



Betrayal of the Promise: How South Africa is Being Stolen

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Presentation to the Maritime Law Association

August 31st, 2018

Franschoek, Cape Town

Outline

- Background
- The Five Levers of a Captured State
- State Capture in Action: The Transnet Locomotive Deal
- Researching State Capture: New Evidence
- Future Research

I: Background

- Report product of multi-university collaboration.
- Formally part of the *State Capacity Research Project (SCRIP)* - drawing in academics from UCT, WITS, UJ, Stellenbosch University, and a journalist.
- What distinguishes this Report is that it serves as an analytical bridge between:
 - Statements of public at large (e.g. the Unburdening Panel; Save South South Africa campaign; BUSA & BLSA statements) on one hand and
 - Journalism on ongoing corruption within the state – provided by the print media coverage of the #GuptaLeaks.
- We tried to provide a more formal structure and analytical rigour to our understanding of state capture, rent-seeking and ongoing institutionalized corruption.

I: Background

- Two events on either side of the *Betrayal of the Promise* report:
 - The Unburdening Panel of the SA Council of Churches on May 18th 2017,
 - First explosion of 200 000-odd emails emanating from desk of senior manager at Sahara [#GuptaLeaks].

II: Five Levers of a Captured State

- A five-pronged strategy to capture the state
 1. Repurpose State Owned Enterprises
 2. Entrench Parallel and Weak Governing Structures
 3. Rise of the Shadow State
 4. Legitimise Rent-Seeking Behaviour at all levels
 5. Control of the National Treasury

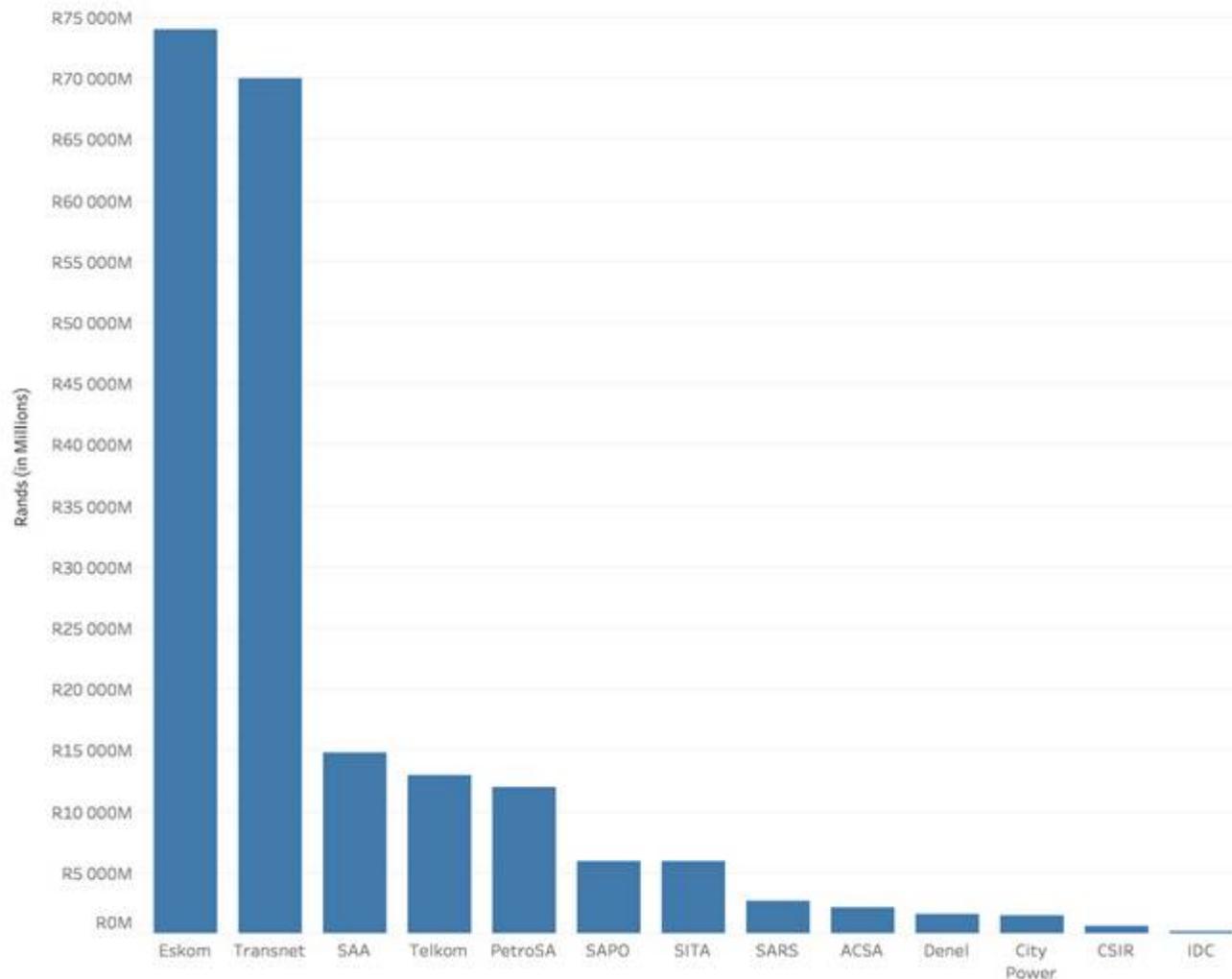
Lever 1: Repurpose State-Owned Enterprises

