THE IMPACT OF PRIVATISATION ON THE ELECTRICITY INDUSTRY WITH SPECIFIC REFERENCE TO GAUTENG

By

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ABSTRACT

The South African economy went through drastic changes since the new democratic government took power in 1994. Different programmes were changed through the process of transition from the old apartheid regime to a new democratic government. The first programme introduced was the RDP, followed by GEAR and then ASGISA, but all these programmes were not enough to circumvent all the challenges experienced by the South African economy. This is the context within which the debate around privatization occurred in the ANC. All the programmes that were changed favoured privatization in one way or other. Through these changes privatization was one of the policies envisaged to be a possible means to address past inequalities.

This thesis focuses on the impact of privatization on the electricity industry in South Africa with specific reference to Gauteng. The paper is based on the fact that Gauteng is believed to be the centre of business in South Africa. However because, competition in the South African electricity industry did not exist, this resulted in poor service delivery. The electricity industry in South Africa is divided into three sectors namely generation, transmission and distribution. Eskom controls almost the entire electricity industry from generation to distribution with a few private players here and there. The only private player in the generation sector is the Kelvin power plant, which holds almost 30 percent of the generation sector. Privatization in the South African electricity industry still has a far way to go before a desirable level of competition is achieved.

In order to recommend how increased competition can be injected, the privatization of electricity in developed, developing and transitional countries such as UK, Greece, Chile, Hungary and Argentina was explored. The thesis recommends how the government can further expand privatization by learning from these countries.

ABBREVIATIONS

ANC	African National Congress
ASGISA	Accelerated Shared Growth Initiatives South Africa
CEE	Center for Energy Economics
CEGB	Central Electricity Generating Board
CNE	National Energy Commission
COSATU	Congress of South African Trade Union
CIPE	Center for International Private Enterprise
DBSA	Development Bank of South Africa
DME	Department of Minerals and Energy
EDI	Electricity Distribution Industry
EDESUR	Empresa Distribuidora Sur
EDESUN	Empresa Distribuidora Norte
EDELAP	Empresa Distribuidora La Plata (Edelap)
EIA	Energy Information Administration
ERIC	Electricity Restructuring Inter-departmental Committee
ESI	Electricity Supply Industry
ESKOM	Electricity Supply Commission
FDI	Foreign Direct Investment
FOSKOR	Phosphate Development Corporation
GDP	Growth Domestic Product
GEAR	Growth Employment and Redistribution
GOSA	Government of South Africa
ICASA	Independent Communications Authority of South Africa
IDC	Industrial Development Corporation
ILO	International Labor Organization
IPPs	Independent Power Producers
ISCOR	South African Iron and Steel Corporation
ISPs	Internet Service Providers
JSE	Johannesburg Stock Exchange
MVM	Magyar Villamos Muvek

NER	National Electricity Regulator
NYSE	New York Stock Exchange
OFTEL	of the Office of Telecommunications
PE	Power Economics
PPP	Public-Private Partnerships
PSIRU	Public Services International Research Unit
RDP	Reconstruction and Development Program
RED	Regional Electricity Distribution
SA	South Africa
SAA	South African Airways
SACP	South African Communist Party
SASOL	South African Coal, Oil and Gas Corporation
SATS	South African Transport Services
SEPS	Strategic Equity Partners
SIP	Share Issue Privatization
SIC	Sistema Interconectado Central
SING	Sistema Interconectado Norte Grande
SOEKOR	South Oil Exploration Corporation
SOEs	State-Owned Enterprises
TELKOM	Telecommunication Service South African
TRANSNET	South African Transport Services
UK	United Kingdom
US	United State
VANS	Value – added Network Services
WEPS	Wholesale Pricing System

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CHAPTER ONE: INTRODUCTION AND RESEARCH METHODOLOGY

1.1 Introduction

This study will argue that there is a need for the electricity industry in South Africa to be privatized, due to the fact that the electricity industry for the past decade has not been doing well. Since the new government took over, the focus has been more on privatization of the electricity industry in an attempt to address areas that are not performing well. The electricity industry is regarded as an essential element of business and economic growth for the obvious reason that businesses use electricity for their daily operation. In order for the new government to realize its goals of social development and economic growth it has to monitor the performance of the electricity industry. It is for this reason that the government reviews its policies to see the performance and impact of that policy on electricity industries. The electricity industry holds growth potential for the increasing electricity demand in Gauteng.

This paper reviews the debate on the privatization on electricity industry with specific reference to Gauteng, for it is the centre of activity of business in South Africa. Choosing Gauteng as a target area will better explain the challenges that the electricity industry is experiencing when implementing privatization as a policy. Also, focusing on Gauteng only will help to narrow down the scope of the research and to create depth of understanding of the topic. Working for City Power, one of the electricity distributing companies, prompted me to conduct this type of research. Doing this type of research will also mean that companies and organizations that are planning to undergo privatization will learn more and avoid falling into the same trap. The research will focus more on the impact of privatization on the electricity industry, how it affects service efficiency and its influence on competition.

1.2 Problem identification

The privatization of state-owned institutions in South Africa was started immediately after the country's democratic elections in 1994. There was an imminent need for a drastic change in the electricity industry to make it more viable and flexible in order to realize unfulfilled needs. The electricity industry was generally characterized by high costs, over-borrowing and lack of competition. This was evident from the Soweto crisis, in which residents were without electricity because they failed to pay their electricity bills. Their main concerns were the abnormally large bills charged for consuming electricity and poor service of electricity supply (Bond, 2002:20).

The South African electricity industry has mostly followed the traditional industry structure, where there is only one dominant vertically integrated and publicly owned utility. As a result of the monopolistic behaviour of the industry, the public and industries that are using electricity experienced difficulties when it came to service delivery from this sole provider. By virtue of the fact that it enjoys its monopolistic form, it does not face any challenges from any supplier. This results in lower competition, high cost, poor service and no room for improvements as previously there has been little incentive for the publicly owned utilities to improve efficiency (Galen, 1998:12).

Galen further expanded on his ideas by arguing that in 1992 the ANC's policy guidelines for a democratic South Africa heralded the intention to introduce a campaign against monopolies in accordance with international norms and practice. The entire electricity industry prior to privatization was operated monopolistically from generation through transmission and up to the distribution side of electricity, which was owned and controlled by Eskom. According to Clark (2001:1) the vertically integrated monopoly of this industry needed to be unbundled in order to allow competition in the industry. The privatization to which this paper will continually refer was introduced in the distribution part of the industry.

1.3 Hypothesis

This research tests the hypothesis that privatization has led to improved service efficiency and better competition. The argument is explored by consulting written documents and literature. Competition is regarded as the most effective means of protecting consumers against the monopolistic power that prevails in the electricity industry (Veljanovski, 1989:26).

To attempt to investigate service efficiency, a comparison between the private and public sectors is conducted, as the impact of privatization on service delivery is a complex issue. Kay, Mayer and Thomson (1986:8) added that it is also difficult to find empirical studies which compare the performance of public and private enterprises.

1.4 The aim and value of the study

It is the purpose of this study to investigate the impact of privatization on the electricity industry in South Africa. It also tries to develop a clear picture of the electricity industry and how it can affect and bolster the government objectives of social development and economic growth. The improvement of the electricity industry would also help government to achieve other general goals such as Foreign Direct Investment (FDI), wider ownership of the economy, greater efficiency, reduction of government's debt, competitive pricing, and support of the African Renaissance (Ngcuka, 2000:2). This paper also aims to provide a review of the arguments about privatization, to draw together some of the important research that has been undertaken on the privatization issue.

The secondary aims of the study include investigating the extent to which service efficiency is affected by the process of privatization to meet customer's expectations; highlighting the level of competition that is introduced in the electricity industry by privatization as a policy; and ascertaining whether a privatized industry can attract new customers more effectively than industries that are not privatized. Furthermore, the research will outline whether the financial credibility of the electricity industry is improved by introducing privatization. Where necessary, recommendations will be made about programmes that should be introduced to speed up privatization.

1.5 Importance of the study

There was an urgent need for the privatization of the electricity industry as a policy, due to the poor performance shown by the industry. It is also imperative for a country to realize its objectives and goals to improve the standard of living for the people. Privatization of state-owned enterprises (SOEs) has become a key component of the structural reform process in many economies. Several developing economies have embarked on extensive privatization programmes in the last decade or more as a means of fostering economic growth (Rangata and Jerome; 2003:1). With the same idea, Jerome (2003: 1) added that, after decades of poor performance and inefficient operations by state-owned enterprises (SOEs), governments over the world have embraced market reform and privatization since the 1980s.

The core aim of this research is to investigate the impact of privatization on the electricity industry. It is therefore important that the research results are made available to every individual and relevant private and public funding institution, municipalities and other interested parties. This will benefit them in that they will learn from the research and rectify their mistakes where necessary. The research will be useful to all the abovementioned institutions in reviewing their policies according to the findings of this research.

Consequently, there is a need to distribute copies of the research results to, inter alia, the University of Johannesburg and relevant directors that are given the task of investigating privatization. The results will help government when it attempts to come up with relevant policy that will help government achieve the macroeconomic objective of better economic growth. The outcomes will be helpful in addressing some economic problems: among other things, the research will help policy-makers in understanding the process of privatization and its preconditions in order for government to realize goals such as price stability and better employment.

1.6 Research methodology

Information for this study has been obtained through both primary and secondary research.

1.6.1 Primary data source

To get the required information and data for this research, it was necessary to gather information from some government departments such as the Department of Minerals and Energy (DME), the National Energy Regulator (NER) and Eskom, municipalities and some non-government organizations (NGOs) around Gauteng. Much of this information and data has been collected from existing published material. Due to the fact that privatization in South Africa is a new phenomenon relative to developing countries, there is a limited amount of information available on the subject. Nevertheless, there is enough information for me to proceed with the research. Random control checks have been used to verify information obtained by using questionnaires. Due to the uncertainty and unreliability of some data, the researcher will utilize references which are more reliable and which will be acknowledged in full in the bibliography.

1.6.2 Secondary data source

To explain the role that is played by the privatization of electricity industry in South African economy, secondary research will be conducted. This will help to outline the steps that government will consider, to address the problems faced by customers regarding poor service and lack of competition within the electricity industry. Gauteng will be the focus area as this will help to identify clearly all the factors that are lacking. Another reason for focusing on Gauteng in this research is that it will be expensive to do it for all provinces and require more time. Having this focus area will help speed up the process of scrutinizing the causes of the problem of poor service delivery. An important fact about targeting a specific area to conduct research is that it makes it easier for government to realize its goals of social development and economic growth.

An extensive amount of literature was consulted for the theoretical basis of the study. This included textbooks, dissertations, research reports, journals and other published documents regarding privatization in South Africa.

A search engine on the internet, for example Google, will be used as it will reduce agency and transaction costs when information is collected. A search engine can be defined as a programme that searches for documents using specified keywords and returns the list of the documents when found. It is a useful and reliable World Wide Web tool. Results obtained through these methods of data collection will be analyzed and certain conclusions drawn. Recommendations with regard to the privatization of the electricity industry in South Africa will be made.

1.7 Division of chapters

Chapter I introduces the dissertation. It explains the problem identification, aim and the value of study, research procedure, methodology, and importance of the study, the division of chapters, and research procedure and methodology. Also the hypothesis that will be tested is outlined in this chapter.

Chapter 2 gives a full description of privatization according to different authors. This chapter provides an overview of privatization, explains how the economy works and offers reasons for government intervention in the case of market failure. The reaction towards public provision and why it is necessary for government to privatize its enterprise are provided. When governments all over the world implement privatization they certainly encounter some obstacles; these are outlined together with the objectives of privatization. Methods of privatization are deployed throughout the world and vary from country to country. This chapter outlines the origins of privatization and what method of privatization countries should choose. In most developing countries there is much opposition to the idea of privatization. This chapter will investigate what the underlying reasons for opposing privatization could be. Finally, alternatives for privatization would be looked at.

Chapter 3 explores the experience of privatization in South Africa. This chapter will place more emphasis on privatization in the pre-1994 period in our country. It will discuss what the economy before privatization was like and how the economy managed to prosper and attain government objectives and goals of a better life for all. Historical developments and progress after the new government took over in 1994 would be looked at, since every government has got its own priorities to focus on. Also, privatization after 1994, when the democratic government took power, will be investigated. The study outlines the response by the state and the public to privatization in South Africa to get various viewpoints on the issue. The research will also compare privatization in developed and developing countries. Furthermore, this chapter outlines the new structure of the electricity industry.

Chapter 4 focuses more on the South African electricity industry as it was fully controlled by Eskom. This caused problems because the monopolistic behaviour and vertical integration of the industry was believed to be the cause of the difficulties it experienced in achieving its objectives. Unbundling this vertically integrated industry, in which one company enjoys full power, would be helpful in addressing problems such as the lack of competition. This will be helpful, especially because this country is in an early stage of transition. In this chapter, theory on electricity privatization with specific reference to South Africa will be examined. The chapter will look at the structure of the electricity industry before and after privatization. The effect of privatization on electricity will also be investigated, and an overview of current South Africa electricity and the government view on restructuring will be provided.

The study will also explore the programme introduced to put into practice the policy of privatization. The plans that government has for power sector reform, which include

Electricity Distribution Industry (EDI), Electricity Supply Industry (ESI) and Regional Electricity Distributions (REDs), will also be examined. The study will also compare privatization in developed and developing countries.

Chapter 5 investigates the experience of the electricity industry in developed, developing and transitional economies. This chapter explains how the UK and Chile experienced their comprehensive electricity privatization, while Hungary and Argentina were chosen as examples of developing and transitional economies. Lessons from international experience would be explored.

Chapter 6 gives a summary of all previous chapters and in this dissertation a number of concluding remarks and recommendations for policy-makers are provided. Suggestions for future studies on the privatization of the electricity industry in South Africa will be outlined.

1.8 Summary and conclusion

It is imperative to privatize the electricity industry in order for government to achieve its goals of social development and economic growth. It is also vitally important for government to intervene in every activity that involves the public, if the organizations or companies that have a role in such activities ignore the interests of people. The research will show that companies that operate in a monopolistic manner offer poor service delivery because competition is negligible. The aim of the research is to investigate the impact of privatization on the electricity industry in South Africa with reference to Gauteng.

CHAPTER TWO: THE IMPACT OF PRIVATIZATION IN SA AND OVERSEAS

2.1 Introduction

Privatization of state-owned enterprises has become an important policy for most countries. The main purpose of privatization is to improve the economic performance of a government. This chapter explains privatization generally, without being specific about any country or industry. Privatization has been implemented by many countries like China, Indonesia, Malaysia, Thailand and the Philippines as a policy aiming to accelerate the transition in the economy. Private companies are encouraged to participate as a means of government luring private investment. Private investment in state-owned enterprises has been implemented in manufacturing and public service enterprises. In many countries, large state-controlled industries such as railways, airlines, mining and telecommunications were transferred to private ownership, while in some others state industries and parastatal companies are sold to foreign investors.

