as homes, land, health care, education and employment. Towns and cities were divided, comprising of well developed commercial farming areas, and impoverished Bantustans, levels of crime were high, and the justice system was skewed in favour of the whites.

#### *Objective*

Recognizing that the problems facing South Africa were all interrelated, and that successful mitigation required well coordinated strategies, mobilizing people and resources to help bury the era of apartheid and build a democratic, non-racial, non-sexist society, the RDP was underpinned by 6 guiding principles:

1. Policies needed to be all-encompassing, addressing all problems and challenges with equal concern and commitment
2. It needed to reflect the needs of the people, as they are the most important resource and carry the hopes of the future
3. The provision of peace and security to all, restructuring the defense forces and legal systems which were previously skewed to protect white interests
4. To build a strong nation which could then develop itself, extending that development pattern into not only Southern Africa, but on to the world, removing the divide caused by apartheid which classified developed countries as the 'first world' and underdeveloped countries as the 'third world'
5. The linking of reconstruction and development, as both economic growth and social development are key aspects for the achievement of success in South Africa. These two goals cannot be undertaken in isolation as their successes are dependent on each other
6. To strengthen the democracy of South Africa, giving a voice to all, allowing everyone the opportunity to contribute to decision making and development.

With these principles, the programme identified 5 key programmes to achieve the desired goals:

1. Satisfying the basic needs of all through the implementation of programmes providing land reform, rural development, and the provision of essential services such as clean water, adequate sanitation, electricity, ICT, transport systems and social welfare funding
2. The development of human resources by focusing on education and training, literacy levels, arts and culture, sport and recreation and the development of the youth
3. To build the economy and the nation, through job creation, the protection of worker's rights, and the abolishment of all discrimination based on race, gender, disability, religion or language
4. Democratization of the state and society through the implementation and upholding of the Constitution, and the Bill of Rights

5. The successful and complete implementation of the RDP objectives at all levels of government, national, provincial and local.

These objectives and goals of the RDP were seen as achievable as the new government would remove division within power structures, allowing for easier and more effective action. Furthermore, this policy was not just the property of the state, but that communities, unions, businesses and workers all had a role to play in the provision of energy and innovation to attain success.

#### *Outcome and Challenges*

While many of the goals of the RDP were achieved, some fell short of their targets, most notably in the delivery of essentials. The two key problems identified for this failure was that firstly, the RDP ignored the gathering of new taxes, rather focusing, far too narrowly on fiscal prudence and the reallocation of existing revenues; and secondly, the new government suffered from a clear lack of sufficiently skilled managers, while policy co-ordination and implementation methods used were not proven to be successful.

This shortage of state capacity and the failure of governmental efficiency, led to the implementation of the new Growth, Employment and Redistribution Strategy in June of 1996 as an extension of the RDP.

#### **Growth, Employment & Redistribution (GEAR) - 1996**

June 1996 saw the introduction of the GEAR strategy by the then Minister of Finance, Trevor Manuel as the updated social and economic policy of South Africa. It represented a 5 year neoliberal economic strategy aimed at the strengthening of economic stabilization, increasing employment creation, and the redistribution of income and socioeconomic opportunities in favour of the poor and previously racially disadvantaged. Many argued that GEAR would replace and override the goals of the RDP, but Manuel disagreed, stating that the implementation of GEAR was necessary to ensure the successful achievement of goals set out in the RDP, emphasizing that the goal of the state was to avoid borrowing, rather utilizing and leveraging the economy of South Africa to avoid the repayment of long-term debt. While the focus of many developing and underdeveloped countries lay on the achievement of short-term, short-lived gains which came at the price of prolonged long-term problems and challenges, South Africa's view with regard to GEAR was to endure the short-term pains in the achievement of long term success in both economic growth and social development.

The most pertinent difference between the RDP and the GEAR strategy policy initiatives was that while the RDP was a people-oriented socialist framework, this new strategy was seen as a pathway to South Africa's economic salvation through the achievement of a higher growth rate, creating an economic environment conducive to private investment which would in turn result in greater job creation and the equitable redistribution of income.