- Weaken governance and operational structures of SOEs:
 - Appointment of Gigaba on 1 Nov, 2010 as Minister of Public Enterprises: Start of systematic *process of Reconfiguring Boards of SOEs* to ensure compliance.
- Example - By 2011, two key events at Transnet:
 - Attempt to get little-known DTI official (& Gupta associate) Iqbal Sharma appointed as Transnet Board Chairperson and
 - Successful appointment of Brian Molefe as Transnet CEO.
- Throughout his tenure until 2014, then Minister of Public Enterprises, Malusi Gigaba engaged in restructuring of SOE boards.
- Second component of Repurposing SOEs:
 - Exploit loophole in Public Finance Management Act (PFMA) making it possible to use procurement procedures of SOEs to benefit selected contractors who had been sanctioned by the Gupta network.

Lever 1: Repurpose State-Owned Enterprises

Value of SOE Procurement, 2010-2011 (Rm)

Value of South African SOE procurement
2010-2011

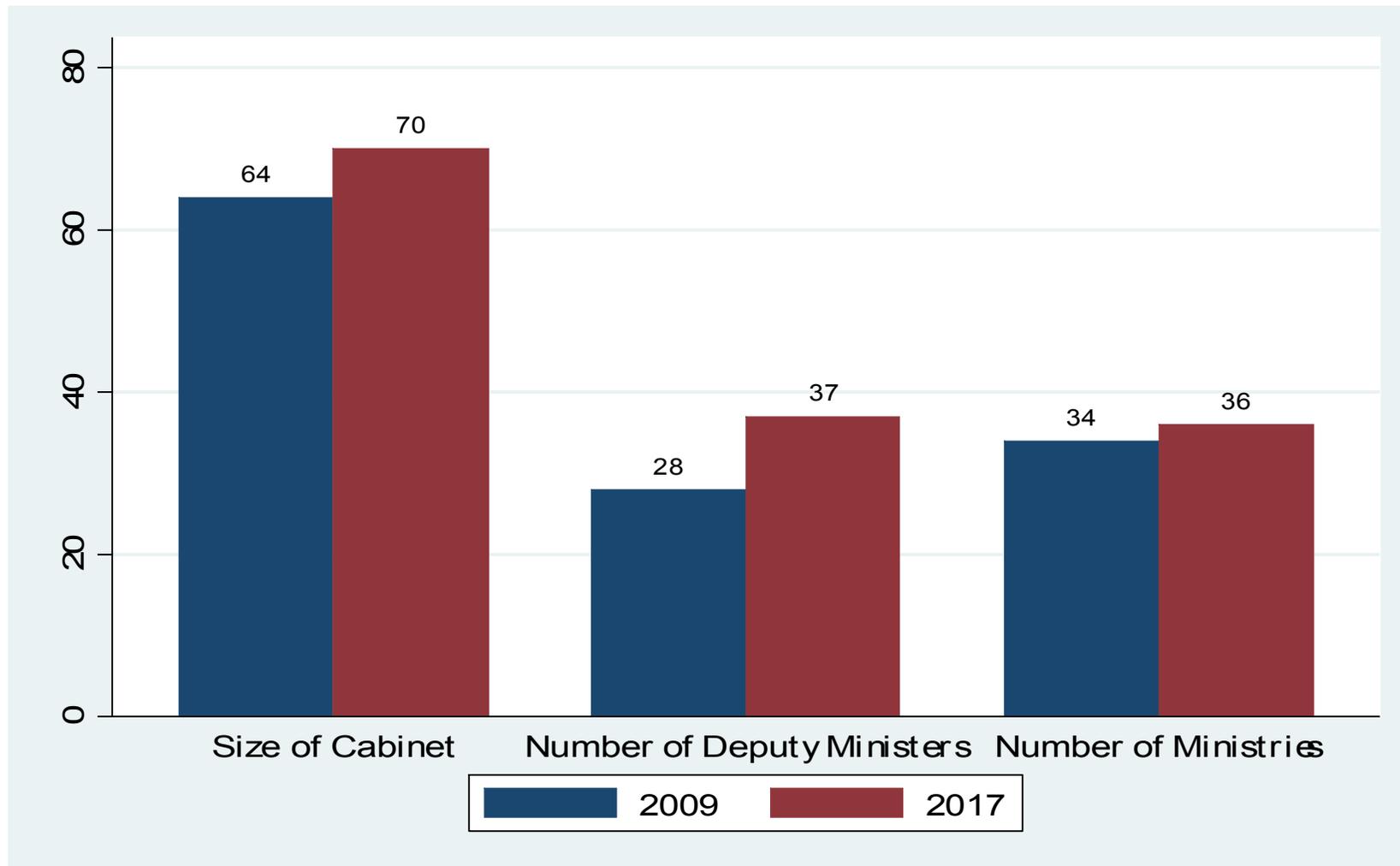


Lever 2: Weak Governing Structures

- *Parallel and/or weak government and decision-making structures that undermine executive and collective decision-making process located in Executive.*
- Includes strengthening of '*Premier League*' and use of a '*Kitchen Cabinet*'.
 - Increase in size of cabinet under Zuma
 - Rise in the political power of 'Premier League'
- Series of political appointments at Cabinet and provincial government levels reinforced the Premier League
 - Ace Magashule emerging as its *de facto* leader.
 - Since 2014 election, President has come to depend increasingly on provincial party machines represented by the Premier League.