Privatization is a means of creating a system of governance that can overcome the weaknesses of state ownership and make enterprises responsible for cost and profits (Rondinelli and Black, 2000: 6). The research reveals that in competitive industries with well-informed consumers, privatization consistently improves efficiency. This improved efficiency is as a result of the competition that is introduced in most newly privatized industries. Such efficiency gains result in a once-off increase in the GDP, but through improved incentives to innovate and reduce costs also tend to raise the rate of economic growth. Although typically there are social costs associated with these efficiency gains, many economists argue that these can be dealt with by appropriate government support through redistribution.

This chapter attempts to find the underlying reasons for privatization, and detail why many countries switched to privatization programmes. The main reason for privatization appears to be to make customer service efficient – hence to make more money and reduce the costs of goods and services and to encourage private participation in the economy.

Privatization is not a new phenomenon in developed countries: Graham and Prosser (1991:2) highlight the fact that the British government has been a world leader in the implementation of privatization policies. Furthermore, a number of overseas privatization programs are directly modeled on British experiences. According to Prokopenko (1995:3) privatization has helped to build infrastructure in Western industrial nations for several hundred years.

2.2 Definitions of privatization

The term privatization has different meanings. It generally means the permanent transfer of control of a public enterprise to a private owner, and takes the form of share sale or recapitalization of the public enterprise by private investors. The broader meaning can be the temporary transfer of control of public enterprises to the private sector by any of the following means:

- Asset sale
- Sales of shares
- Liquidation
- Management contracts
- Joint ventures and public private partnerships
- Leases and concessions
- Management and employee buy-outs

Any of the above methods can be applied or used by different countries depending on the country's needs. Privatization should be in line with government policies of promoting economic growth and development.

There is no officially stated position on the concept of privatization and certainly no universal definition. The word itself had been used in many different countries and the meaning of the concept has gained many different tinges (Wiltshire, 1987:15).

Wiltshire (1987:15) has noted that there have been four separate components grouped under the term privatization:

- The privatization of financing a service that continues to be produced by the public sector
- The privatization of the production of a service that continues to be financed by the public sector, as in contracting out, and education vouchers
- Denationalization and load-shedding, which means selling of public enterprises and transfer of state functions to the private sector
- Liberalization, meaning the relaxation of any statutory monopolies or licensing arrangements that prevent private sector firms from entering markets previously exclusively supplied by the public sector

Definitions from other sources are also worth reproducing because of the increased dimensions they provide. According to Kay and Thompson (1986:18), privatization is a word which is used to cover several distinct and possible alternatives, a way of changing the relationship between the government and the private sector. Among the most important are denationalization, deregulation and contracting out.

Boycko, Shleifer and Vishny (1996:313) mention that privatization means a combination of two changes undertaken by reform. The first is turnover of control from spending politicians to managers; this is often referred to as corporatization. Such turnover can be implemented by a strong reform government that effectively suppresses the ministries and bureaucracy. Alternatively, such turnover can happen more spontaneously, as the power of bureaucracy to protect its control rights diminishes. The second transition is the reduction of the cash-flow ownership by the treasury and the increase of cash-flow ownership by managers and outside shareholders.

Megginson and Netter (2001:321) define privatization as the deliberate sale by a government of state-owned enterprises (SOEs) or assets to private economic agents. Since it was first introduced in Europe, it has been implemented internationally as an accepted and reliable policy for restructuring. Privatization is a common tool that is used by markets to allocate resources. Most countries implemented privatization with hopes that it would boost the profits of their companies.

2.3 Overview of privatization

Privatization is often associated with service-orientated enterprises, such as mining and manufacturing; however, it can also apply to any asset, such as land and roads. In recent years, government services such as health, sanitation and education have been particularly targeted for privatization in many countries.

The issue of privatization is a serious concern, not only for any one country but for the entire world. According to Boycko, Shleifer and Vishny (1996:309), privatization of state enterprises has swept the world and thousands of state firms in Africa, Asia, Latin America, Western and Eastern Europe have been privatized.

Privatization is favoured over nationalization for the reason that private companies are efficient and competitive. However, privatization has the downfall of being profit-orientated. Privatization has different meanings to many people, but basically, it means a change of ownership. The argument of the research is that publicly owned enterprises are incompetent and as a result of this they become inefficient and perform poorly.

The research outlines the fact that many people agree on certain services that should be provided by the public sector, but still disagree on whether these services should be provided by public or private companies. Their disagreement might be influenced by two facts: firstly, the extent to which government should intervene in the economy; and, secondly, the difference of opinion around the relative costs of public and private production. Part of the argument is that public-sector managers, unlike their private-sector counterparts, do not concern themselves with making profits. Hence public-sector managers have little incentive to monitor the activities of their enterprises carefully (Rosen, 1192:62).

In many parts of the world, the assumption is that private ownership improves corporate performance. But in order to establish whether private ownership indeed improves performance empirical evidence has to be found by comparing the performance of industry before and after privatization (Frydman, Gray, and Rapaczylnski, 1999:1153). Privatization results in the interaction of private ownership and competition, and these results in efficiency. The injection of competition into the industry will encourage a non-performing company to work hard or it will realize low profits, which often means that the company is liquidated. Another important fact about privatization is that it dismantles the monopolistic behaviour of companies that enjoy individual supremacy. Nationalized industries find it difficult to attract investment into the country, and companies that are not privatized have less incentive to perform.

Privatization does not necessary rule out government involvement in the provision of services, as in certain instances it provides government with the role of facilitator rather than the provider of services. Privatization will result in the achievement of economic efficiency in public enterprises and harness them with government goals for economic growth, economic welfare and sustainable job-creation.

According to Mackenzie (1998:363), privatization is not supposed to be undertaken to fill a hole in the budget. Its purpose is to achieve the redeployment of assets in the economy from the public sector, where it is assumed that they are being used inefficiently, to the private sector, where it is expected that they will be utilized more efficiently. Consequently, privatization should lead to a permanent increase in the level of aggregate output, if not in its rate of growth, and should be welfare-enhancing.

2.4 Market failure: the rationale for government intervention

The reasons for the existence of the public sector can be clearly seen in the degree to which government intervention improves allocation efficiency. Government intervention will be necessary if that intervention reduces the degree of market failure. It is vital to examine the causes and consequences of market failure. The best way to understand market failure is by first understanding market success. If there are enough markets and all consumers and producers behave competitively, then there will be no need for government intervention. However, if most companies become inefficient and less competitive, there is a need for government intervention.

According to Bailey (1995:26-27) there are two possible causes of markets failure: firstly, when price does not equal marginal cost in all sectors of the economy market failure results. Price will equal marginal cost under perfect competition. However, perfect competition may not exist because producers have monopoly power and can therefore control prices. In this case, a natural monopoly exists. Alternatively, it may be because of restrictive trade practices amongst a few large suppliers; this is known as oligopoly as there is less competition based on the fact that markets are not contestable.

Secondly, when prices fail to incorporate all costs and benefits besides equating prices and marginal costs, perfect competition assumes perfect knowledge. However, markets will not be in equilibrium if individual consumers poorly judge their own welfare with the result that they are not willing to pay for economically optimal levels of consumption of particular commodities.

It is widely accepted that, when maximizing social welfare, public intervention is necessary in cases where markets fail. If an economy with no priced externalities and with perfectly competitive markets exists, equilibrium should be achieved. However, in developing countries, establishing the case for market failure is hardly necessary as in these economies market failures remains pervasive.

2.5 The reaction against public provision

There are two different ideas regarding the arguments for government intervention in the economy in cases of market failure. Firstly, there are ideological objections: it is often held that individual liberty is dependent on the preservation of market capitalism, which opposes government intervention. The belief in laissez-faire, which holds that nature takes its course by giving free rule to the market, also often prevails. For these reasons, government must not intervene. Secondly, positive objections arise based on the fact that personal incentives are always the best motive. The belief held here is that the efficiency of market capitalism leads to anti-statism. An additional argument is that government dissipates the gains from the division of labour because it pursues its their own self-interest.

Although most countries have preferred privatization of state-owned assets, many criticisms of privatization abound. Possible arguments in favour of privatization are countered by the possibility that increased private company profits have resulted at the expense of the rest of society through the exploitation of market power. Critics often appeal to a tradition in economics that regards state-owned enterprise (SOEs) as instruments capable of curing market failure by implementing pricing policies that take into account social marginal costs (La Porta and Lopez-de-Silences, 1999:1193). Besides, this experience dictates that privatization results in the burden of restructuring through layoffs and wage cuts.

2.6 Why is privatization necessary?

The main aims of privatization are to boost and stimulate economic growth by ensuring that privatization injects competition, improves economic efficiency and sustains the private sector of the economy. According to Bailey (1995:302-303), the relative efficiency of the privatized industries can be assessed by comparing the return on capital employed with those achieved by nationalized industries. However, there are a number of methodological difficulties in making such comparisons. These include differences in risk, lack of monopoly profits, lack of comparable private sector companies, lack of standardized accounting methods, and the use of nationalized industries as macroeconomic instruments and social functions. With these methodological problems it is difficult to perfectly compare the economic efficiency of the nationalized industries in relation to private companies. Nevertheless, privatized companies are deemed to be more competitive and efficient.

The reasons for privatization of state enterprises vary from country to country, but the main reason is poor performance of public enterprises. Most countries have engaged in intensive programmes of privatization of publicly owned companies, as they have learned from the experiences of other countries that have implemented privatization as a policy. Many Western countries cite their main reasons for privatization as follows:

- The profit motive is a more effective way of reducing inefficiencies in production than any form of monitoring of public management; therefore, all other things being equal a private firm will be more efficient than a public one.
- A more efficient government improves the efficiency of the industry (De Fraja; 1991:311).

The chapter previously stipulated that the aim of restructuring and privatizing state-owned enterprises varies between countries and according to the findings by different researchers. Brittan (1986:33) offers the following list as the possible aims of the denationalization of public-sector industries:

- Improvements of the economic performance of the industries concerned
- Resolving the deficiencies of relations between government and nationalized industries
- Revenue-raising
- Reduction of the power of public-sector unions.
- The promotion of a popular capitalism through wider share-ownership.

Privatization is important, as it presents significant opportunities for the redistribution of income and wealth (Vickers and Yarrow: 1991:119). Moreover, privatization's purpose is to achieve the redeployment of assets in the economy from the public sector, where it is assumed they are being used inefficiently, to the private sector, where it is expected that they will be utilized more efficiently. Privatization leads to a permanent increase in the level of aggregate output, not only in its rate of growth but also by enhancing welfare. Many governments have also seen privatization as a source of budgetary revenue (Mackenzie, 1998:365).

Brittan (1986:33) contributed additional reasons in favour of privatization. His research shows that privatization helped to solve the difficulties of relations between government and nationalized industries. Among other things, privatization reduced the power of public-sector unions. Also, privatization promoted a popular capitalization through wider share-ownership and increased revenue.

Ramanadham (1995:3) mentioned that the return on equity invested in public-sector enterprises is around one-third of that in the private sector. Thus, mobilizing capital for investment will modernize the private sector and free up resources by reducing the financial burden of loss-making public-sector enterprises and redirecting state resources to more socially beneficial projects such as health and education.

A private company is deemed far more efficient than a public company as it is the only way in which an entity that can compete with entities from other countries can be created. Private companies also have opportunity to make their management independent, and thus not accountable to an agency of the government. If the company is privatized, economic decisions are not made for political reasons (De Saint Phalle, 1990:1). Another reason for privatization is that the technologies of tomorrow can be concentrated on, and generally companies which are more technologically advanced employ less people, because they rely on capital and machinery to solve the problems of competition.

2.7 Methods of privatization

There are number of factors to consider when selecting a privatization method. An example of one method is the state of development of the domestic capital market and the need for restructuring the company being privatized. A deep national capital market and a company with little need of restructuring favour a public offering.

As mentioned by Giersch (1997:97), the method of privatization will also depend on the goals that government wishes to achieve. However, there are two main goals that most reform-minded governments share. Firstly, an efficient allocation of ownership rights should be achieved. In a competitive market economy when a firm has to be privatized, preference would be given to those companies who can yield the highest profits, and who, therefore, have the strongest incentive to restructure and to develop new products. Secondly, most governments are largely concerned with maximizing revenue from privatization.

There are many other broad and different methods of privatization that this study will focus on. Three methods are described by Meggison and Netter (2001:339). The first method is privatization through restitution. This method of privatization is applicable when land or other easily identifiable property that was expropriated in years past can be returned to the original owners.

The second method described is privatization through the sale of state property. Here the government trades its ownership claim for a clear cash payment. This method takes two important forms. The first results directly in the sale of state-owned enterprises to an individual, an existing corporation, or a group of investors. The second form is called share issue privatization (SIP), where the entire governmental stake in SOEs is sold to investors through a public share offering.

The third method describes mass or voucher privatization which results in eligible citizens using vouchers that are distributed free or at nominal cost to bid for a stake in SOEs, or other assets. According to Mackenzie (1998:370), under a voucher programme, participants receive free vouchers that grant ownership of a given fraction of an enterprise or group of enterprises. Privatization by voucher is akin to a capital transfer by the government to the private sector financed by a sale of assets.

2.8 Objectives of privatization

There are many commonly shared objectives for privatization around the world. This research examines the following two objectives:

- Promoting efficiency by exposing businesses and services to the greatest possible competition, which should benefit the consumer; and

- Spreading share ownership as widely as possible amongst the general population.

2.8.1 Competition

Competition is the best way to ensure that goods and services desired by the customer are supplied at an affordable cost. If customers have choice over their supplier, this results in sustainable pressure for a company to increase efficiency. Generally companies operate in a competitive market environment. In Britain, for example, government did not strictly confine the benefits of privatization to businesses in competitive areas of the economy. Privatization was meant to include utility monopolies such as airports, electricity, gas and water, where competition is limited in scope (Vickers and Yarrow, 1991:116).

Privatization was intended to satisfy customers and employees and to boost the economy as a whole. Customers are satisfied when the efficiency is improved and this can be achieved through the injection of competition into the economy. Privatized entities are more responsive to changing customers demands and more innovative by introducing new products to the market.

On the employee side, privatization meant working for companies with clear objectives, being provided with ways to achieve them and rewards for the successes. This reinforces the customer focus that is at the heart of the success of the business. The economy benefits if the market gets a high return on capital in the privatized industries, which can no longer pre-empt the resources from elsewhere in the economy, but must compete for funds in the open capital market.

2.8.2 Wider share ownership

Promotion of wider share ownership has been one of the main objectives of privatization around the globe. Broad government policy extends the ownership of wealth widely in the economy, giving employees a direct stake in the success of the industry, and removing the distinction between owners and workers. However, there are lot of obstacles that can impede the achievement of those objectives.

2.9 Problems, barriers and constraints in implementing privatization

Progress has been made in many countries regarding the privatization of SOEs and fostering the participation of the private sector in economic activities. However, the progress and the pace have often been slow. There were several factors to which the delay in implementing economic reforms and the privatization of state enterprises can be attributed. These are factors such as macroeconomic, political, bureaucratic, cultural and institutional problems, and lack of competence. These include the difficulties experienced in implementing changes rapidly under conditions of economic uncertainty, political ambivalence over the pace and scope of economic reform and privatization, opposition by vested interest groups, limited demand and weak financial markets, resistance by some of managers and workers in SOEs to restructuring and privatization, and bureaucratic complexities in carrying out privatization procedures.