### *Objectives*

While the GEAR strategy encompassed most of the social goals and objectives of the RDP, it also added a number of economic objectives as noted in the Macroeconomic Strategy Document (DF 1996):

- The implementation of a fiscal deficit reduction programme to counter inflation, free up resources and reduce the deficit to below 3% of GDP, and a budgetary reform to assist in the strengthening of the distributive thrust of expenditure, cutting down government expenditure to 18% of GDP.
- The formation of an exchange rate policy to keep the exchange rate competitive, with an effective monetary policy to keep inflation below 6%, and the removal of foreign exchange controls and the implementation of tax incentives to stimulate new investment in competitive and labour absorbing projects, with a reduction in tariffs to contain input prices and facilitate industrial restructuring
- The achievement of an average economic growth rate of 4.2% per year by 2000, and the creation of 400 000 new jobs per year.

### *Outcome and Challenges*

Economically, GEAR has brought a mixed bag of success for while in some areas performance far exceeded expectations; other targets were missed by a significant margin. By the end of 2000, fiscal deficit, inflation and government consumption targets were all met, reporting figures of 2.2%, 5.4% and 18% respectively, bringing about greater macroeconomic stability, better reporting and increased accountability, but private investment, job creation and GDP growth indicators were disappointing and the only success seen with regard to GDP was that the negative growth rate of the early nineties was reversed.

While the management of public finances improved drastically under GEAR, three key reasons for the disappointment of the growth rate were identified (Hirsch 2005). Firstly, the tightened monetary policy which was implemented to achieve inflation goals was further tightened in response to the 1998 crises of

Asia, Brazil and Russia, and when combined with the depreciation of the rand, contributed to the low levels of investment and growth. Second, the restructuring of government at national, provincial and local government levels led to a reduction in government expenditure; and thirdly, both the national and international private sector remained hesitant with regard to South Africa's future and as such FDI remained elusive.

Furthermore, the low levels of economic growth and private investment were insufficient to contribute to the reduction in unemployment, and according to NALEDI, the research branch of COSATU, more than 400 000 formal sector jobs were lost between 1996 and 1999, and the jobs which were created by the GEAR policy were in the informal, low-paying sectors. Although economic growth and the economy's performance saw an improvement in the early and mid 2000s, much of the growth has been jobless, in that it contributed very little to the reduction of unemployment.

On the social side, GEAR achieved very little success with the distribution of wealth remaining uneven and the disparity gap between the rich and the poor widening. This led to COSATU becoming one of the GEAR policy's biggest critics in which they touted that the GEAR strategy as a structural adjustment programme which placed too much emphasis on monetary and fiscal targets, and macroeconomic policy, neglecting the social aspects such as the needs of the people, poverty reduction and redistribution of income.

### **Accelerated and Shared Growth Initiative for South Africa (AsgiSA) - 2006**

While the GEAR strategy was sufficient for the achievement of macroeconomic objectives, it clearly fell short with regard to the social challenges of the country, most notably poverty reduction and employment creation. The improved economic growth and economic performance experienced in the mid 2000s gave the South African government renewed hope that these two social challenges could be overcome with the implementation of policy and as a result a new policy, the Accelerated and Shared Growth Initiative for South Africa was formulated.

#### *Objectives*

AsgiSA, acknowledging these challenges of prolonged poverty driven by unemployment, underemployment and low earnings, and the jobless nature of economic growth, was thus formulated with the aim of reducing poverty by 2010, and halving unemployment by 2014 from the 28% in 2004 to 14%

by 2012<sup>2</sup>. It recognized that the policies implemented to address these issues needed to be at the forefront of economic policy decision making and not just a sideline policy, while acknowledging that an average growth rate of at least 4.5% between 2005 and 2009 was needed to have a realistic chance of achieving the aforementioned goals, while growth would have to increase to above 6% from 2010 and beyond.

