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**FINANCIAL ASSISTANCE TO STATE-OWNED ENTERPRISES BY
THE STATE
IN SOUTH AFRICA:
A CASE STUDY OF ESKOM**

by

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DECLARATION

I declare that **FINANCIAL ASSISTANCE TO STATE-OWNED ENTERPRISES BY THE STATE IN SOUTH AFRICA: A CASE STUDY OF ESKOM** is my own work and that all sources that I have used or quoted have been indicated and acknowledged by means of complete references.

.....
SIGNATURE
(M SADIKI)

.....
DATE

ACKNOWLEDGEMENTS

I would like to acknowledge and thank God for my mom, Queen Ndouvhada, who has encouraged me to value and use education to make my life better and to make a contribution to society.

Many thanks go to my supervisor, Professor GM Ferreira, for not giving up on me and always encouraging me to finish my Master's with positive criticism, and my co-supervisor, Professor JC Pauw, for always sharing ideas and assisting me in becoming a true researcher.

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ABSTRACT

State-owned enterprises (SOES) exist in South Africa to drive economic development and improve service delivery to the large population. In order for SOES to achieve their mandates, as set out by government through their shareholding department, financial assistance by the state is imperative. In the case of the monopolistic power utility, Eskom, the South African government (SAGO) has 100% ownership which is managed through the Department of Public Enterprises (DPE). This total ownership by the state means that government is responsible in ensuring that the utility is operational and supported financially.

The current study was aimed at evaluating the financial assistance received by SOEs in South Africa by the state with specific focus on Eskom. Eskom was selected from the eight SOES managed by the DPE for the purpose of focusing the research. The focus of the study was on the financial assistance to SOES in South Africa by the state.

In 2008, Eskom received funding from different sources through loan intervention of the South African government. The loan and guarantees made available to Eskom by government, enabled the SOE to achieve a positive credit rating.

Data for this research was primarily collected through academic journals, books, Acts, White Papers, legislation and personal interviews at the National Treasury (NT).

The recommendation that this research states relates to the need for a single policy document on state financial assistance to SOES in South Africa.

KEY TERMS:

State Owned Enterprises, Eskom, Energy, Financial Assistance, Department of Public Enterprises, South African Government, National Treasury, loan, monopoly

ETHICAL CLEARANCE

All ethical issues in this research were taken into consideration and observed. Permission to conduct Interviews was obtained as reflected under annexure A. All questions asked as reflected under annexure B and the entire research adhered to all ethical requirements.

ACRONYMS AND ABBREVIATIONS

A4ID	Advocate for International Development
ADB	African Development Bank
AFD	<i>Agence Française de Développement</i>
AGSA	Auditor General of South Africa
CAPEX	Capital programme expenditure
CEO	Chief executive officer
CPI	Consumer price index
DBSA	Development Bank of Southern Africa
DFIS	Development Finance Institutions
DME	Department of Minerals and Energy
DoE	Department of Energy
DPE	Department of Public Enterprises
ECAS	Export Credit Agencies
ECA	Economic Commission for Africa
ESKOM	Electricity Supply Commission
GEAR	Growth Employment and Redistribution
IPPS	Independent Power Producers
ISMO	Independent System and Market Operator
JBIC	Japan Bank of International Cooperation
MDBS	Multilateral Development Banks
NER	National Electricity Regulator
NERSA	National Energy Regulator of South Africa
NPC	National Planning Commission
NT	National Treasury

NPA	New Public Administration
NPM	New Public Management
NRF	National Revenue Fund
OECD	Organisation for Economic Co-operation and Development
PFMA	Public Finance Management Act 1 of 1999
RDP	Reconstruction and Development Programme
REFIT	Renewable Energy Feed-in Tariffs
REIPPP	Renewable Energy Independent Power Producer Procurement
RSA	Republic of South Africa
SA	South Africa
SAGO	South African Government
SOES	State Owned Enterprises
USA	United States of America

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CHAPTER 1

GENERAL OVERVIEW

1.1 INTRODUCTION

The research reported here focuses on the state's funding policy to state owned enterprises (SOES) in South Africa and comprises a case study of the Electricity Supply Commission (Eskom). The focus is on the electricity industry. The purpose of this study is to demonstrate the significance of state funding to SOES in South Africa, and to identify and discuss policies applied by Parliament and government departments to assist SOES financially.

This research looks at the processes followed by Parliament and the National Treasury (NT) to financially assist SOES. The outcome of this research could help identify areas that have worked and highlight key elements for possible reform in policy, as well as to identify the extent of the nature of parliamentary oversight over the funding policy for SOES.

The current chapter provides the background to the research and a brief identification of the literature surveyed. This chapter also looks into the objectives of the research, problem statement, research question and the significance of the research. The data collection method is highlighted to show the different approaches to obtaining information for this research. Concepts associated with the research will be defined, including the concept of SOES. Lastly, the limitation of the research and the brief overview of the structure of the research is provided.

1.2 BACKGROUND TO THE RESEARCH

Independent developing countries, and many Western countries facing reconstruction after World War II, saw a major role for the state in the development and production processes (Meier, 1995:548). During the 1960s and 1970s, SOES rapidly increased in importance, both in number and in size in different developing countries, as the state was seen as a vehicle for development. Towards the end of

the 1970s, the total output of SOES had contributed more than 60 percent of the total production in countries like Senegal, Tanzania, Bangladesh and Egypt (Todaro, 1997:567). Recent literature argues that state intervention in the economy could be justified in the case of market failures such as inequality and unstable markets (Harmse, Jordaan & Van Rensburg, 2004:384).