All of the following factors are cited from Prokopenko (1995:24-35):

2.9.1 National economic uncertainty and instability

By the late 1980s and 1990s, governments in the developing countries of Africa and Latin America and Central Europe were pursuing privatization under adverse conditions of economic recession and instability. They were experiencing low wages, rising prices, threats of continuing inflation and decreasing exports. The demands for the SOEs' products were declining remarkably and this made industries less attractive to private investors.

2.9.2 Political ambivalence towards privatization

In some developing countries and emerging market economies, economic and social changes created political ambivalence and resistance to rapid privatization. There are a number of countries in Central and Eastern Europe, like Czechoslovakia, Hungary and Poland, where disagreements over the pace and scope of economic reform and privatization have resulted. For example, in Poland, the process of privatization was impeded by contention amongst the numerous political factions within parliament and government.

2.9.3 Opposition from powerful interest groups

In developing countries powerful interest groups have impeded privatization and the expansion and participation of private-sector players. Leaders who normally control patronage positions in civil service employees' organizations and labour unions fear the loss of government jobs. Other organized groups that fear large increases in the cost of goods and reduced subsidization by government are the ones who, in most instances, oppose and impede the implementation of privatization policies.

2.9.4 Limited demand and weak financial markets

The slow pace of SOE divestment resulted from limited demand in most of Africa and Latin America. Inefficient management of state companies and the weak financial condition resulted in the inability of counties such as Bolivia, the Dominican Republic and Peru to privatize SOEs at the pace desired by government. More than 100 SOEs that were privatized faltered, as they failed to lure enough investors into the country.

2.9.5 Management and employee resistance

In several former socialist countries privatization had been impeded as a result of resistance from some managers and workers in state-owned enterprises. In the early stages of privatization in Central Europe, most SOE mangers in the former Czechoslovakia and Poland balked at attempts to restructure their enterprise to suit the requirements of private investor, while others took advantage of their positions to buy up or sell off state assets at very low prices before limitations were placed on spontaneous privatization.

2.9.6 Bureaucratic complexity

Privatization has been slower than anticipated because organisational structures and procedures were often weak. Attempts to assess the value of state enterprises were conducted in Malaysia and the Philippines. Administration and legal constraints are cited as the cause of slow privatization in Malaysia. Some of the departments and agencies operated under legislation that had to be amended through a long and complicated process in order to authorize them to sell off all or part of their assets. Difficulties also emerged as a result of the fact that public employees had their pension rights constitutionally guaranteed.

2.10 Opposition against privatization

Opponents of privatization dispute the claims made by proponents of privatization, especially the ones concerning the alleged lack of incentives for governments to ensure that enterprises are well run, on the basis of the idea that governments are accountable to the people. It is argued that a nationalized government that runs enterprises poorly will lose public support and votes, while a government which runs those enterprises well will gain public support and votes. Thus, democratic governments, under this argument, do have an incentive to maximize efficiency in nationalized companies, due to the pressure of future elections.

It is further argued by opponents of privatization that it is undesirable to let private entrepreneurs own public institutions for the following reasons (Banerjee and Munger, 2004: 221-225):

- Profiteering. The only goal that Private companies have is to maximize profit. Critics of privatization argue that a private company will serve the needs of those who are most willing to pay, as opposed to the needs of the disenfranchised majority.
- Corruption. Buyers of public property have often, most notably in Russia, used insider positions to grossly enrich both themselves and civil servants in their selling positions.
- No public accountability. The public does not have any control or oversight of private companies.

- Cuts in essential services. If a government-owned company providing an essential service such as water-supply to all citizens is privatized, its new owners could stop providing this service to those who are too poor to pay, or to regions where this service is unprofitable.
- Inefficiency. A centralized enterprise is generally more cost-effective than multiple smaller ones. Therefore splitting up a public company into smaller private chunks will reduce efficiency.
- Natural monopolies. Privatization will not result in true competition if a natural monopoly exists.
- Concentration of wealth. Profits from successful enterprises end up in private pockets instead of being available for the common good of the people.
- Insecurity. Nationalized industries are usually protected from bankruptcy by the state. They can therefore borrow money at a lower interest rate to reflect the lower risk of a loan default to the lender. This does not apply to private industries.
- Downsizing. In cases where public services or utilities are privatized, this can create a conflict of interest between profit and maintaining an adequate service. A private company may be tempted to cut back on maintenance or staff training in order to maximize profits.
- Waste of risk capital. Public services are by definition low-risk ventures that do not need scarce risk capital.

In practical terms, there are many pitfalls to privatization. Privatization has encountered many problems, because it is so intertwined with political concerns, especially in post-communist economies or in developing nations where corruption is endemic. Even in nations with advanced market economies like Britain, where privatization has been popular with governments since the Thatcher era, problems resulting from the fact that privatization programmes are very politically sensitive have raised many legitimate political debates.

Briefly, privatization can potentially cause tremendous social upheaval, as privatization programmes are often accompanied by retrenchment. When small firms are privatized in a large economy, the effect may be negligible. If a single large firm or many small firms are privatized at once and upheaval results, particularly if the state mishandles the privatization process, a whole nation's economy may go into decline.

When considering the transformation in the post-communist countries, one must take into account the specifics of the communist and socialist regimes which ruled those countries for decades. Further, the opening of the markets for the import of the products which, in many cases, afforded the consumers higher quality or lower prices, has given the consumers a new array of choices to compete with the old national industries.

Privatization, in the absence of a transparent market system, may lead to assets being held by an oligarchy of a few very wealthy people at the expense of the general population. This may discredit the process of economic reform in the opinion of the public and outside observers. This has occurred most notably in Russia and Mexico (Nellis, 1999:3).

Moreover, where free-market economics are rapidly imposed, a country may not have the bureaucratic tools necessary to regulate it. As Nellis (1999:3) has noted, the lack of prudential regulation and an enforcement mechanism in the market opened the door to a variety of highly dubious and some illegal actions that enriched fund managers at the expense of minority shareholders and harmed the financial health of the companies involved.

Some economists have different views if a privatized company is a natural monopoly or exists in a market which is prone to serious market failures. Consumers may be worse off when the company is in private hands. Countries like New Zealand experienced problems like these with their rail privatization, and public dissatisfaction has led to government intervention. In some other countries where privatization has been successful, it is because genuine competition has arisen.

One example of privatization that was considered a failure and was largely abandoned is British Rail. The track-owning company has been effectively repossessed by the British government, and many of the train-running companies are at risk of having their concession removed on the grounds that they fail to provide adequate services. One of them, Connex Company, actually had its franchise cut short in June 2003 by the government for what the Strategic Rail Authority called poor financial management. In this case, one of the causes for the necessary re-nationalization was the incomplete nature of the privatization, not leaving enough incentive for the firm to make capital investments (Letza, Smallman and Sun, 2004:162).

However, in other cases, particularly in poor countries, privatized enterprises cannot be renationalized so easily. These governments do not have the political will to do it, and there is strong pressure exerted by international lending agencies to maintain the privatization. Additionally, investors may be scared away by nationalization programmes, fearing that any business they start may be taken from them.

Most people have different views on strategies of privatization: for example, Russia differed from those seen in more successful post-communist economies like Hungary and Poland. The defects of the process in Russia, combined with capital market liberalization and the failure to establish institutional infrastructure, have led to incentives for capital flight, contributing to post-communist economic contraction in Russia.

Also, South American countries, which have embarked upon far-reaching privatization programmes, selling off valuable, profitable industries such as energy companies, have seen the rapid impoverishment of their governments. Revenue streams which could previously be directed towards public spending suddenly dried up, resulting in a severe drop in government services.

Privatization can also have a ripple effect on local economies. State-owned enterprises are often required by law to patronize national or local suppliers. Privatized companies, in general, do not have that restriction, and hence will shift purchasing elsewhere. It is also possible for local and national economies to be affected by increases in prices resulting from privatization especially with services fundamental to business, such as postal, public transport and utility services, without which they cannot survive. Countries like Bolivia underwent a rigorous privatization programme in the mid-1990s, with disastrous impacts on the local economy in the short term.

It has been argued that the privatization and economic reform that has taken place in countries like China illustrated that economic reform can take place in the absence of large-scale privatization, although the Chinese government has been following limited forms of privatization since the 1990s.

2.11 Alternatives to privatization

There are different alternatives to privatization that most unions and other organizations prefer to privatization. However, the chapter emphasizes only on the two methods mentioned below:

2.11.1 Sub-contracting

Using incentive contracts is regarded as the potential way to improve performance for state-owned enterprises. Megginson and Netter (2001:338) cited China as an example of a country that underwent widespread economic reforms with minimal privatization by making use of contracts. The economic reforms in China resulted in remarkable improvements in the marginal and total factor productivity of over 272 Chinese SOEs over the period of 1980-89. Megginson and Netter further argued that increases in productivity due to contracting were experienced. A more notable example of this was also experienced in the United Kingdom, where the government is currently debating the possibility of involving the private sector more in the workings of the national health services, principally by referring patients to private surgeries to ease the load on existing national health service human resources, and covering the cost of this.

2.11.2 Public-Private Partnerships (PPPs)

This involves a partnership between the public and private sector for the purpose of delivering a service which was previously provided by the public sector. This approach allows each sector to perform a specific task that they are better equipped to perform. PPP recognizes that both public and private sectors have specific advantages relative to the other in the performance of specific tasks. This will allow public services to be more economically viable and result in efficient service delivery. The document by DBSA

(2000:36) mentioned that PPP will help in ensuring that councils achieve their responsibility of basic service delivery to all citizens. The private sector has the potential advantage of bringing appropriate managerial skills that are required for efficient service delivery.

2.12 Conclusion

This chapter has provided an analysis of different economic sectors and countries regarding privatization. It revealed that the meaning and definition of the word privatization can be differently interpreted according to various authors from diverse countries. The meaning also depends on the reasons for the privatization policy implemented. Some countries sell public assets to private ownership to improve service efficiency by introducing competition in the industries, while others are only concerned with private participation. However, the main aim for privatization is to boost economic performance and improve infrastructure.

Arguments have been advanced that private companies are not concerned with efficiency, but are profit-driven organizations. Some organizations worry that privatization will result in management changes, which will in turn result in some employees being retrenched. The chapter found that privatization started in Britain and that the other countries emulated it. In some countries industries like airlines, telecommunications, and roads were privatized.

CHAPTER THREE: THE IMPACT OF PRIVATIZATION IN SOUTH AFRICA

3.1 Introduction

In the new government privatization means the adaptation and reformation of institutions, both in the public and private sectors. Privatization is undertaken in order to accommodate both political and economic factors. Ruth (2004:8) asserts that in the previous decade privatization and transformation swept the private and public sectors in South Africa in an attempt to accommodate drastic changes in the political arena.

Poor performance and inefficiency are cited as the main reasons for governments all over the world embracing privatization. Privatization is seen as a means to foster economic growth, reduce public-sector borrowing and attain macroeconomic stability. By virtue of these reasons the idea of privatization was welcomed by many countries worldwide. During the early 1980s in UK, privatization was made popular as a policy instrument and now it dominates the entire globe (Malik, 1996:1). The South African government has also developed an interest in privatization as a means to improve the standard of living for its people.

In South Africa plans to restructure state-owned industries and attempts to resolve problems faced by the country were in place during the past regime; however, the implementation was lacking. Since the new government took over in 1994, privatization as a topic was raised in many debates, because privatization was considered to be an instrument that could help to realize government's goals. The South African government was wary when it planned to replace public monopolies with private ones, because this could have led to a possible alienation of civil servants and a potential increase in unemployment. Due to the fact that privatization has been used as policy by other countries, the South African government tried to ensure that it did not fall into the same trap as the other countries.

Privatization involves changes in the relationship between the government and the private sector in the areas of control, ownership, production and finance. The result should be a reduction in the size and functions of government activities in the economy. The assumption is that private management is inherently more efficient than state management.

Privatization was deemed a policy that would help many countries to achieve their goals; however, criticism of privatization has emerged for various reasons. In the arguments by La Porta and Lopez-de-silance (1999:1193-1194) their main criticism stems from the fact that privatization has centred on the possibility that higher profitability of private companies may occur at the expense of the rest of society through the exploitation of market power. Another equally relevant argument against privatization is that workers are retrenched or laid off and wage cuts result. This is based on the fact that privatization tends to increase economic efficiency with a resultant reduction in costs, including cost of labour.

According to PGI (2006:3), the decision to privatize state-owned enterprises (SOEs) by the government of South Africa (GoSA) was clear and transparent. Attempts were made when the divisions of Denel, Eskom and Transnet were privatized. Privatization in South Africa gained momentum when the National Party government published its White Paper on Privatization and Deregulation in 1987. Prior to that, major privatization took place when the South African Coal, Oil and Gas Corporation (Sasol) was sold in 1979.

This chapter focuses on the impact of privatization in South Africa; it uses a comparison of a nationalized economy with a privatized economy to highlight this impact. The history of South Africa up to 1994, when the new democratic government came to power, is also explored. Criticism by different organization and parties is discussed in this chapter. Lastly this chapter will investigate the success of privatization efforts in South Africa.

3.2 Nationalization versus privatization

It is imperative to first consider nationalization when exploring the need for privatization. Clearly, industry can be privatized only if it was nationalized before. As mentioned by Vorhies (1990:6-11), the goals of nationalization include: to promote a culture of social cooperation; to ensure that the means of production are fully used to the best advantage;

to ensure that industrial democracy is promoted through community ownership of capital; and to ensure that there is social equality in the society. This, however, does not equip the community with enough stimuli for development and competition, when there is lack of incentives for good performance and competition in the industries. Customers would have no choice over their supply and, because of lack of competition in a nationalized economy, customers would prefer privatization.

In contrast, privatization stimulates competition between firms. The overall objectives of privatization are to boost the performance of the economy by improving utilization of resources; encourage optimal functioning of market forces; facilitate the development of small businesses; and create more opportunities for members of all population groups to participate in the free enterprise system to the full extent of their ability (Leiman, 2003:241-255).

The different impact of nationalization as opposed to privatization can be viewed better when one looks at the industries that were privatized and those that are in the hands of public ownership. MIT (2000) elaborated that public ownership may be used to control and redistribute consumer and producer surplus, which means that low prices may be supported by tax and cheap loans as part of a welfare policy (e.g. public transport). Also high prices may be enforced as revenue collection activities (e.g. state liquor store). However, the ANC government was not happy with nationalization, and as a result introduced privatization as a new policy to substitute for nationalization.

There were lot of questions that the ANC government asked itself prior to the 1994 democratic elections regarding what needed to be privatized and how to conduct the privatization. The same applies to nationalization: questions arise as to what to nationalize and how to nationalize. Deciding which policy (nationalization or privatization) is good for restructuring an economy will depend entirely on how it is conducted (Louw, 2002:2).

A privatized undertaking is efficient and relatively free of corruption or debilitating political patronage and manipulation. However, nationalization and privatization both have both positive and negative sides. The ANC's standpoint regarding nationalization is that it will definitely occur with compensation. This made the South African government choose privatization as opposed to nationalization. In South Africa the government had specific reasons for adopting the privatization option, including:

- To open up investment opportunities for the private sector by reducing the size of public and government spending.
- It required minimum regulation and no state intervention in order to allow business to develop and grow.
- Cutbacks on state spending and money raised by selling off state assets could provide much-needed funds for government (ILRIG, 1999:26).