To overcome the constraints facing faster economic growth, AsgiSA identified 6 key binding constraints for which it will implement the required interventions:

1. The volatility of the currency in spite of the improved monetary and fiscal stance of South Africa is a threat to investment in tradable goods and services. This, accompanied by the overvalued Rand, results in the diversion of investment to narrower, safer areas.
2. The cost, efficiency and capacity of the national logistics system resulted in the major backlogs experienced in the country with respect to infrastructure and investment and have had a detrimental effect on the costs of moving goods and thus competitiveness.
3. The shortage of suitably skilled labour is one of the most serious challenges facing the successful economic and social development of the country and is an extension of the prolonged and deliberately inferior education system offered to blacks. This is amplified by with the irrational spatial patterns of settlements and the high costs of labour
4. Barriers to entry, limits to competition and limited new investment opportunities: These negative factors have led to the lack of diversification in the economy, leaving it concentrated on upstream production sectors, and impacting negatively on service industry development.
5. The regulatory environment and the burden placed on small and medium enterprises have hampered the development of business within South, most notably in areas such as tax administration, labour laws, and municipal regulation. This is especially evident in the lackluster performance of the SME sector in its contribution to GDP and employment.
6. Deficiencies in state organisation, capacity and leadership are a further constraint to the achieving the country's growth potential

AsgiSA, having recognized the above challenges, identified six initiatives to help mitigate these constraints and achieve the goals and objectives of policy more effectively:

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<sup>2</sup> Unemployment here is defined using the 'narrow' definition

- Infrastructure programmes in which the government has committed itself to the ramping up of public sector investment to not only remove the existing backlog, but to also further research and development infrastructure, expand communications infrastructure and to upgrade and maintain public infrastructure.
- The need for sector specific investment strategies has been acknowledging as the various sectors within the economy require different solutions to overcome challenges and garner private sector investment, government prepared sector specific strategies. Two priority sectors were singled out, business process outsourcing (BPO), and tourism, with other sectors such as biofuels, agro processing and metals beneficiation later added in.
- Together with its sister programme, the Joint Initiative on Priority Skills Acquisition (JIPSA), a 3 year programme to address skills shortages and enhance policy implementation, AsgiSA aims to identify skills shortfalls, while raising the levels of skills needed through the deployment of experienced professionals, the Adult Basic and Education Training programme, and the upgraded career guidance programme.
- AsgiSA identified that interventions were needed to bridge the gap with the second economy and aims to do so by leveraging the first economy. This will be done in two ways; firstly, by increasing the levels of public expenditure in the promotion of small businesses and broad – based empowerment, and secondly, through the above-mentioned sector specific strategies.
- Within macroeconomic intervention, strategies were to be put in place to reduce the volatility and overvaluation of the currency and improve budgeting and expenditure management, while simultaneously ensuring that fiscal and monetary policy work effectively within an inflation targeting regime to produce sustained and shared growth.
- Public administration issues: The formation and implementation of new institutional interventions is a costly exercise which can be avoided if existing institutions and capacity are redeployed and levered into new functions and responsibilities.

### *Outcome and Challenges*

While AsgiSA has achieved a certain level of success, the level of implementation and future of the programme was uncertain as no official word come from government regarding the fate of AsgiSA,

President Zuma did, in his inauguration speech, set the target of 500 000 jobs by the end of 2009, and 4 million jobs by 2014, in line with the goals of AsgiSA.

### **The Medium Term Strategic Framework - 2009**

The Medium Term Strategic Framework 2009 - 2014 (MTSF) presented by the now Minister in the Presidency, Trevor Manuel, was formulated with the aim of guiding government programmes in the electoral mandate period, to achieve a democratic, prosperous society. The main focus for this policy was to minimize the impact of the economic downturn on the country's productive capacity, and to identify new areas of growth and economic participation (Minister of the Presidency 2009). The key strategic priority areas included:

