The performance and regulation of South African state-owned entities (SOEs) have been a major focus in 2016.

South African Airways is a perennial recipient of state aid, with cumulative guarantees over the past five years reportedly about R14-billion (USD 125-million). The drawn-out deliberation on the funding proposals for South African Airways has been the subject of great public debate, even more so now that the recent loss made by Mango, the low-cost airline wholly owned by South African Airways, has been disclosed.

With the key roles played by SOEs in providing essential goods and services, and the increasing levels of liberalisation in the sectors being serviced, such debates are relevant across Africa.

Any sovereign state is entitled to assist their SOEs according to its laws and regulations. Beneficial outcomes of state aid include securing the provision of important services and preserving employment levels of SOEs. Adverse outcomes include harm to the private competitors of the SOE and a decline in the funding available for other critical sectors in the economy. In South Africa competitors have, over the recent years, expressed concern about the unfair advantage that state support gives an SOE.

A relevant question, therefore, is how to balance both the beneficial and adverse outcomes, particularly any adverse effect on competition?

An economic approach proposes that any state intervention should aim to optimise the efficient allocation of goods and services, preventing market failure. In the EU, for example, the provision of state aid must address a three-step test:

The state aid addresses a market failure and not a firm failure.
The focus is on solving the failure of the market to operate effectively. This does not include solving a given firm's failure like in the case of a poorly performing SOE.

The state aid measure is targeted.
Key considerations include assessing if the state aid is appropriate, it will bring about a change in a firm's behaviour and whether the desired change in the firm's behaviour can be achieved with less aid. A narrow focus with strongly motivated reasons is most acceptable.

The distortions in competition and the effect on trade are limited.
This implies that resources are allocated so that improvements can be made to any participant's well-being without reducing any other participant's well-being. An instructive application of limiting distortions in competition in the EU is the Market Economy Investor Principle by which state intervention in an SOE is only considered acceptable if it is made on terms that a private player operating under market conditions would have accepted.

The state should ensure that any form of support to SOEs, including funding, should be well designed and targeted so that market failure and potential competition and trade impacts are limited.

James Hodge
Managing Partner
Competition and Regulatory Economics

For more Information on Competition Economics

G:ENESIS
UNLOCKING VALUE