Despite the intention of the SA government to privatize there are number of myths about privatization and these can influence the anti-privatization campaign to continue with its action against privatization. These myths as described by Louw (2002:5) are:

- State monopolies should not be privatized because they will become private monopolies which will be even worse.
- Privatization would lead to higher prices because there would be no more subsidies.
- Natural monopolies cannot experience the benefits of competition.
- Privatization leads to unemployment. This reason is just myth without practical evidence; it does not necessarily mean if privatization in one country resulted in job losses to employees, then the same would happen in our country. There are lots of factors that might make a difference in our country – for example, the infrastructure is different, and it could have much impact on the process of privatization.

The abovementioned reasons are just myths based on the fact that private companies are driven by performance: if they are not performing well customers would opt for other companies. The myth that says privatization will lead to higher prices is not true because private companies cannot set high prices while there is another company that is providing the same service at affordable prices: customers would choose companies that are offering a better prices.

Myths are stories without proof which can have a great influence on decisions or choices made by individuals or organizations. However, myths have not seemed to have much influence on the South African government when making decisions and choices regarding policies since it took over.

However, the South African government since it took over in 1994 did clearly show its position on whether it chose nationalization or privatization. The evidence of this was seen when the government introduced the Reconstruction and Development Program (RDP). This program does not go against privatization: the RDP program emphasized the position that public sector investment must play a significant role in complementing the role of the private sector and community participation in stimulating reconstruction and development (ILRIG, 1999:28).

In order to have a thorough understanding of privatization, previous experience with privatization needs to be explored. This chapter will also investigate the history of privatization and whether prior to 1994 the apartheid government was in favour of privatization or not.

3.3 Previous experience with privatization in SA

3.3.1 Privatization before 1994

Mr P W Botha announced on 5 February 1988 that the NP government planned to restructure the economy by means of privatization. After this announcement, a steady stream of activities indicated that the privatization process was gaining momentum.

Towards the end of 1980s the apartheid regime had already made two significant achievements on privatization, that of the South African Iron and Steel Corporation (ISCOR) in November 1989 and also the privatization of state-owned breweries producing traditional sorghum beer in 1991. The state had moved into the private sector and listed on the Johannesburg Stock Exchange the fuel-from-coal producer Sasol. However, the state still retained significant ownership in Sasol and Iscor through the Industrial Development Corporation (IDC) (Rumney, 2005:3).

Hentz (2000:22) mentions that in the late 1980s privatization was used as a (successful) exit strategy by the erstwhile National Party government. Hentz goes on to argue that the privatization policy adopted by the apartheid regime during the 1980s was a political tactic used to satisfy a political constituency.

Before the democratic government took power, South Africa was one of the most promising growing economies in the world. In the 1980s, the National Party government was feeling the effects of the global economic crisis. In 1987 the National party government came up with a White Paper on Privatization and Deregulation. The White Paper put forward the following motivations for privatization and deregulation: the size of the public sector and government spending needed to be reduced to open up investment opportunities for private investment; business must be allowed to develop and grow without state intervention; and cutbacks on state spending and money raised by selling off state assets could provide much-needed funds for government (Mostert, 2002: 9-10). According to Sekgobela (2003:6) the privatization process in South Africa was motivated by the financial pressure experienced by government due to sanctions in the 1980s, and increasing burdens caused by debt repayment.

Jerome and Rangata (2003:7-9) emphasize that the sale of corporate assets had been used to overcome the debt burden and improve government revenue for the development of social activities. But, based on the international sanctions imposed against South Africa, the program of selling corporate assets did not do well mainly because the international sanctions had discouraged multinational enterprises from buying South African enterprises.

Sanctions against South Africa caused several companies to relocate from South Africa and seek their fortunes in other countries. This resulted in a decrease in foreign direct investment inflows into the country. Groups of international banks began to sever links with South Africa and called for immediate loan repayments on short-term credit. The United States and European countries imposed sanctions against South Africa, which included the banning of new investments and bank loans to South Africa. As a result of sanctions many countries were not willing to buy public enterprises in South Africa, and also trade unions and anti-privatization organizations were strong enough to discourage government from engaging in privatization. All of this delayed the implementation of privatization. Sanctions became a burden for South Africa because, in the absence of government funding, SOEs borrowed heavily. This over-borrowing resulted in low productivity, inefficiencies and stagnation (Jerome, 2004:5).

3.3.2 Privatization after 1994

The release of Nelson Mandela brought significant changes to the South African economy and revived the belief of Africans that the ANC's Freedom Charter would be adopted and implemented. After Mandela was released he stuck to the Freedom Charter as the policy that was believed would bring equal share and distribution of wealth in the economy. The Freedom Charter also stipulates that the mineral wealth beneath the soil and the bank and monopoly industries shall be transferred to the ownership of the people as a whole (Mostert, 2002:10).

The Reconstruction and Development Program (RDP) were introduced as a possible replacement for the Freedom Charter. The RDP introduced a balance between nationalization and the creation of state-owned entities (SOEs) with the possibility of reducing the public sector to enhance efficiency. Privatization took another turn when the new Minister of Public Enterprises was appointed in 1994. The Minister steered government privatization policy to ensure government was in a good position to deliver on economic needs. Privatization itself was not changed but the overriding priority had been changed to use large state companies to unlock South Africa's economic growth.

Restructuring started clearly after government unveiled its macroeconomic policy document in 1996, "Growth, Employment and Redistribution" (GEAR). The policy aimed to bolster economic growth and create employment. The document showed that the South African government could realize the aims of economic growth and employment creation by its commitment to open markets through trade liberalization, reducing government intervention by privatization and ensuring a favorable climate for investment and economic growth. The aims of the South African government in introducing GEAR was to achieve real GDP growth of 6 percent or more and create 400 000 jobs every year. Moreover, the policy was meant to increase investment, particularly foreign direct investment (FDI) (Rumney, 2005:3-5). Achieving all these goals was not easy, however, given that the vision of the previous government was utterly different to the one of the democratic government.

It was difficult for the new government because of the legacy left by the apartheid government, since the infrastructure was not on the same standard as that of a developing country. As Jerome (2004:6) notes, the new government was faced with an economy in which the infrastructure sector – transport, electricity and telecommunications – was fully controlled by state-owned entities that were inefficient. For example, in 1994, teledensity (which is the percentage of telephones per 100 people) was below 10 percent, and only 45 percent of households were connected to electricity supply.

When the new government took over in 1994, it governed under the idea that people are equal, must be treated fairly and are entitled to express their own opinion. When government contemplated their plan for privatization of state enterprises, there were different views from a variety of unions. The unions' criticism of privatization was based on some of the reasons mentioned by ILRIG (1999:5): the private sector would only be interested in those parastatals/services that would generate profit, and that privatization would only benefit big business and a few people from previously disadvantaged backgrounds. When the government envisaged introducing this new policy, opposition parties and unions were consulted.

The ruling party further attempted to achieve goals of a better life and improved economic growth by introducing the Accelerated Shared Growth Initiative in South Africa (ASGISA) as the third strategy since democratic elections took place in 1994. This policy aimed to halve unemployment and poverty by 2014. The policy was planned to work as a catalyst to accelerate Shared Growth Development. ASGISA encouraged people and organizations to work jointly with the government to accelerate the implementation of policies in order to meet government goals such as poverty eradication and economic growth (The Presidency, 2006).

3.3.3 Specific cases of privatization in SA

The Minister of Public Enterprises highlighted the fact that government recognized the need to restructure and privatize the SOEs. At the Lekgotla in 1999 government made clear its intention to restructure the “big four”, namely Telkom, Iscor, Transnet and Eskom. These corporations were the Post and Telecommunications Services of South African (Telkom), Iron and Steel Corporation (Iscor), South African Transport Services (Transnet) and The Electricity Supply Commission (Eskom) (Ministry of Public Enterprises, 2000: 3-4). The big four comprised 91 percent of government’s estimated total assets, and provided 86 percent of government turnover (Southall, 2006:6).

3.3.3.1 The South African Iron and Steel Corporation

Iscor was the first major parastatal to be sold in November 1989. The process of privatizing Iscor was not difficult because the entity was already managed like a private company. It was sold for R3 billion, after which government scaled down its plans and in the early 1990s, the future of privatization was unclear. Officials estimated that the roughly R250 billion needed to finance the purchase of the largest state corporations probably could not be found inside the country. The argument for privatization was also weakened by the worsening investment climate as political negotiations stalled and violence increased. Government opponents, even within the ANC, vigorously opposed privatization, because they viewed it as a ploy to maintain white control after majority rule took effect (Jerome, 2004:12).

The idea of job losses overwhelms employees and public alike when privatization of SOEs is envisaged. The South African Iron and Steel corporation was not unique: both management and employees were skeptical about privatization as they were under the impression that privatization resulted in job losses. Campaigns were launched to address the public and employees on what would result from privatization. Managers were trained in privatization at different levels in special seminars.

There is empirical evidence that shows that positive results were brought about by privatization. This included the revival of one of Iscor’s branches in Newcastle. Iscor’s branch in Newcastle did struggle for long time and it was on the brink of ceasing operations. After privatization it became more profitable. Profit increased from R14.2 billion to R19 billion rand in 2002 (Robertson, 2003:2-4). However, the South African Iron and Steel Corporation did not achieve all of its goals after embarking on privatization.

The South African government made use of every possible means to sell its political and economic stability to the outside world. It allowed private participation to encourage competition in the industry and make trade more open, but this was not enough to bring foreign investors to South Africa. The failure of the South African government to encourage enough foreign direct investment (FDI) in South Africa meant that the privatization policy did not realize the goals that it was hoped to achieve. South Africa had struggled to lure enough FDI since the new government come to power in 1994.

3.3.3.2 The South African Transport Service

It was difficult to privatize the South African Transport Services, given that the entire parastatals were managed like a state department. Its budget was also subject to parliamentary approval. The South African transport industry is dominated and controlled by Transnet. This public entity first had to be corporatized – that is, reorganized according to the Companies Act of 1973 with shares issued on the stock exchange (Mostert, 2002:29).

Transnet was named in 1990 after the South African Transport Services (SATS) industry was reorganized. It comprised six divisions which included: Spoornet – rail roads; Portnet – ports; Autonet – road transport; the SAA (South African Airways) – the national airline; Petronet – petroleum pipelines; and PX – parcel delivery.

According to Howard and Barrett (2001), writing in the COSATU weekly newspaper, there were about 50 000 job losses (mainly at Spoornet) after 1994. Some of the job losses were as a result of outsourcing of some of the functions from Transnet. There were also about 3 000 jobs that were transferred to the private sector, resulting in 47 000 job losses in Transnet. A further 2 500 people were retrenched and services were reduced on the provincial bus parastatals as a result of the introduction of competitive tendering combined with part sale. Most importantly, in other areas of Transnet many skills were lost, which was a blow because Transnet was believed to have the best railway and aviation engineering skills in the world (Howard and Barrett, 2001). The prime cause of job losses was not privatization, but the inefficiency that privatization is a response to. However, if valuable skills are lost in the process, it indicates that there is a problem with implementation.

In South Africa privatization has played a major role in restructuring the economy: this is the positive side to privatization. Not all job losses that occur after privatization are caused by privatization. There are other factors such as costs and efficiency measured that might result in job losses. The positive sides of privatization can be seen if the aims of privatization are achieved. For instance, one of the reasons for privatization in South Africa was to increase revenue. And the South African government achieved remarkable revenue in the sale of state assets: an amount of R11, 629 million was acquired (Rumney, 2005: 5-8).

The overall performance in terms of revenue seems positive and contributed to the significant profit increase in Spoornet, Portnet and Petronet. Radebe (2001:1-2) in his presentation to 2nd Economist Roundtable in Cape Town elaborated on the success and progress of privatization of Transnet. Although the democratic government had inherited a legacy in which the national railway network was planned to meet the needs of a minority population, the privatization and reorganizing within Transnet achieved significant efficiency. Khumalo (2003:1) added that the privatization of Transnet was on the right track; however, current restructuring was required to complement and be in line with the government policy and objectives of enlarging and modernizing South and Southern Africa's transport and logistical infrastructure. This would also help to encourage investment, which has not been doing well in the past years. Khumalo goes not to note that a further R80 billion needed to be spent on the infrastructure as Transnet's dual role of development and commercial viability could be achieved through better infrastructure.

3.3.3.3 South African Post and Telecommunication Service

The South African privatization of telecommunication was not a first. In 1984 British Telecommunications was effectively privatized with the sale of 51 percent of its equity. The Telecommunications Act was promulgated to give privatized entities full control, while still being supported by government. The Act also provided for the establishment of the office of Telecommunications (OFTEL). OFTEL is a non-Ministerial Government Department, meaning it operates independently of ministers so that it can carry out its activities free from political pressure (Veljanovski, 1989: 81).

In South Africa privatization was meant to help the telecommunications sector to perform better as this is in line with the twin SA national policy objectives of affordable access to communications services and accelerated development to meet the needs of a modern economy. The industry was regulated by the Independent Communications Authority of South Africa (ICASA) to ensure that local telecommunications companies do not engage in anticompetitive conduct and that competition is injected into the industry, by allowing a range of telecom companies, including internet service providers (ISPs) and value-added network services (Vans) to improve competitiveness. Without effective regulation, the assumed benefits of privatization (including more affordable access through improved management of the incumbent and more efficient allocation of resources in the market through competition) would not materialize (Gillwald, 2005:469).

Telecommunications in South Africa is managed by a company called Telkom and two providers of wireless cellular telephony. Telkom installs, maintains and operates voice and non-voice telecommunication networks. It gives service to a variety of businesses which included Transtel, Sentech and a supplier of value-added supply service. In an attempt to achieve its goals Telkom ensured that improved technology would make life easier. At first a 30 percent stake in Telkom was sold to SBS Communications, a United States-based consortium, and further privatization occurred when Telkom sold a 12 percent stake in 2003 to Telkom Malaysia. The sale included a primary listing on the

Johannesburg Stock Exchange (JSE) and a secondary listing on the New York Stock Exchange (NYSE). This reduced government's shareholding by 39 percent (Jerome, 2004:8-12).

Privatization started in 1997 and government executed privatization cautiously under pressure by unions. Privatization of telecommunication in South Africa yielded an increase in revenue from R8.4 billion in 1994 to R30.4 billion in 1999. The positive outcome of privatization was the fact that privatization sent positive signs directly and indirectly to foreign investors, although in 2003 SA foreign direct investment attracted only about R8, 170 million (Rumney, 2005:8-10).

The privatization of Telkom was proclaimed to be successful, although it did not reach all the objectives that were hoped for. But the majority of the government's goals were achieved – goals such as the transfer of skills, increasing investment in the industry and training and human resource development. Mostert (2002:33-34) shows that Telkom revenue has more than doubled in the five years following privatization, from R11 billion in 1997 to R22.6 billion in 2002.

3.3.3.4 Electricity Supply Commission

Eskom is the dominant electricity supplier that delivers energy to South Africa and neighbouring countries like Zimbabwe, Swaziland and Mozambique. It supplies 95 percent of South Africa's electricity, which is equal to more than half of the electricity generated by the African region. The industry itself is a regulated monopoly industry and is structured into three main groups, namely generation, transmission and distribution. Eskom helps the government to realize its goals and priorities by providing affordable or low-cost electricity to the consumer: it is envisaged that more than 300 000 new households each year would be supplied with electricity (Bond, 2002: 2).