- The speeding up of economic growth and transformation to create decent work and sustainable livelihoods through the maintenance of cohesive monetary and fiscal policy, macroeconomic stability, affirmative action, competitiveness and the exploitation of comparative advantages
- The implementation of massive programmes to build economic and social infrastructure such as electricity, ICT, public transportation, water, and low and affordable housing, along with a comprehensive rural development strategy to achieve reform and food security. This will assist in the stimulation of agriculture, land reform, skills development, and the revitalization of rural towns.
- Strengthening the skills and human resource base through early childhood development, the provision of adequate basic services and safe environments conducive to learning, broadening access to higher education and effective schools management.
- Improving the health profile of all South Africans assisted by the phasing in of the National Health Insurance (NHI) system, increasing institutional capacity and the implementation of the Comprehensive Plan for the Treatment, Management and Care of HIV and AIDS.
- To intensify the fight against crime and corruption through the modernization of the Criminal Justice System (CJS), to help improve its efficiency and effectiveness, the rehabilitation of detainees and the regulation of private security companies. This further entails the building of

cohesive, caring and sustainable communities through social assistance, a shared value system, the promotion of unity and the development and strengthening of community organizations.

- The pursuing of African advancement and enhanced international cooperation through the continued prioritization of the African continent, the improvement of political and economic integration in SADC, the strengthening of South-South relations, and participation in the global system of governance.
- The building of a developmental state while improving public services and strengthening democratic institutions, enhancing the culture of an efficient, transparent and honest public service.

### **New growth path - 2010**

Despite the various policies formulated by the government since the end of apartheid, structural unemployment remains extremely high poverty continues to afflict millions, oppression of workers continues and the inequalities are now deeper than ever before. Government has recognized the need for a new and effective growth path to help overcome these structural challenges and contribute to the achievement of higher levels of economic growth. The key pillars identified for this effective, long-term, sustainable and equitable strategy are that firstly, government should fulfil the core state functions that are required for sustained economic growth, through supportive fiscal and monetary policies, and the provision of adequate infrastructure, social services and efficient regulation. Second, the diversification of the production structure to maximize employment creation in the short and medium term while laying the basis for long-run knowledge based growth. Thirdly, increasing equity and social mobility through the broader ownership of assets, access to skills for workers, a more merit-based access to quality education, and the discouragement of conspicuous consumption by the rich; and finally, social protection linked to active labour market policies, providing protection to the poor and permitting greater economic responsiveness (ANC 2010).

In the design of this new growth path, the measures which should be included are:

- Appropriate fiscal and monetary measures that are actively directed at the promotion of more job opportunities. This should also be linked with measures, such as a more competitive and stable exchange rate, to assist in the control of inflation and the improving of efficiency.

- Targeted measures should also be implemented in a systematic way to improve the performance of the economy in those areas which contribute to equity and growth such as rural development, the strengthening of industrial and trade policies, the improvement of education and skills, the promotion of small business and cooperatives, and the development of the African region.

It is evident from the policies which have been implemented since 1994 in the form of the RDP, GEAR, AsgiSA, and the MTSE, that overcoming the legacies of Apartheid; unemployment, poverty and inequality, have been the driving forces behind the formulation of these policies. Results, however, show that the implementation of these policy measures has achieved little success in these areas, for unemployment and poverty is on the rise, while the inequality divide is now greater than ever before. Government and the decision-makers need to look at the new growth path policy to ensure that it is sufficiently different from the previous frameworks to mitigate the challenges encountered, while achieving the preset targets in areas related to social upliftment.

### **THE ROLE OF DFIS IN SOUTH AFRICA'S TRANSFORMATION**

Development Finance Institutions (DFIs) are established with the aim of providing finance to those projects, economic sectors or sections of the population that are not well served by the financial system as a whole. They thus seek to address financial market failures, complementing both government resources and market funding. While this financing role is important, DFIs are also expected to address policy objectives, contributing to society through private sector development, employment creation, income redistribution, import substitution and the development of poor groups, regions or sectors.

The importance of DFIs to development and growth is apparent from the roles which they are able to fill, as they act not only as financiers or lender of last resort, in the channeling and provision of funding, and the provision of countercyclical finance, but also in the other three traditional areas of assistance. The technical assistance role encompasses project preparation and feasibility studies, as well as the promotion of economic linkages and business opportunities; while the capacity building role refers to the critical expertise provided for risk analysis and project preparation and the promotion of entrepreneurial and business development.