Lever 2: Weak Governing Structures

Change in Size of Cabinet and Ministry Creation: 2009-2017



Lever 2: Weak Governing Structures

- *The Rise of the Inter-Ministerial Committees:*
 - Critical decisions delegated to handpicked groups, masked as Inter-Ministerial Committees, able to function in an unaccountable manner. Recent examples include:
 - The **IMC on Banks** (purportedly set up to investigate the regulations and legislation that govern them, but strangely chaired by Mines Minister Mosebenzi Zwane and set up after the Bank's closed the Gupta bank accounts);
 - The **IMC on Communication**, unusually chaired by the President;
 - The **National Nuclear Energy Co-ordination Committee (NNEECC)**, chaired by President Zuma.
- Nature of IMCs:
 - *Lack Transparency*
 - *Do not report to Parliament* (which individual members of Cabinet are required to do)
 - *Not formulated in legislation* (as is the case of formal Cabinet Structures)

Lever 3: Rise of the Shadow State

- Securing loyalty of security and intelligence services by appointing loyalists – ‘*Replace good cops with bad cops*’.
- Process of removing key people from security and intelligence agencies critical to creating and enforcing new rules of the repurposed state.
- Replaced with loyalists, to deal with ‘troublesome individuals’, especially key players
- Key institutions of the shadow state:
 - Hawks, police services, intelligence.
 - Also in conjunction here, all institutions with prosecuting powers are muted e.g. SARS.