The privatization of Eskom meant the unbundling of vertically integrated electricity supply by separating out the distribution part from generation and transmission parts and also horizontally dismantling Eskom's monopoly from a generation point of view.

The privatization of South African SOEs was expected to offset the imbalances that happened between government and its customers. The main drive behind the privatization of Eskom was to make the electricity industry viable by promoting economic and technological efficiency (Winkler, 2001:1). It becomes easy when South Africa keeps itself up to the international standard as far as technology is concerned.

Eskom has had to deliver in very large measure. In 1994, Eskom committed itself to connecting 1.75 million homes in six years. However, Eskom managed to deliver connections to just under two million homes, which is a rate of 1 000 homes connected per day and over 300 000 homes per annum (Mangaliso and Nkomo, 2001:8). Further explanation of Eskom's experience with privatization will be outlined in more detail in Chapter 4.

3.4 Responses to privatization from unions and organizations in South Africa

The majority of unions did not agree with the adoption of privatization by the new government; they argued that privatization would not address the problems that are faced by this country. The privatization policy was not accepted by most organizations and unions.

3.4.1 Congress of South African Trade Unions (COSATU)

COSATU has negative views on privatization. Its argument stems from the fact that privatization is the extension of the control and wealth of the private sector at the cost of the state. Its view is that the state must carry on providing and managing state assets. It also believes that, given tremendous poverty, private interest will not provide enough to the public, as most private companies are driven by profit.

The main arguments presented by COSATU were not just with a view to ending the sale of state assets, but also to force a rethink of whether it was desirable for market forces to govern the delivery of basic services. The core of its argument was based on the definition of privatization. It explained privatization in terms of the extension of the control by the private sector and wealth at the cost of the state. Moreover, its definition of privatization covered not only the sale of state assets, but the introduction of private competitors in sectors historically controlled by the state, relinquishing the management of state functions to private interests, and the requirement that the state functions operate on a commercial basis, which in some cases meant registering under the Companies Act (Mostert, 2002:21).

Some calls from COSATU to reject privatization as a policy that will bring changes in South Africa are not valid. COSATU concerns itself too much with a very narrow definition of privatization as a way of transferring control to private sector, while privatization by definition does not necessarily mean the transfer of control to the private sector. But privatization can also be defined as the transfer of risk to private companies; partnership, not just the sale of assets; activities, not necessarily assets; and involvement, not just ownership (Allen, 2004:1-3).

What COSATU forgets is that even if an enterprise is in the hands of a private company, government sets a number of agencies to regulate those private companies to ensure that they meet and will achieve the required goals that were hoped for. Moreover, public enterprises do not have enough incentive to perform, whereas private companies will be under pressure if they do not perform. Also, because of the competition that comes along with privatization, service becomes more efficient. In most cases a private company's price is set by market forces, because if a private company sets a price that is completely out of line with its competitors offering the same service, consumers will go to the one with affordable rates.

3.4.2 South African Communist Party (SACP)

The main argument of the SACP is that public control of enterprises and services is essential for economic development. It also stresses the vitality of developing a much clearer industrial policy strategy to guide the restructuring of public-owned assets. It particularly points out that restructuring makes a state agency weak. The arguments put forward by the SACP against privatization are outlined by Mostert (2002:23) in the following way:

Development priorities: privately owned corporations would not deliver education, health, electricity, transport and telecommunications infrastructure and services to the marginalized, because privately owned corporations would not invest resources to overcome structural inequalities within the society.

Strategic economic priorities, including the defense of a national economic sovereignty: public ownership is needed in a number of key areas for critical strategic priorities to be realized.

Attempting to regulate the private sector might be more complicated than actually owning and managing a public-owned entity: it will be more difficult to regulate major private transnational corporations than improving public service capacity and resources.

In conclusion, the arguments from COSATU and the SACP are that the past regime had left people with the legacy of an uncaring government and an unequal distribution of resources. The main argument from COSATU and the SACP is that the market is not designed properly to serve the poor, who cannot afford to pay for basic services. This complements the RDP, which promotes the idea that government must ensure that there is no citizen who goes without basic services like housing, water, electricity, health care and transport. Private companies will provide these services provided the people can pay, because private companies are driven by profit. COSATU and the SACP further argue that privatization undermines service to the poor and makes unemployment worse. The SACP has consistently condemned privatization, saying that there is nowhere in the continent where privatization had led to economic growth and improved service to the poor. The party also argues that privatization results in job losses and reduced access to basic service because of slow economic growth.

In most cases privatization has been seen as a cause of job losses; however, this issue has been cleared by investigations done by different institutions. The findings reveal cost reduction as the main cause of job losses; privatization in other words does not induce job losses. Moreover, if privatization occurs it will be on a small scale (Russia has been cited as one example). In Russia the difference in employment performance between privatized and state-owned enterprises was looked at and the findings show that more jobs were lost in the state-owned entities than those that were privatized. Also, in China privatization accounted for only 3 percent of job losses (Evans-Clock & Samorodov, 2000:2-6).

Despite the criticism by different unions, there are numerous successful privatization efforts that government can point out to its opponents. Privatization can indeed be a helpful policy in attempting to address some of the problems faced by the South African economy. COSATU and the SACP are deceived about privatization: privatization must be measured according to the goals that it set out to achieve. When privatization was implemented the main idea was to encourage private participation and competition in the economy. This is evidenced, for example, in the fact that electricity distribution was performed by Eskom alone before privatization; but now, the distribution function is performed by private companies and municipalities.

3.5 Further successful privatization efforts in South Africa

Privatization has reliably come up with changes that have revived the South African economy. Since it took over, the new government has embarked on privatization in several areas. These are as outlined in the following table.

Table 3.1. Successful Privatization Efforts in South Africa		
	Accomplishment	Impact
Infrastructure	Road construction, management and maintenance are privatized.	• Private contractors develop BOOT system • Major investment in needed road construction • Improved transportation & increased commerce • Ownership of road system to be transferred to government in 25 years
Defence	The national armaments industry, Armscor, is commercialized into a private entity, Denel, which in turn is unbundled into five subsidiaries.	• Emergence of aviation, artillery, civilian products, information technology, & real estate sectors • Improved efficiencies • Reduced costs
Local government	City of Benoni emergency services are privatized.	• Improved response time • Reduced operational costs • Consolidation of ambulance and fire services • Fire service radio transmitters converted to cell phone use
National orchestra	Subsidies are cut by government.	• More frequent performances • Larger attendance and wider musical repertoire

Source: Louw (1999:3-4)

The above table shows that the privatization efforts that have been successful. Government monopolies derail economic growth and discourage private participation. Government's goal, such as attracting FDI, cannot be achieved under monopolistic market conditions. Privatization brings competition to the market, and quality of service become efficient. The table depicts that when enterprises are privatized, private participation is stimulated and cost-reduction is achieved.

3.6 Conclusion

Since the new government took control in 1994 there have been significant changes in the economy and privatization has moved ahead gradually. Privatization has taken place on both national and local levels. Although the original purpose of privatization was mainly the enhancement of the free market system, recent developments pertaining to the policy that the new government adopted since it took leadership in 1994 have emphasized more the upliftment of disadvantaged communities. The aim and purpose of privatization varies from country to country. In South Africa the purpose of privatization is to incentivize private participation in the economy.

Despite all the efforts by the ruling party, privatization has been heavily criticized for the way it was conducted. Privatization of SOEs was not welcomed by organizations and unions, such as the SACP and COSATU, who make every effort to ensure that their discontent is heard. The core of their argument stems from the fact that privatized companies are concerned less about providing basic services to the people than about maximizing profit. Both claim that the privatization process will be at the expense of citizens and that it will result in layoffs of some workers. Unions forget that the privatization policy was adopted to encourage private participation in the economy and to ensure that poor people get access to basic services. Government has ensured that these goals have been realized, at least in part: for example, most provinces now have better schools as a result of the privatization of some basic services (Goldstein, 2001: 12-13).

Government embraces privatization in the belief that it will encourage customer choice over supply, and that the injection of competition into industries that were monopolized will result in better service. In introducing privatization government believes that private participation will be encouraged and open investment opportunities by reducing public control. When new policies are implemented, they are implemented in an attempt to realize the goals of a better life for all. ASGISA was later introduced to encourage cooperation in the form of unity among government entities and the private sector.

CHAPTER FOUR: THE IMPACT OF PRIVATIZATION ON THE ELECTRICITY INDUSTRY IN SOUTH AFRICA

4.1 Introduction

The issue of privatization was debated in countries such as Europe, North America, Japan and numerous developing and newly industrialized countries (Vickers and Yarrow, 1988:1). It sounds uncomplicated to introduce a privatization policy as a process of selling state-owned property to private owners. However, the South African government found itself with a problem it had not foreseen when it put electricity and gas industries on the block.

After the transition from the old regime to the new regime, the ruling party came up with different policies and programs. There was the Reconstruction and Development Programme (RDP) followed by Growth Employment and Redistribution (GEAR). The government saw a need to introduce privatization for various reasons. At an early stage of the GEAR program, privatization was meant to inject competition and encourage the spirit of entrepreneurship, as this was lacking in the economy. Also the programme was introduced as a way of raising funds for the government and spreading ownership by placing shares on stake.

The government recently introduced the Accelerated and Shared Growth Initiative in SA (ASGISA). ASGISA's ultimate objective is to halve unemployment and reduce poverty by 2014. However, there are other goals that it pursues – like meeting the demand for electricity and providing an efficient and competitive logistic infrastructure. Although ASGISA does not directly affect the privatization of the electricity industry, it promotes the common goals of a competitive and efficient environment.

The electricity industry in South Africa requires urgent restructuring, because the current structure of the electricity industry creates difficulties in terms of service delivery to its customers. These difficulties conflict with the government's objectives of social and economic development. The difficulties that government is facing include the failure of the industry to secure viable employment for skilled people and the desertion of skilled labour in the industry in search of a more secure job environment in other industries. South Africa is participating in trade and industry globally, and it is therefore of concern that some of the technology used by our public entities is outdated.

The privatization of the electricity industry was also fuelled by the lack of competition in the industry. Because of the monopolistic state of the industry, it followed the traditional industrial structure of being a dominant, vertically integrated, publicly owned utility. Eskom, as it is the major provider of electricity on the whole continent, involved itself in all aspects of the industry including: generation, transmission, distribution, sales and ancillary services. Now because of the monopolistic nature of the electricity industry, customer service is inefficient and competition is non-existent within the structure; also customers have no choice of supplier even if they are not happy with the service they receive. Through privatization, government deemed it fit to structure the industry in such a way that it put customers first by letting them have a choice of suppliers. Government also aimed to lower costs and prices by forcing improved efficiency through commercialization and exposure of the industry to greater competition and private ownership.

4.2 The need for change

South Africa's electricity industry is dominated by Eskom, the national vertically integrated electricity utility. Eskom is regarded as Africa's largest energy institution, and ranked the fourth-largest electricity utility in the world. It supplies 95 percent of South Africa's electricity, which amounts to more than half of the electricity consumed on the entire continent (NER, 1999). Electricity within the country is generated from different sources, but 92 percent of electricity is generated from coal, which really shows that coal is the major source of energy in the country. Only 6 percent is generated from nuclear power and the remaining 2 percent is from hydro and emergency gas turbines. At the moment the National Electricity Regulator is accountable and responsible for 55 power stations and Eskom operates 25 power stations, 13 of them coal-fired stations. Eskom also operates Africa's only nuclear station. Electricity is currently supplied to customers and 378 municipalities by Eskom (Clark, 2001:1-3).

Eskom has legislative rights to supply electricity throughout South Africa where other distributors are not supplying, because the municipalities are only accountable for supplying the local areas. To fulfill this part, the Eskom Conversion Bill was enacted to give Eskom the power to perform its function with full power.

The Eskom Conversion Bill of 2001 was an amendment of the old Eskom Act of 1987. This Bill was part of an initiative to restructure state-owned enterprises and was initiated by the Department of Public Enterprises. The policy framework was published by the ministry of Public Enterprises and reflected the fact that Eskom would have separate corporate entities – namely, transmission, distribution and generation. Competition would be promoted by introducing different generating companies, and different evaluations of models had to be conducted by the Department of Public Enterprises in consultation with the Department of Minerals and Energy (Winkler, 2001:1-2). Eberhard (2001:9) added that the purpose of the Bill was to bring efficiency to the electricity industry and expose Eskom to global trends.

It is important that government utilities work together to accomplish the goal of uplifting the standard of living of citizens. Since the electricity distribution industry plays a major role in the achievement of this goal, the following key objectives were set by the EDI Holdings Pty Ltd (the company established to lead the process of restructuring the electricity industry) for the industry: the promotion of low-cost electricity to its customers; reliable and high-quality supply and service to help achieve the economic and social development goals set by government; meeting electrification targets in the most efficient manner; and ensuring that the electricity industry operated in a financially sound environment (DME, 2001:2).

To meet all of these key objectives the South African government had to ensure that it strove to promote social development and economic growth by reforming the electricity industry. The restructuring of the electricity industry in South Africa was not only driven by international developments, but also from within the country. The following are the core reasons why the government required the urgent restructuring of Eskom (Eberhard, 2001:6-7):

- To ensure that the electricity industry is efficient and prices are as low as possible.
- To ensure that the financial and economic returns are maximized.
- Sustainable foreign direct investment.
- New Africa Initiative – this involved the positioning of Eskom to contribute to the Millennium Africa Plan and the New African Initiative.
- Improving customer service by giving customers a choice of supply.
- Promoting opportunities for black economic empowerment to ensure full participation from previously disadvantaged people.
- Increasing resource availability and opportunities for technological change taking into account competition from other parts of Africa.
- Protecting public benefits such as widened access to the poor, energy efficiency and development and environmental sustainability.

In pursuing the above key objectives, the South African electricity distribution industry in particular required urgent reform for the following reasons (Mlambo-Ngcuka, 2000):

- Financial viability: the electricity distribution industry (EDI) was in a financial crisis. This was evident from the fact that many municipal distributors had suffered financial collapse, while others were on the brink of bankruptcy. They were facing severe debt problems including backlogs of non-payment for bulk supplies to Eskom. In some cases Eskom distributors and other municipalities or provincial governments undertook distribution operations for operators who failed to distribute.
- Because of the financial weakness of the distribution business, employees found themselves in insecure working conditions. As a result many skilled workers left the industry for more secure jobs.

- Inequitable treatment of consumers: consumers were facing different tariff levels, standards of supply reliability and service across the country. This did not complement the government's objectives of promoting economic and social development throughout the country, particularly:

  i. Unfair discrepancies that existed between Eskom distribution and municipal distribution purchasing tariffs from Eskom Transmission.

  ii. Electrification was unevenly distributed within the country, with some of the poorer regions having the greatest need. More attention in terms of supply of electricity was placed on the rich regions.

- Inefficiencies: the EDI was too fragmented, with more than 350 distribution businesses. This fragmented structure was difficult to regulate and monitor. According to international standards the businesses were very small. Economies of scale were being lost along the way, and administration and technical functions were duplicated across distributors in rural, urban and industrial areas.