The area of importance for DFIs in the transformation process is their role as an implementer of government policy which requires that they serve as they financial arm for developmental policies, assist

government in the formulation of such policies through lessons learned, bridging the gap between government and the private sector, and the promotion of regional trade and cooperation.

Within South Africa, the review and restructuring of the Development Finance System (DFS) is a regular occurrence on the South African institutional landscape, with the effectiveness of DFIs in supporting the implementation of government's objectives a reoccurring theme on the agenda of many policy discussions. A review conducted by the National Treasury in 2008 concluded that DFIs in South Africa were not realizing their developmental potential for a number of reasons. There is a clear lack of clarity and coordination around mandates, resulting in a number of overlaps as well as gaps, with individual institutions given a wide scope to interpret mandates at will. The contrasting goals of development effectiveness and financial sustainability further constrain the ability of DFIs to contribute to development, while political interference in the operations of DFIs further compounds an already complex situation (DBSA 2010a).

The Development Bank of Southern Africa (DBSA) is one such institution and was established in 1983 to perform a broad economic development function within the then homeland constitution dispensation. The transformation of 1994, led to a change in the role of the DBSA and in 1997, the Bank was officially reconstituted as a DFI. Its new roles consist of the provision of assistance to the state in the achievement of its goals through a number of strategic objectives such as the promotion of broad based economic growth, job creation and integration, the building of human and institutional capacity, and the co-delivering of social and economic infrastructure. Areas contributing to social transformation and economic stimulation have been singled out as potential investment destinations, to help alleviate the existing backlogs in the provision of water, sanitation, electricity, communication and health care. In the provision of assistance and capacity to the state, the DBSA has always played an integral part in the formulation and implementation of post apartheid government policies such as the RDP, GEAR, and AsgiSA (DBSA 2010b).

Going forward, there are a number of key areas where the DBSA, and in particular the Policy Unit will provide support to the state and institutions. To the DFI forum, the DBSA houses the secretariat with the aim of promoting South African DFI involvement in the drafting of policies and engagement in projects, while encouraging and facilitating cohesion between the various institutions. To the Speaker of Parliament, the DBSA will provide support capacity for its oversight role and the ensuring of efficiency in its governance role. With the Department of Performance, Monitoring and Evaluation (DPME), the Bank conducts policy advisory engagements such as stock takes and think tanks.

## CONCLUSION

From the policies which have been implemented since the beginning of transformation in South Africa, a number of key trends have come through which could serve as lessons to economies which are transforming. Firstly, it is essential that the social and economic policies which are to be implemented be clearly defined, setting out its goals and objectives in a comprehensive manner. Second, stakeholder buy-in is essential for the successful implementation of any policy and requires broad, in-depth consultation with relevant parties. Thirdly, the process of implementation is important, such that the execution of strategies should be done in a systematic manner. Fourth, capacity of government and institutions is essential for both the implementation phases, as well as for the purposes of monitoring and evaluation, finally, good governance and an efficient regulatory environment is essential for the effective alleviation of the lingering social challenges of inequality, unemployment and poverty.

The role of DFIs in the transformation process is that they should not only provide the necessary support to the state in the formulation and implementation of policies in the form of advice and capacity, but also ensure cohesion between the mandate they follow and the objectives of the state. This is an essential element for while DFIs should have focused mandates, it should also allow for a sufficient degree of flexibility to enable DFIs to have sufficiently wide portfolios to manage risk and returns, and to cater for changes in national objectives over time.

Countries seeking to undergo the process of transformation and implement policy change should take heed of the lessons highlighted in this paper, for although the South African government attempted to achieve change, the clear lack of cohesion and capacity impeded the achievement of post apartheid social and economic goals. When formulating policies, decision-makers should carefully analyse the benefits, costs and challenges it may face, crowding in all stakeholders for the achievement of growth and development cannot come from state action alone, but requires inputs and cooperation from DFIs, the private sector, labour unions and the general public.

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