Lever 4: An Active Rent-Seeking State

- Rent-seeking opportunities actively sought within government departments.
- Government ministers acting in concert with private interests:
 - Use regulatory instruments or policy decisions in an arbitrary manner to “shake down” incumbent businesses – including black businesses – and favour particular interests.
 - Instead of prioritising job creation and economic growth, decisions are taken for the benefit of a particular company, faction or group.
- Tegeta-Glencore Optimum deal and Free State dairy farm theft good examples.
- The rise of ‘micro-corruption’.

Lever 5: National Treasury - The Ultimate Prize

- Securing control over the country's fiscal sovereignty viewed as the final frontier to complete state capture.
- Gordhan & Jonas and staff of National Treasury viewed as obstacle to project of centralising the management of rents.
 - NT believed in levelling of playing field and good governance, hence establishment of Chief Procurement Officer in 2013.
 - NT were aware of and opposed the increasingly corrupted and centralised rent management system that Zuma's power elite was setting up.
- Key instruments of power in the NT for the corrupt network:
 - The Financial Intelligence Centre (FIC) to track illicit financial flows to illuminate workings of shadow state.
 - Prior to cabinet reshuffle, Financial Intelligence Centre was only intelligence agency not controlled by the Zuma network.
 - The Public Investment Corporation, which is the largest institutional investor on the Johannesburg Stock Exchange.
- Zuma's power elite realised that to effectively centralise control of rent seeking, needed control of the Office of the Chief Procurement Officer, the Finance Intelligence Centre, the Public Investment Corporation and the unique power available to the Minister of Finance to issue guarantees.
- Above is only possible if a loyal Minister of Finance is in place.

III: State Capture In Action: The Transnet Case

5 Steps to Corruption:

- **Step 1:** Repurpose the governance of the SOE
- **Step 2:** Find a Broker
- **Step 3:** Create the Mechanism for Corruption at the Board Level
- **Step 4:** Structuring the Corruption
- **Step 5:** Launder the Financial Flows

State Capture In Action: The Transnet Case

- **Step 1: *Repurpose Governance of Transnet***
 - Appointing new malleable Minister (Min. M.Gigaba).
 - Min M.Gigaba in our model is an ‘entrepreneur’ to Zuma, who is the patron. You then need middle-men or brokers.
- **Step 2: *Find a Broker***
 - Enter Iqbal Sharma.
 - Rejected as Board Chair of Transnet (blocked by Cabinet), but appointed to Board (June 2010). Also at this time Brian Molefe (another Broker) appointed CEO, March 2011.
- **Step 3: *The ‘Switch’.***
 - Key Change: Transnet creates a new structure, called the ***Board Acquisitions and Disposals Committee***, to supervise planned pipeline of future large-scale infrastructure spending (all tenders worth more than R2.5 billion).
 - Sharma becomes Chair of committee.
 - At this point that Gupta-linked entities began benefitting from Transnet tender opportunities.

State Capture In Action: The Transnet Case

- **Step 4: *Structuring the Corruption***
 - Case of the R52 billion tender for purchase of 1064 Locomotives.
 - Deal adjudicated by Sharma, and theft of public funds took place through three key avenues:
 - **Professional Services**
 - **‘Insider Procurement’**
 - **Information Technology**

State Capture In Action: The Transnet Case

- **On Professional Services**

- Gupta network (in this case through Trillian Capital and Eric Wood) invoiced Transnet on this locomotive deal, as well as others huge sums of money for supposed advisory, professional and financial services.
- Not clear what these services have been.
- Total sum we've located only to the Locomotive deal ± R170 million.
 - *Recent research suggests this is a significant under-estimate.*

- **On 'Insider Procurement':**

- Just before successful bidders of locomotives tender announced, Sharma emerges as a buyer of VR Laser Property - owns the property upon which VR Laser Services is situated (owned by the Guptas and Duduzane Zuma)
- Arguably in a highly advantageous position to benefit from supplying component parts to successful bidders in the locomotives deal (required by state procurement policy to source large proportion of their components from South African subcontractors).