4.3 The privatization of the electricity industry in South Africa

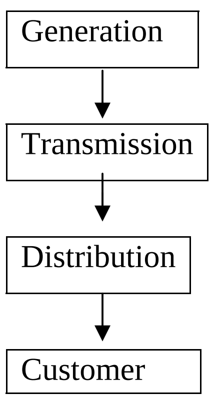
The privatization of state-owned institutions in South Africa was started immediately after the country's democratic elections in 1994. There was an imminent need for drastic changes in the electricity industry to make it more viable and flexible to meet the fast-growing need. The electricity industry was generally characterized by high costs, over-borrowing and little competition and this was evident from the 2001 Soweto crisis, in which residents were without electricity because of a failure to pay their electricity bills. Their main complaint was the high bills charged for electricity consumed (Bond, 2002:20). It is for this reason that the ANC government formulated its policy to comply with international standards.

The ANC's 1992 policy guidelines for a democratic South Africa heralded its intention to introduce anti-monopoly action in accordance with international norms and practice (Galen, 1998:12). This meant unbundling the vertically integrated monopoly of the electricity industry by introducing a number of private companies in the distribution part of the supply to enhance service delivery.

4.3.1 Old structure of the electricity industry before privatization in SA

For the past two decades the South African electricity industry was structured in a way that only one company dominated the market. Eskom controlled the entire industry without any fear of competitive pressure. Eskom and about 415 municipal distributors distributed electricity in the country. The figure below depicts the way in which the electricity industry was structured.

Figure 4.1: Old structure of electricity industry



Source: (Eberhard, 2001:8)

Figure 1 shows the four sectors of the electricity industry in South Africa. The first sector is the generation sector: in this sector electricity is generated, sold and supplied to relevant consumer. The second sector is the transmission sector: this sector involves network lines that are used to convey electricity to the final consumer. The third sector is distribution: this sector buys electricity from generation and transmits it to the customer. The last sector is the final consumer, the people or companies that consume electricity.

The electricity industry was completely monopolistic as it was entirely controlled and managed by Eskom. Eskom controlled all four structures – i.e. generation to distribution of electricity to customers. But because of problems with the municipal distributors, the number has since been reduced to 237 (Eskom, 2003:4).

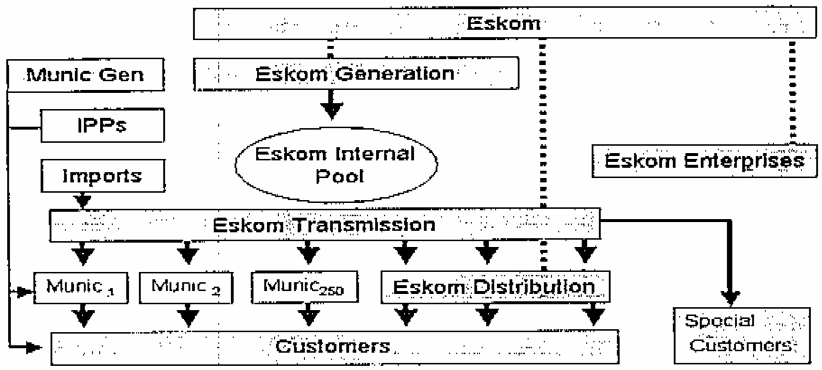
4.3.2 The current structure of electricity industry in SA

Given the fact that the industry was monopolistic in nature, service delivery was not efficient and government objectives such as social and economic development could not be realized under this type of structure. The South African government considered privatizing the electricity industry as a vehicle for creating jobs and improved service delivery.

The current structure of the electricity industry is much the same as before. Although Eskom still enjoys a monopoly, privatization was introduced in the distribution part. The new distributors have control and ownership over their market (municipalities and private entities), and they are controlled by a Board of Directors selected by municipalities. By injecting privatization into the system it was hoped that competition amongst the distributors would be encouraged and that it would result in better service delivery and improved sector performance.

The first privatization of the generation grid was seen in 2001 when the City of Johannesburg Municipal Metropolitan sold its generation grid to a private company. The generation sector is dominated by Eskom, in which Eskom own 70 percent of power generation, while 30 percent is controlled by independent power producers like the Kelvin power plant. The Kelvin power plant is the only independent power producer in South Africa and is responsible for producing 600 megawatts of electricity per month solely for Johannesburg's customers. In mid-2001 AES Corporate, which is an American company, purchased 50 percent of the Kelvin power station; the deal was between a consortium of AES, the black empowerment partner Global Africa Power and the Johannesburg council (Norton, 2006:1-3).

Figure 4.2: The existing electricity industry structure



Source: (Eberhard, 2001:15)

Figure 2 shows that Eskom currently dominates the generation sector, while only a small fraction of generation is undertaken by a privately owned company. As reflected in Figure 2, transmission is solely controlled by Eskom. It also shows that distribution is shared by municipalities and private companies like City Power. Although distribution is controlled by private companies and municipalities, there is a portion of electricity that is directly distributed to customers by Eskom. Customers are still suffering from the sole provider scenario in other areas such as generation because little privatization has taken place in this sector.

4.3.3 The effect of privatization on the electricity industry in SA

Although in South Africa privatization is a new phenomenon, especially in the electricity industry, there are signs of positive gradual changes since the beginning of the privatization of the electricity industry. This includes competition in the distribution of electricity to customers. Rapid changes in technology have occurred in both the generation of electricity and in the computing systems used to meet and dispatch power. The private sector offers many new solutions to provide power at lower cost, especially to consumers with low levels of demand, through innovations in customer service

(Eskom, 1999).According to Johnson and Chirwa (2003:3-9), privatization and further sector reform will help to avoid inefficiencies that might arise as a result of fragmentation, ensure network maintenance and avoid disparate tariffs. Some inefficiency was still seen in the number of power outages in Johannesburg in 2004.

The frequent occurrence of outages clearly indicated that the current electricity industry was facing serious problems. There are two types of outages: planned outages which result when the company concerned undertakes maintenance of networks (here customers are informed in advance) and unplanned outages which emanate from unknown reasons and could result in customers losing their businesses depending on the severity of the outages. Unplanned outages result from poor infrastructure and aging network cables that have not been replaced for over 50 years. Electricity infrastructure is dilapidated to such an extent that it would take some years to overhaul the entire electricity distribution system (Phasiwe and Claasen, 2005:2-5). The industry weaknesses were exposed by lack of investment and maintenance in the power distribution infrastructure, plus the growing demand for electricity. For these reasons government planned further restructuring of the electricity industry.

4.4 Plans for further power sector reform

The government planned further reforms of the electricity industry in order to ensure that its goals were achieved. These goals included the provision of low-cost electricity to all customers, providing a high quality of supply and service to all customers and meeting the country's electrification targets in the most cost-effective manner.

Power sector reform has taken place in both the electricity supply industry and the electricity distribution industry since 2005.

4.4.1 Electricity distribution industry reform

Much of the transformation that is needed in the South African electricity industry is required in the electricity distribution industry. The Electricity Restructuring Inter-Departmental Committee (ERIC) was thus formed 1997 to formulate government's position regarding the future structure. The ERIC report 1997 explained the challenges that the electricity industry was facing and what actions were needed to make the electricity industry more efficient.

For sustainability and service efficiency, government started to introduce Regional Electricity Distributors (REDs) in 2005 in which Eskom's distribution division would be amalgamated with the local authority distributors into a number of Regional Electricity Distribution companies (REDs). Under the REDs model all businesses that are currently owned by Eskom distribution division and municipalities will be under one management. This means all electricity businesses, municipal and Eskom distribution, maintenance, billing, human resources, finances, excluding Eskom's high voltage transmission network, will be ring-fenced and brought under a single management structure (Galen, 1998: 7-10).

4.4.2 Electricity supply industry reform

Concerning the plans for reforms of generation and transmission, the most important aspects were as follows (Clark, 2001:7):

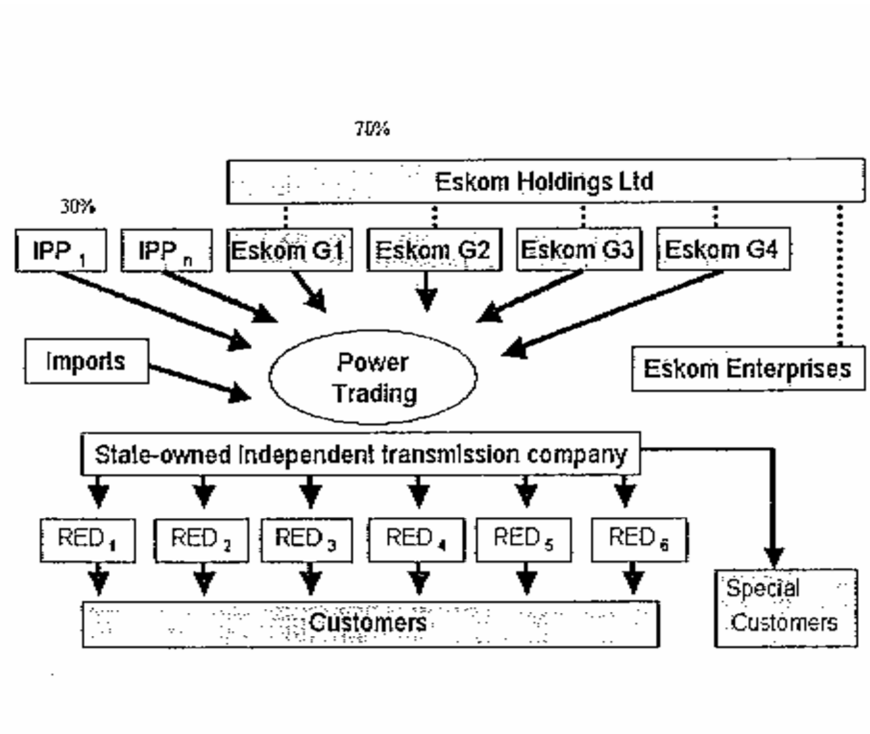
- Eskom's 24 power stations will be grouped in competing clusters.
- Transmission will be the responsibility of an independent state-owned company.
- Eskom will remain the dominant player in the generation sector for the foreseeable future. It holds up to 85 percent of the generation sector and to encourage competition independent power producers will be licensed for the other 15 percent.
- Black economic empowerment companies will be given a share in generation providers.

This will help government to meet its objectives by virtue of the fact that a reliable and sustainable electricity industry will encourage more foreign investment in the economy, because the risk of suffering losses is reduced. Also if competition is strong enough in the market it will offer customers better service at lower cost.

4.4.3 The expected new structure of the South African electricity industry

This new structure was proposed by Eberhard (2001:16), although there is no formal structure in place for the electricity industry in South Africa.

Figure 4.3: Planned new structure



Source: Eberhard (2001:16)

The structure in Figure 3 shows that a great deal of competition will be introduced in the generation of electricity, where independent power producers (IPPs) are used. Figure 3 also shows that Eskom will control 70 percent of generation and the remaining 30 percent will be in the hands of independent power producers. Transmission will be established as a state-owned company and non-discriminatory access to the electricity grid will be guaranteed. Eskom's distribution division will be incorporated into the national Electricity Distribution Industry Holdings and into six REDs that will be responsible for the supply of electricity to customers. All key customers or special customers will be solely supplied by Eskom.

4.4.4 Progress towards REDs

It would appear that the South African government has achieved its deadline of July 2005 for the establishment of the first RED. The first RED was kick-started in Cape Town in July 2005 and was named RED one. When the first RED started in Cape Town, the distribution sector of Eskom utilities was amalgamated with other municipalities. In the process the operating agreement, which commits the stakeholders to continue to provide good service, was signed. Pretorius (2005:1) shows that the restructuring of the electricity industry was meant to improve governance of the sector and stimulate growth. Also of importance is the fact that the establishment of the REDs will ensure better service to the consumer. To ensure that, Eskom and RED one agreed on promoting and continuing with the provision of good-quality services. According to Mlambo-Ngcuka (2000), the establishment of REDs is a first step in the consolidation of state-controlled assets in the distribution electricity industry and in the long run it will be commercializing and privatizing them.

Some notable successes have therefore been achieved with the establishment of the REDs. These are as follows, as pointed out by EDI (2004):

- The approval of RED one by the metropolitan council of City of Cape Town.
- The finalization of the RED governance structure: this means that RED one will be an established municipal entity and will be governed by local government.
- The launch of the transitional labour relations structure to facilitate agreement with labour on issues related to staff within the electricity industry.

- The development of a financial model to evaluate the impact on key stakeholders. The model would provide a view on all metropolitan municipalities and Eskom's region per RED.

The introduction of REDs in the electricity industry of South Africa is one way for the government to overcome problems faced by the electricity industry, although there might be some expectations that cannot be achieved.

The privatization of the electricity industry is a new phenomenon in South Africa, so there might be lot of expectations that will not be realized. When a new government takes power, a lot is expected from it. South Africa thus far is doing well by introducing a variety of policies that attempt to redress some of the problems faced by the electricity industry.

The successes of RED one cannot be measured yet, given that it started only in July 2005 and just over a year has elapsed since it commenced. It will take time before a balanced judgment of the success of RED one can be made, but so far it appears to be doing well. It should be noted that RED one was not responsible for the major outages in Cape Town in 2006 since the outages were caused on the generation side.

4.5 Privatization of electricity in Gauteng

There are several actions that can be taken by a private company in the distribution sector to improve service delivery, namely: expanding networks to connect more customers, improve operation efficiency and improve service delivery (Ferreira, 2005).

The privatization of the electricity industry in Gauteng occurred when City Power Company was launched in 2000 (Ferreira, 2005). As stated previously, the electricity industry in South Africa is divided into four sectors, namely generation, transmission, distribution and customer service. City Power is responsible for the distribution of electricity in Gauteng only, it is not accountable for the generation and transmission of electricity the province. It purchases electricity from Eskom and Kelvin power generation and distributes electricity to its customers.

The introduction of City Power as a private player in the distribution sector of the electricity industry was a positive attempt by the Johannesburg City Council to address problems such as poor service delivery. As a result, City Power Company was established in November 2000 as the first private company to distribute electricity in Gauteng since the new democratic government took over in 1994.

At first City Power was responsible for the electricity supply to non-domestic customers, which are all businesses that consume electricity around Johannesburg and suburban areas. But it gradually took responsibility for distributing electricity to domestic customers in Johannesburg.

Although power interruptions still occur, the contribution made by City Power thus far is felt and acknowledged by its customers. The success of City Power can be observed from the fact that when customers experience problems, there are depots in their vicinity that can quickly address their queries. There are also a number of transformers that are maintained and some were replaced to ensure that they remain able to meet the growing service demand.

4.6 Conclusion

Privatization in the South African electricity industry is slowly gaining in pace but has not expanded enough to lure foreign direct investment. Much delay was caused by the legacy left by the past regime, because nationalization was used. To address this, a number of programs were put in place to face the challenges encountered by the government. These programs included the RDP, Gear and ASGISA, and each program has supported privatization in its own way to help with the restructuring of the electricity industry.