State Capture In Action: The Transnet Case

- **On ‘Information Technology’:**
 - Neotel benefitted from significant Transnet work, but seemingly only as a result of an obscure Gupta-linked entity, Homix, which acted as a broker between Neotel and Transnet.
 - SAP strongly encouraged by Transnet to partner with a Gupta entity, Global Softech Solutions, in order to win parts of the Transnet locomotive bid.
 - Above are examples of classic ‘finder’s fee’ or rent-seeking which we most commonly associate with corrupt activities.
 - On this one deal only, we estimate total of about R100 million was made by Homix and other Gupta-linked companies.

State Capture In Action: The Transnet Case

- **Step 5: *Laundering the Financial Flows***
 - Evidence that much of proceeds of locomotive deal monies laundered via Hong Kong and through three Gupta-linked companies.
 - The 3 Gupta-linked companies which feature most prominently in the Hong Kong movement of money are:
 - Regiments Asia Ltd (unrelated to the SA company Regiments) Tequesta Group Ltd, and Morningstar International Trade Ltd.
 - Note: Morningstar shares a Hong Kong address with three of Salim Essa's companies (where he is listed as the director): Regiments Asia, Tequesta Group, and VR Laser Asia.

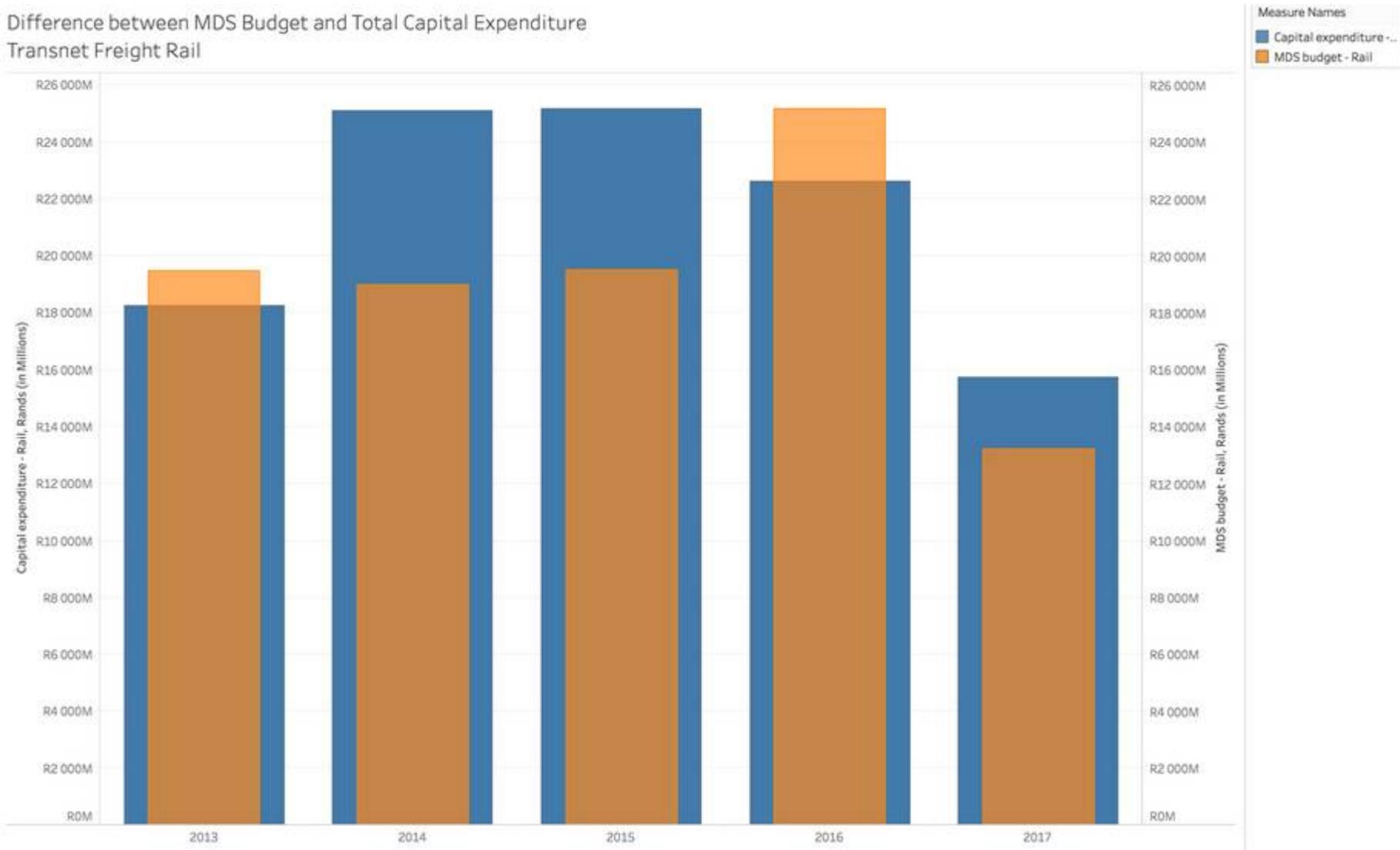
Researching State Capture: New Evidence

Transnet's Market Demand Strategy: Laying the Groundwork for Corruption

- The MDS (2012-2018) aimed to expand rail, ports and pipeline infrastructure – with expenditure of over R420 billion
- In a 2015 presentation Anoj Singh (then CFO) noted that majority of investment was in freight and rail
- In 2013 Gordhan had already expressed concern:
 - *“the profitability of the project is highly dependent on Transnet’s general freight business being able to grow the volumes transported at amounts above GDP growth and tariffs charged at above CPI [inflation]. [...] Failure to achieve these optimistic growth figures would have an adverse effect on the expected revenues and thus the profitability of the project.”*

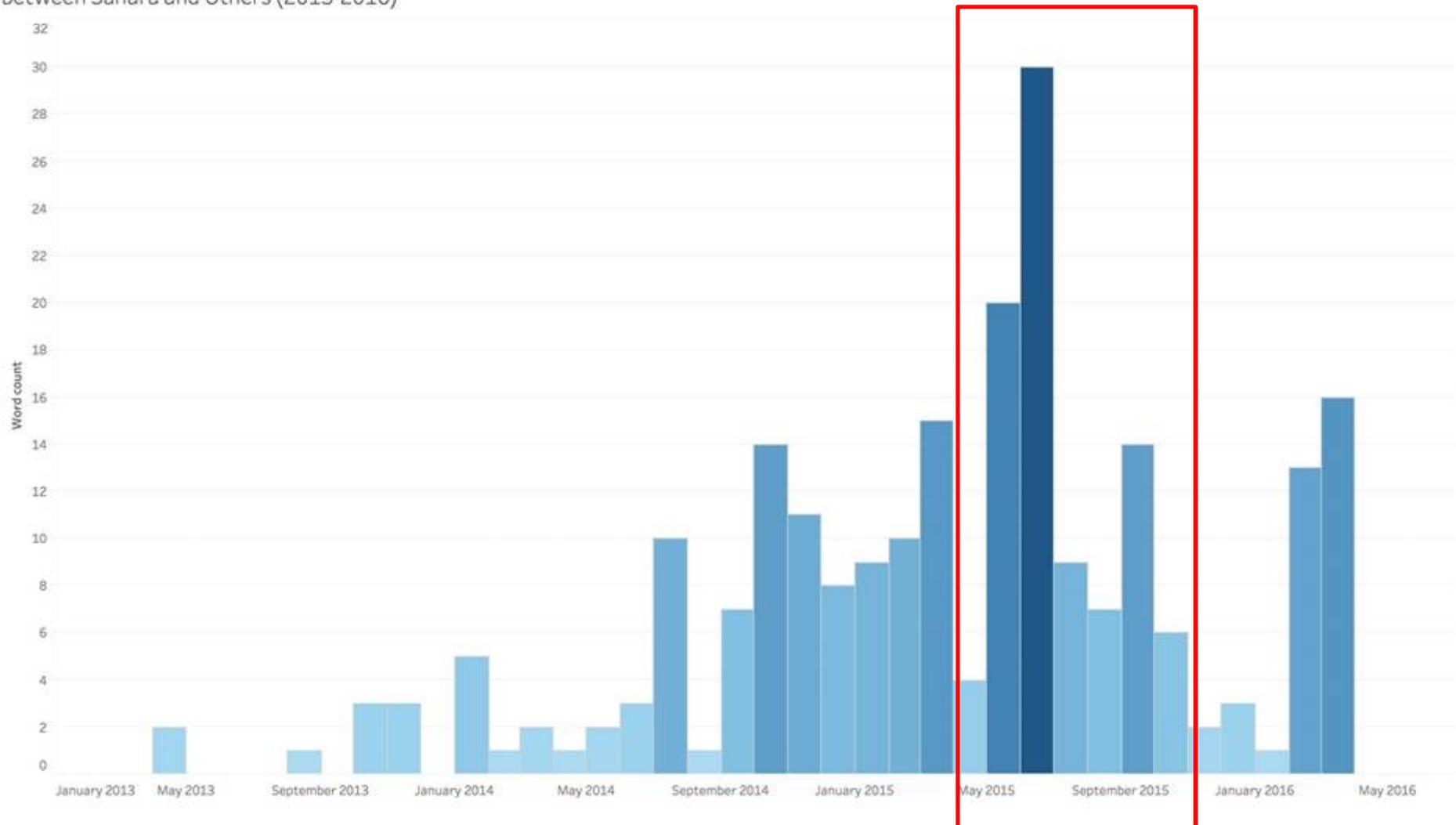
Transnet Freight: MDS and CapEx (2013-2017)

Difference between MDS Budget and Total Capital Expenditure
Transnet Freight Rail



Heatmap of #GuptaLeaks: Incidence of Transnet Mentions

Heatmap of mentions of Transnet in emails
between Sahara and Others (2013-2016)



Corrupt Transnet Contracts

- Over the 2012-2017 period Transnet paid billions of Rands on large infrastructure procurement contracts that had direct and indirect links to the Guptas
- These included contracts for procurement of locomotives, IT hardware, systems and services, consulting, and cranes
- Below we show the total amounts paid on these contracts, relative to Transnet's overall Revenue, EBITDA and Capital Expenditure on Infrastructure

Tainted Contract Payments by Transnet: 2012-2017

| Suppliers (2012-2017) | Total Tainted Contract Payments |
|--|---------------------------------|
| Locomotive Procurement (Chinese Rail Suppliers only) | R24 536 720 525 |
| Neotel | R4 925 269 609 |
| ZPMC | R 22 202 620 |
| Liebherr | R1 213 618 738 |
| SAP | R940 206 214 |
| Consulting: Regiments/Trillian | R1 099 143 538 |
| T-systems and Zestillor | R3 538 448 681 |
| Software AG | R45 239 463 |
| TOTAL | R36 320 849 389 |
| Cost as a % of Transnet Revenue | 11% |
| Cost as a % of Transnet EBITDA | 25% |
| Cost as a % of Transnet CapEx Infrastr. | 54% |