The restructuring of the electricity industry was implemented to improve service delivery and give the customer a choice as regards supply. But from the government's point of view, the previous reforms were inadequate and that is why it recently planned to introduce Reds. Government would like to see its objectives of social and economic development fulfilled. This could be achieved by upgrading infrastructure: the South African government believes that the electricity industry needs to be reformed urgently, because it is an important driving force of the economy. Because of the fact that the electricity industry is crucial to the thriving of businesses and industries, if the whole electricity industry is viable it will encourage foreign direct investment and bolster economic growth.

The discussion of the privatization of electricity in Gauteng emphasized that even though there is private participation in the distribution sector of the electricity industry, customers do not have a choice over their supplier. Government should find ways to prioritize customer satisfaction.

CHAPTER FIVE: INTERNATIONAL EXPERIENCE WITH ELECTRICITY PRIVATIZATION

5.1 Introduction

Countries generally embark on the privatization of their electricity industries as a means of improving service efficiency in the electricity industry. The first country to engage in comprehensive privatization of the electricity industry was the United Kingdom. Other countries had privatized their electricity industries but on a small scale. The pace of privatization of the electricity industries in the other countries had rapidly increased and their reforms were more sophisticated. The UK was used as policy guide for other countries when they needed to privatize their electricity sectors.

There are many reasons that led to the privatization of the electricity industry in many countries. The reasons included: poor service delivery because a monopolistic company did not have incentives to become competitive; insufficient expansion of access to electricity service for the people; improving revenue for the government; technology transfer; improving managerial performance; and encouraging private companies to participate in the economy.

Most countries encountered difficulties basically because of the transition that took place. In most cases the past or previous government had rigid electricity industries that could not face the then current demand for electricity. Because privatization involves inclusion of private players, privatization of the electricity industry was not easily accepted by most countries as their possible means to overcome the burdens faced by their countries.

5.2 Experience in developed countries

The restructuring of the electricity industry is a global issue, since governments around the globe attempt to find a ways of improving service efficiency and economic development. Experience from developed countries would be looked at because when it began privatizing its electricity industry the South African government tried to learn from privatization in developed countries as the first to privatize electricity industries. There are other developed countries that went through comprehensive privatization but this chapter will explore the experience from UK and Greece.

5.2.1 UK

In the UK, the electricity industry, prior to reform, was dominated by a vertically integrated monopoly and publicly owned state utilities meeting the needs of individuals (Goldstein, 2001:17). To unbundle the vertically integrated monopoly, the UK introduced privatization of the electricity industry immediately after Margaret Thatcher took power in 1979. Privatization of the electricity industry in the UK was intended to inject competition into the electricity industry. However, the more challenging factor that faced the electricity industry in the UK was how to allocate the financial burdens associated with stranded costs. (Stranded costs are defined as the value of unamortized investments in electricity assets that could not be recovered in a competitive marketplace or the difference between the market value and the book value of these assets.) The aim of privatization of the electricity industry was to reduce the government's role in the economy and to make the electricity industry more competitive. The UK government decided to make the generation sector more competitive and leave transmission and distribution as monopolistic for an indefinite time. Hall (1999:4) mentioned that the UK adopted the type of privatization in which vertical divisions between generators and distributors were created. This allowed an oligopoly for generators and regional monopoly distributors.

In the UK, the Central Electricity Generating Board (CEGB) owned all power stations and transmission grids prior to privatization. The UK government then introduced privatization in the electricity industry because it was solely controlled by one company. Subsequently the CEBD was dismantled into four separate companies owned by the UK government. Privatization occurred when two power generation companies, Power Gen and National Power, acquired almost a quarter of the UK's electricity-generation capacity. The transmission sector was managed by National Grid Company, which was owned by twelve regional electricity distributors that became an independent company in 1995. This injected a significant amount of competition into the UK electricity industry (Bunn, 1994:369-372).

To further encourage competition and have the private sector participating in the generation sector of the electricity industry, the Thatcher government introduced the Energy Policy Act 1982, in 1983. This Energy Act was meant to remove the barriers to private players by encouraging independent power producers to have access to the national grid. However, the Thatcher government did not lure enough independent power producers to participate in the electricity industry. Subsequently in July 1989, the Electricity Act 1989 was introduced to help the UK government achieve the goal of inducing competition in the generation markets. The Electricity Act was also aimed at speeding up the establishment of strong regulatory framework in an area that was monopolistic in nature (EIA, 1997:4-6).

The establishment of the Electricity Act brought confidence to foreign investors, and this was followed by independent power investment in which foreign companies invested in England and Wales. These happened when Enron purchased 1,875 megawatts (MV) in 1991 from Wales. Another independent power-generation investment by United States companies occurred when Central and South West (Seeboard's parent company) bought a 660-MW natural gas-fired power plant. Also two coal-fired plants were sold in 1992 to NIGEN, which is a consortium of the U.S. company AES and a Belgian company. There was also nuclear power privatization as a means to make the electricity industry more viable to be able to meet the UK's energy demand. However, at first the idea of privatizing nuclear power plans failed because the British government was concerned more about the safety of the nuclear plants. But in 1996 Britain consolidated eight of its nuclear power plants into one company and sold it off to encourage competition (EIA, 1996:6-8).

There were several things that the UK government did right in privatizing its electricity industry. The privatization of electricity was favoured by the Thatcher government: the

Electricity Act of 1982 was enacted and this was followed by the Electricity Act 1989 to encourage private power-producers to participate in the generation sector. This helped UK privatization, because having a single source of power-supply generation was too risky. The UK shifted its reliance from nuclear energy to rely more on coal and other sources of power. The Electricity Act ensured that barriers were removed so that private players could play a role.

However, there were also things that they could have been improved on when privatization of the UK electricity industry occurred. Before the Thatcher government took power the UK government relied heavily on nuclear power production. Nuclear power production was not favoured due to the fact that it was perceived not to be safe, and it was also costly in comparison with coal, which was reliable and cheaper. The Thatcher government also did not bring enough private players in the electricity industry.

5.2.2 Greece

The process of privatizing the electricity industry in Greece began in 1990 when the Greek government felt the need for restructuring the electricity industry. The Greek government decided to reduce and limit government interference in the electricity industry. Private participation was preferred by the government because it was perceived to assist in reducing the problems in the electricity industry. The privatization policy was the driving force behind ensuring private participation in the electricity industry (Burnes, Katsouros and Jones, 2004:5).

Both internal and external factors had a significant influence on the privatization and liberalization of the Greek electricity industry. External factors emanated from the fact that the European Union urged European countries to open their markets by offering 30 percent of their business to private companies. Internal factors came from the fact that the Greek electricity industry was monopolistic in nature and dominated by the Public Power Corporation (DEH), which controlled 98 percent of electricity supply and generation capacity. DEH also controlled the high-voltage transmission grid and low-voltage distribution. Frequent outages prompted the Greek government to liberalize and privatize the electricity industry; it was also perceived as a way to attract more foreign investment (PE, 2001:9).

Electricity in Greece was solely controlled by the Public Power Corporation (DEH). DEH is the largest power-generating company and is the sole power supply company in Greece. Privatization of the power sector in Greece occurred when power licenses were granted to private companies. Subsequently an independent company took over the transmission function and the entire power sector in Greece is now in the hands of Regulating Authority of Energy (RAE). Privatization of the electricity industry yielded positive results in Greece. According to Burnes, Katsouros and Jones (2004:8), the privatization of the Greek electricity industry produced positive results, including increasing profits by more than 50 percent to €399m.

The good thing about the Greek government's privatization was that although all levels (generation, transmission and distribution) of the electricity industry were in the hands of the state, the government did not simply allow private players at every level simultaneously. Private participation was started in the generation sector and government took time to observe whether privatization worked before it thought of further unbundling.

The bad thing that the Greek government did was to fail to communicate with workers when it embarked on privatizing the electricity industry. Because workers felt marginalized and felt that privatization of the electricity industry would benefit a small elite of managers, this led to a slower pace of privatization in Greece.

5.3 Experience from developing and transitional economies

In most developing and transitional countries governments attempted to introduce policies that could stimulate growth and meet other challenges that these countries encountered. Privatization was proposed as a policy to address macroeconomic objectives in developing countries. Flexibility in the electricity industry could help governments to realize their goals. The success of privatization required strong political leadership and clear policies to give support to authorities that were responsible for the implementation of privatization. This chapter will focus on the experience of the developing and transitional economies of Chile, Hungary and Argentina.

5.3.1 Chile

Literature shows that in 1973 the privatization of the electricity industry in Chile was followed by government intervention over the longer term. In Chile the privatization of the electricity industry took place in the depths of a recession, so public companies were purchased at rock-bottom prices (Jackson and Price, 1994:20). The government did not get the expected revenue from these sales. As a result of this problem, Chile established regulatory and legal procedures that attempted to win investors’ confidence.

The privatization of the electricity industry in Chile was comprehensive and more successful than in most developing countries. The success was attributed to good policies that were in place and good regulatory bodies in the economy – such as the National Energy Commission (CNE). It was extremely difficult to come up with a good way to the implement privatization, because there was not enough experience from the privatization of electricity industries in other countries that could be drawn on. Only a few countries had privatized their electricity industries before Chile – namely, the UK, France and Belgium (Pollitt, 2004:4). From these countries they learned and observed the culture of separated generation and distribution companies.

The electricity industry in Chile was privatized by the separation of the generation, transmission and distribution sectors. Privatization took place by encouraging private companies to participate in the generation and distribution sectors (CEE, 2004:2). At first there were only two main companies responsible for generation and distribution. These two companies were unbundled into six generating companies and eleven distribution companies in 1980. Investment through increased private participation was larger than was anticipated; in 1989, 100 percent of Endesa (the government power company) was in the hands of private ownership.

The Chilean electricity industry was organized according to four grid systems – namely, Sistema Interconectado Central (SIC), Sistema Interconectado Norte Grande (SING), and the Aysen and Magallanes Grids. These four grid systems communicated through the Economic Dispatching Centre (CDEC). Privatization continued to expand and resulted in 100 percent of Chilean electricity generation being controlled by private companies by 2000 (CEE, 2004:3).

Chile's privatization yielded positive results, and this was experienced when electricity prices fell drastically. The price charged for power delivered was reduced from $30.93 to $23.97 per KWH in 1982. There was a remarkable efficiency improvement which resulted in the combination of reduced prices and a high rate of return. The privatization of electricity helped Chile to achieve its goals – namely, efficiency improvement, increased investment, and rural electrification. Before privatization, 62 percent of rural areas were without electricity; but by 2002 only 14 percent were without electricity. This remarkable achievement was as a result of the privatization of the electricity industry in Chile (Pollitt, 2004:9-11).

The Chilean government did well despite the fact that when it embarked on privatizing the electricity industry there were few countries that Chile could learn from. Only the UK, France and Belgium had undertaken comprehensive privatization of their electricity industries before Chile began to privatize its electricity industry. The good thing about privatization of Chile's electricity industry is that the government allowed free entry into the generation sector. This free entry brought increased competition to the electricity industry. The Chilean government also soon realized the importance of regulation, and put the necessary regulation bodies in place.

The bad thing about Chile's privatization effort was that privatization in this sector happened during a recessional phase of the business cycle. If there is a significant decline in economic activity, the desired result and benefits of privatization will not easily be realized. If the economy is faltering, perhaps as a result of poor service delivery by government, this failure could be associated with privatization even if is not privatization that led to the failure.

5.3.2 Hungary

In 1993, the energy sector in Hungary was controlled by Magyar Villamos Muvek (MVM, Hungarian Power Company Ltd). Because the Hungarian government did not see a difference between electricity prices pre and post socialist times, a new energy policy was introduced in 1994 to reduce its dependency on Russian suppliers. It also aimed to improve service efficiency by encouraging competition in the electricity sector through privatization. Bakos (2000:1120-1121) added that the energy policy was meant to arrange the electricity industry into three level of systems. Level one included eight grouped generating companies, level two was the MVM, which controlled the entire transmission process, and level three comprised one group formed by six supplier companies.

Privatization of the Hungarian electricity industry emanated from the burden left by a centrally planned economy. The electricity industry faced serious challenges as a result of its state-owned monopolistic characteristics. Despite all the challenges, Hungary proceeded with the privatization of the electricity sector. Pesic and Urge-Vorsatz (2001: 87-89) provide the following reasons for this initiative: improving government's revenue so that foreign debt that was left by the previous government could be paid; and turning the accumulated losses of the Hungarian Power Company into profits.

In 1994, the Act XLVIII (Electricity Act) was promulgated by the Hungarian government. This act was a means of giving support and power to the electricity industry. The Act explained the clear role that should be played by the electricity industry and its managerial responsibility. But the Electricity Act did not give clear guidance about whether privatization should be structured to allow more private local players or to encourage foreign direct investment. However, financial resource allocation was the priority and this urged government to privatize the electricity industry in 1995. Privatization of the Hungarian market included the entrance of new international players into the market – amongst them American and Japanese investors. Continued foreign investment was extended when six power producers and the entire distribution were in the hands of foreign companies (Pesic and Urge-Vorsatz 2001:6).

Privatization of the Hungarian electricity industry started at a slow pace, because the Hungarian government did not have a clear picture of the kind of privatization it wanted to embark on. The first attempt, which entailed inviting only single foreign strategic investors to participate, had failed. But after the door was opened for competition, by allowing several foreign investors to participate in the electricity industry, privatization of the electricity industry started to advance. This was confirmed when six distribution companies and three power plants were sold, which was followed by selling the shares of two more plants (Budapest Power Plant Ltd and Tisza Power Plant Ltd). In the end, privatization was successful because six power producers and the entire distribution were owned by private companies (Hall, 1999:6-5).

The Hungarian government enacted the Electricity Act to give the private companies that participated in the electricity industry full support, and to make it clear what role that Hungarian government should play. The Electricity Act also made it transparent that government should play a bigger role in regulating, licensing and dealing with issues such as maintenance of supply security. This brought stability to the Hungarian electricity industry.

The Hungarian government did not have a clear picture on how to conduct its privatization of the electricity industry. This included whether it should privatize the whole system or whether separate sectors should be privatized. This happened despite the fact that there were many countries that did privatize their electricity industries before Hungary from which the Hungarian government should have learned. The uncertainty on how to privatize their electricity industry in Hungary was experienced when the first attempt to privatize failed when only a single foreign strategic investor was involved.

Better results would have been experienced if more investors were allowed to participate from the start.

5.3.3 Argentina

The poor performance of the electricity industry in Argentina in recent decades reached a level of crisis between 1988 and 1989. This led to the decision by the government to find a way of satisfying the power needs of Argentineans. Because regulated industries were controlled by the public sector and their decisions were driven by politics rather than market conditions, more pressure was exerted on government to privatize the industry (Abdullah, 2002:7). Juan (1994:2) also noted that privatization in Argentina was fuelled by inefficient administration and inadequate investment. To find a way of quickly addressing these problems, the Argentinean government implemented the privatization of the electricity industry. The model used for privatizing the electricity industry in Argentina was that of Chile, where almost the entire electricity industry was privatized.

Privatization of the electricity industry in Argentina focused on promoting growth and reducing electricity prices. This offered an opportunity for investment and private participation. To make this more attainable, the Electricity Act was promulgated in 1992 to support the privatization of the electricity sector. This Act divided the electricity industry into generation, transmission and distribution sectors. The division of the electricity industry took power away from the Argentinean government in order to remove direct contact from government and encourage competition. Generation companies were divided into thermal energy and hydroelectricity, and transmission and distribution were owned by private companies (CEE, 2004:3).