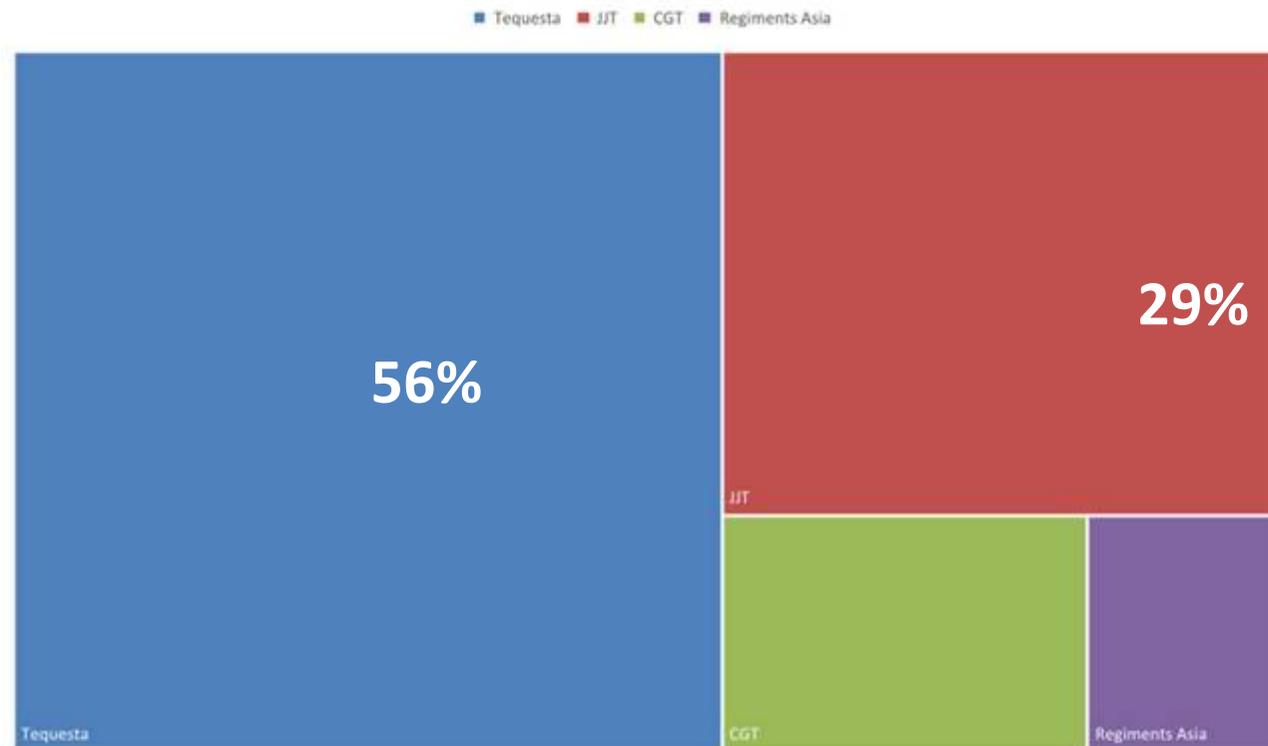
The Transnet Locomotive Deals

- The largest payments made by Transnet were on locomotives – it is also where we currently have best estimates of total costs of corruption
- In addition to General Electric, Mitsui & Bombardier the major procurements came from China South Rail (CSR) and China North Rail (CNR)
- Evidence shows that over the 2012-2017 period 22% of total amounts paid from Transnet to CSR and CNR were passed on to 4 Gupta-linked companies

Quantifying the Kickbacks: The Chinese Locomotives



Quantifying the Kickbacks: The Chinese Locomotives & Gupta Disbursements



Chinese Locomotive Procurement: Impact on Transnet Financial Balances (2012- 2017)

| Financial Totals (2012-2017) | Balances | Total Chinese Loco. Payments (%) [R24 536 720 525] | Gupta-linked Kickbacks (%) [R5 554 275 335] |
|---------------------------------|-------------------|--|---|
| Revenue | R 341 497 000 000 | 7% | 2% |
| EBITDA | R 142 967 000 000 | 17% | 4% |
| CapEx Infrastructure | R 66 860 000 000 | 37% | 8% |

Future Research

- A Developing Story: Some follow-up questions and work – *The Economics Of Corruption*:
 - What is the appropriate model of corruption? (monopoly vs. perf competitive market?)
 - A full audit of corruption at SOEs
 - Insider Trading by the Gupta network (Rand and Bond markets)
 - The Art of Money Laundering.

Thank you