Private participation improved when the distribution system allowed Empresa Distribuidora Sur (Edesur), Empresa Distribuidora Norte (Edesun) and Empresa Distribuidora La Plata (Edelap) to have shares in the distribution system. The Argentinean distribution sector experienced more private participation when three companies – Edesal, Edelar and Edesa – took over the distribution sector in the San Luis, La Rioja and Salta provinces (Abdullah, 2002:9).

The current state of the electricity industry is highly competitive, with most competition in the generation sector. The generation sector in Argentina is more open with different sources of energy. This has resulted in a low price for electricity and made electricity industries reliable and sustainable.

The good thing about the privatization of the electricity industry in Argentina is that the generation sector became more open and competitive. Competition in this sector was introduced by private companies, which were allowed to participate in the generation sector. This was experienced when 43 generating companies took ownership of 96 plants. More importantly, the Argentinean government did well when it divided generating companies according to the diverse sources of energy, which included 60 thermal plants, 34 hydroelectric plants and 2 nuclear plants. This helps if the country experiences drought, for example. This would mean that the hydroelectric plants will be affected but the production of the other power generators like thermal or nuclear electricity plants will be expanded.

5.4 Lessons from international experience

The importance of learning from the experiences of other countries can be seen from Chile. When the Chilean government implemented privatization of the electricity industry it learned from the experiences of other countries that had already embarked on privatization. Chile learned that separate generation, transmission and distribution sectors, with several independent generation and distribution companies, worked better. It also found that the electricity industry would perform better if it had sound regulating agencies from the generation sector up to the distribution sector (Pollitt, 2004:12-20). Having regulation agencies in place helps the government to realize its vision.

Government must have a clear vision when planning to privatize the electricity industry. Failure to do so will result in stuttering privatization. This was experienced by Hungary when it engaged in privatization. The Hungarian government did not have a clear plan on the kind of privatization it wanted – for example, whether privatization should be focused more on encouraging local or foreign direct investment. This caused tremendous delays in its first attempt at privatization, which involved single strategic foreign investors in the country, and delivered poor results.

To avoid delays and other negatives of privatization, countries should consider the time of the business cycle at which to introduce privatization (whether recession or boom cycle). If privatization takes place during a recessional phase the result of privatization will not be felt, as privatization will be associated with declining economic performance. The best example in this regards is Chile. Chile privatized its electricity industry when there was a significant decline in economic activity, and the desired result and benefits of privatization were not easily realized.

Before government can act on the implementation of privatization policy, communication must be effective. Lack of communication and information between staff and managers can result in tardy privatization, and was experienced in Greece. Because employees in Greece felt marginalized and felt that privatization would benefit only a small elite of managers, they resisted privatization, causing unnecessary delays.

Another point that can be learned from the privatization of the electricity industry in developed and developing countries is that privatization is a lengthy and complex process; the desired results cannot be achieved in the short term. For example in Greece, it took an inordinate time for the government to observe the results of privatization, because privatization was introduced in the generation sector first and a result was first waited for before it continued to unbundle. While this was prudent, and allowed them to learn from their own experience, it required much patience from all stakeholders.

The government's role of ensuring supply security is crucial in the privatization of the electricity industry. Good power-supply security will help countries to win investors' confidence, as happened in the UK, Argentina and Hungary. These countries showed their support by promulgating Electricity Acts. These Acts advocated that government's role should be to ensure the availability of electricity at all times.

The benefits and results of privatization depend on how privatization is approached. Argentina and UK showed that the generation sector needs to be made more competitive by being divided according to energy sources before privatization takes place. This means that electricity generation can be privatized using different sources of energy (such as nuclear power and thermal power) rather than relying on one single power producer like coal. Not only did this enhance supply security by diversification, it also ensured competitiveness by increasing the number of competitive arenas.

5.5 Conclusion

The problem of service inefficiency is a universal problem not only for South Africa but also for all developed and developing countries. Governments use privatization as a tool to address the issue of service inefficiency. In developed countries like Greece and Britain, privatization was widely implemented and found to be a useful policy. Privatization allows the market to be free and induces competition amongst the firms and the industry, because if companies are not competent enough this will drive away customers and companies will cease operation. Companies must be able to maximize profit and minimize cost to remain in the market. Government is an important influence on economic performance, although its intervention is very limited as the private companies are granted full power to act independently. To ensure this, most developing and developed country promulgated Electricity Acts to give control to electricity governing bodies and ensure that government interference is limited.

Privatization might not be the only solution for customer satisfaction and service efficiency. It takes time before fully fledged privatization can be accomplished because some companies lack the required skills to do the job. As a result privatization becomes a process that takes time before one can judge its success.

CHAPTER SIX: CONCLUSION AND RECOMMENDATIONS

6.1 Concluding remarks

Since 1994, when the first democratic government was elected after the release of Nelson Mandela, the South African government had used every means possible to surmount inequalities and the abject poverty in the economy. More emphasis was placed on the alteration of policies that would be able to uplift the standard of living of the poor. Although there are still challenges like unemployment, stimulating economic growth and social development that were left behind by the past regime, enough progress and effort has been made towards the closing of the gap. The other challenges that the country are facing is finding suitable policies that can quickly address these challenges. South Africa supported privatization as a means or a suitable policy to face the new phenomenon of restructuring the electricity industry.

The first economic program that was enacted by the democratic government was the Reconstruction and Development Programme (RDP). This programme postulated that the reconstruction and development of economy would be achieved when the state plays a major role, combined with the participation of society and the private sector. It stated that there is a significant role that the public sector can play to complement the private sector in order to stimulate reconstruction and development. With regard to privatization, the RDP illustrated the need for flexibility in creating a balance between privatization and the creation of state-owned entities with minimum participation by the public sector. In support of these initial plans, 30 percent of the state electricity utility Eskom was to be sold off in order to encourage foreign investment in the generation sector of the electricity industry. This was realized in 2001 when the first private company (Kelvin power plant) purchased 30 percent of Eskom’s generation power.

The second programme introduced by the government was the Growth, Employment and Redistribution (GEAR) programme in 1996. This policy suggested that government should own few assets, but that it should play a more pivotal role in formulating rules in regulating the economy and encouraging foreign direct investment (FDI). The GEAR programme fully supported privatization, but did not use the term privatization. Instead the term restructuring of state-owned enterprises was used. More recently, after more than ten years after the first democratic election, the South African government introduced the third programme named the Accelerated Shared Growth Initiative South Africa (ASGISA). The program aimed to halve unemployment and reduce poverty by 2014. These initiatives supported the fact that all sectors should work together to accelerate delivery to sustain development. The ASGISA program supports goals such as service efficiency, which was meant to be achieved through privatization.

Because the electricity industry was deemed to be a driving force of the economy, it is incumbent upon government to ensure the superb performance of this industry. If the electricity industry is not performing well it will send negative signals to investors, and as a result foreign investors will be discouraged to invest in the economy.

In an attempt to address the problems faced by the electricity industry, privatization was introduced. The electricity industry was structured in four spheres: generation, transmission, distribution and supply. Eskom is a dominant player in all the spheres of the electricity industry. This monopolistic type of behaviour displayed by Eskom encouraged inefficiency and a culture of incompetence in the electricity industry. The South African government introduced private companies to help improve service delivery in the electricity industry. The initiative that government made was to include private players in the generation sector of the electricity industry in 2001 when Kelvin generation was sold to a private company. This was the only privatization that occurred in this sector. The transmission sector was entirely controlled by Eskom and distribution and supply functions were performed by municipalities and partly by Eskom. There was a need for more comprehensive privatization in the electricity industry.

The privatization of the electricity industry was inadequate and too slow to meet the growing need of the South African industry. However, there were a number of obstacles that caused the delay. Many institutions like COSATU and other trade unions did not like the idea of the privatization of the electricity industry. Unions such as COSATU and

FEDUSA had different views towards the privatization of the electricity industry. While COSATU is one of the most influential unions in the economy, and because the majority of its followers oppose privatization, the ruling party could not ignore its views. The discontent from unions and other anti-privatization organizations stemmed from the belief that privatization would result in job losses and that private institutions are more driven by profit. Unions and anti-privatization sentiment disregard the fact that private companies are more efficient than public companies, because in private companies prices are set by market forces.

The electricity industry suffered a major set-back in the privatization programme because of those unions. It took an inordinate amount of time before government resuscitated the idea of the privatization of the electricity industry in 1994. Government realized that privatization of the generation grid did not do enough, and it had another thought by introducing privatization in the distribution and supply sectors of the electricity industry. This was seen when City Power Company was formed to address the problems that were faced by the electricity industry around Johannesburg. Although there were a number of problems that persisted, City Power did much in terms of service delivery. Customers were no longer waiting for long periods in queues before being attended to, and this also meant that customers did not to travel long before they got help. The building of offices in several depots also brought services closer to the customers. Because of the small scale of privatization in the electricity industry most of the goals that were aimed at were not realized.

The South African government showed that its hearts were focused on the needs of people. It continued with its restructuring of the electricity industry to ensure that the goals were realized. This was seen when government planned to introduce REDs in the electricity industry. REDs support collaboration in the form of joint ventures, and will consolidate municipal distribution into six REDS. This means Eskom distribution, municipalities and others distribution companies will be under one management, but all key customers would solely be supplied by Eskom. To ensure that further restructuring through REDs would be achieved in time, government established a private company

(EDI Holding Pty Ltd) to monitor progress. The first RED was established in July 2005 in Cape Town and is called RED one. So far RED one is doing well and observers hope government will reveal when the next RED will be started.

6.2 General recommendations

Having done an investigation of different countries' electricity industries in this research, the following recommendations have been made to be able to help government to review its electricity privatization and attempt to expand the existing privatization of electricity industry.

The current structure of the South African electricity industry shows that privatization has not gone far enough. In its endeavours to tackle this problem the South African government should realize that privatization is a process on its own. Privatization of the electricity industry needs to be wider in scale: government needs to expand privatization gradually from one sector to the next, to observe and learn from each experience and to apply further privatization efforts to other sectors of the electricity industry.

The area that needs particular attention is the generation sector. Because Eskom enjoys a monopoly and this has resulted in lack of competition, the continuing service inefficiency might discourage foreign investment in our country. To address this problem the South African government must make the generation sector more competitive by dividing it according to energy source before privatizing each source. This will ensure more competition and enhance supply security by diversification as in Argentina. A comparison with developed countries like the UK reveals that the UK generation sector is more open to private participation. Private participation was injected into the UK electricity industry when two private companies – namely, Power Gen and National Power – bought almost half of the generation sector.

The current structure of the electricity industry in South Africa is problematic in the sense that its electricity-generating capacity is expected to become increasingly inadequate. With the fast-growing demand for electricity industry, the South African government should find a way of building new generation plants or expanding the existing ones. In an attempt to overcome the problem of generating capacity, government should broaden the privatization of the generation sector to add alternative sources of electricity production. Currently, South African electricity is produced from coal (which is cheaper), but relying on one source of electricity producer might be risky.

The risk comes from the fact that the coal base is no longer able to cope with the surging demand for coal by the generation sector. To avoid this, government should increase the production by increasing production from alternative sources of power. The same was experienced by the British government, which relied too much on nuclear energy and in the end citizens realized the danger of relying on nuclear electricity. The Thatcher government then privatized the generation sector by allowing more power producers with different sources of energy. Supply security is crucial for South Africa because this will help with sustainability of the electricity supply, and because frequent outages around Gauteng gave privatization a bad reputation. The South African government should also ensure that privatization is conducted through the expansion of the sources of energy.

More privatization is needed particularly in generation to add competition to the electricity industry. This can be learned from Chile, which had more independent power producers and this encouraged competition. Competition in generation will help to enhance consumer welfare. Privatization is a vital tool to unlock the rigid electricity industries so that more private companies are encouraged to participate. Privatization requires some regulation by the government in order to discourage private companies from focusing more on profit than service delivery. The South African government must emphasize the issue of sound regulation agencies in the electricity industry, as are in place in Chile.

The privatization of the South African electricity industry is not advanced enough to handle the problems faced by the electricity industry. Goals such as service efficiency and competition were not realized on the scale that was projected. Because of that the South African government planned a new structure that envisaged competition in the generation sector in which Eskom will be competing with a number of independent players. The new planned structure shows that service efficiency will be possible in the distribution sector – mainly by way of the establishment of REDs, the first of which was started in Cape Town in 2005 and was named Red One. After the establishment of RED one, Cape Town was hit by major power failures, but these failures must not be associated with RED one, as the problem was in the generation sector. Had privatization been introduced earlier in the generation sector, this sector would have been more competitive (as in Argentina). Major outages (such as happened in Cape Town) would have seen less likely in a more competitive environment.

The notion that unemployment and job losses will result from privatization is a fallacy, and needs to be addressed. Awareness need to be created to clarify the relationship between job losses and privatization. Job losses are attributable to inefficiency, not to actions that aim to reduce inefficiency. If the electricity industry is more open and private companies play a bigger role, jobs will be created by virtue of increased investment. When private companies are more flexible and profitable, they are likely to increase their production. More production means more work would be created. Government should assist in implementing policies that are more open and transparent to encourage enough FDI, and the South African government should ensure supply security through its involvement in the industry (to avoid the problems experienced in Hungary).

Another point that the South African government should consider when further privatization is envisaged is communication with workers. Failure to inform workers resulted in the delay of privatization of the electricity industry in Greece. If workers have limited information pertaining to privatization due to inadequate communication by the government this will create uncertainty and cause unnecessary staff turnover. As a result government will face the adverse consequences of losing valuable skills that workers acquired over a long period. Poor communication culminates in resistance from unions such as COSATU and FEDUSA over the issue of privatization, because they are under the impression that privatization will result in job losses.

The electricity industry should learn from other developing countries by considering the improvement of its core business by expansion through international markets. This can be done by partnerships with international electricity generation or distribution companies.

The South African government should not, as happened in Chile, further privatize its electricity industry during a recessional period of the business cycle. Instead it should privatize the electricity industry during a boom phase so that the result of privatization is not affected by poor economic performance, and so that government revenue is maximized.

South Africa should compare all models applied by various countries and choose a model that is suitable and applicable to the economy. There are many countries like the UK and Chile from which the South African government can learn, given that these countries went through a comprehensive privatization of their electricity industries. Drawing on the experience from developed countries and developing countries, South Africa can design its own model of privatizing the electricity industry.

6.3 Recommendation regarding privatization of electricity in Gauteng

City Power is a large company and is profitable enough to conduct and administer its own business. To be able to further reduce power interruptions caused by old transformer and cables, their plan of action should prioritize maintenance. This means focusing for a certain period on saving money and channeling it to maintenance. This strategy will aid City Power in raising sufficient capital for maintenance of transformers.

Even though there is private participation in both the generation (Kelvin) and distribution (City Power) of electricity in Gauteng, more needs to be done. A public monopoly was simply replaced with a private monopoly and customers still do not have a choice of supplier. Government should increase the number of private players in the electricity industry in Gauteng in order to encourage competition. This will ensure greater efficiency and customer satisfaction and help to iron out the current problems in electricity generation and distribution in Gauteng.

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