This research focuses on financial assistance to SOES in South Africa through gaining an understanding of the state's funding policy to SOES in South Africa, using Eskom, the power utility, as a case study. For a clear understanding of state funding to SOES with specific reference to and a focus on Eskom, government policy in this area will be studied, along with trends in state financial assistance towards Eskom in particular.

According to section 1 (a), b), (c) and (d) (i, ii) of the *Public Finance Management Act (PFMA) 1 of 1999 as amended by Act 29 of 1999*, a national government business enterprise is defined as an entity which

- is a juristic person under the ownership control of the national executive;
- has been assigned financial and operational authority to carry on a business activity;
- as its principal business, provides goods or services in accordance with ordinary business principles; and
- is financed fully or substantially from sources other than the National Revenue Fund (NRF); or by way of a tax, levy or other statutory money.

The Table 1.1 lists the eight SOES that report to the Department of Public Enterprises (DPE). The DPE is the shareholder representative of government with oversight responsibility for the SOES. SOES have a crucial role to play in advancing economic growth, since they are responsible for the development of key infrastructure and manufacturing capacity for South Africa (DPE, 2013:1).

Table 1.1: List of SOES under DPE

Name of SOE	Core business
1. Alexkor	The mining and promotion of diamonds
2. Infraco	Towards available, reliable and affordable broadband
3. Denel	The largest manufacturer of defence equipment in South Africa
4. Eskom	South Africa's major electricity utility
5. SAA	The country's largest airline with global reach
6. SA Express	Regional airline with routes covering major local and regional cities
7. SAFCOL	Owns and manages prime saw log forestry assets
8. Transnet	South Africa's rail, port and pipeline utility

Source (DPE, 2013:2)

SOES in South Africa form a significant part of certain vital industries that serve as inputs to other industries (DPE, 2002:2). The electricity, transport and fixed-line telecommunications sectors are dominated by SOES (Steyn, 2012:6). These sectors are responsible for a meaningful percentage of input costs to potential high-growth industries like tourism (Goldstuck, 2012:8), information and communication technology and export industries (Abrahams, 2011:157). Managing input industries to be efficient and to offer high-quality services can lower the costs and improve the services they offer (Raynolds & Ngcwangu, 2010:76). High-growth sectors can be stimulated by ensuring that their input costs are reasonable, that they are managed efficiently and that appropriate infrastructure exists for them to perform efficiently and effectively (Booyens, 2011:3).

The dominant tendency in the evolution of the power sector in South Africa was the growth and consolidation of a large and dominant state-owned monopoly in the electricity sector, i.e. Eskom. The early private power producers were gradually taken over by Eskom, which became the dominant new supplier of power accounting for almost 79% of the installed capacity in 2010 in South Africa (Eberbach, 2013:26).

Monopolies have been a sustaining source of controversy for policy makers and the general public since the industrial revolution. In South Africa, the discovery of diamonds (1867) and gold (1886) were facilitators in the introduction of electricity on a commercial scale, with gold mining as the major driver of electricity consumption (Development Bank of Southern Africa [DBSA], 2012:62).

Governments have long since protected and promoted monopolies in electricity supply (Foley, Gallachóir, Hur, Baldick & McKeogh, 2010:4523), public transport (Seim & Waldfogel, 2010:3) and communication in order to advance the benefits for the general welfare of their citizens (Kajee, 2013:2), scale economies and to provide a measure of political control over public services (Clifton & Diaz-Fuentes, 2010:286). At the time of this research, Eskom was the seventh largest electricity utility in the world. It is wholly owned by the South African government and conducts its business within a regulated environment (World Finance, 2012:1). The electricity sector has been dominated by a large public corporation that dominates generation, transmission and distribution for decades (Hansen, 2000:339). Eskom is a publicly owned, vertically integrated monopoly with relatively cheap prices globally when compared to industrialised countries at the end of the 20th century (Eberhard & Mtepa, 2000:215). In 2010 a benchmarking study on average tariffs was conducted based on a simple exchange rate conversion of a tariff per kWh for utilities in four countries. The benchmarking ranked South Africa (Eskom) as the fourth cheapest supplier on average electricity tariffs when compared to the 15 countries' utilities suppliers included in the survey (LTE Energy, s.a:15). The bottom four countries on a list comparing 15 countries were South Africa, India, Australia and China, which had a marginal difference on average electricity tariffs being approximately 2 cents in South African rand terms. The next group of countries included in the survey had 10-20 cents difference on average for the electricity tariff. These countries were Argentina, Canada, the United States of America (USA), Denmark, South Korea, Thailand and Kenya. The highest average electricity tariffs were found in Malaysia, Spain and the United Kingdom (UK) (LTE Energy, s.a:15).

Relative to international electricity prices, electricity in South Africa was sold at the cheapest rates prior to price increases by Eskom in 2007/2008 (Pegels, 2010:4949). However, this view is debatable due to the number of South Africans who cannot afford the tariffs and therefore have no access to electricity (Vecciato, 2013:1).

In 2007/2008 price hikes were granted by the National Energy Regulator of South Africa (NERSA) to assist Eskom in raising funds to build more power plants as a means to avoid the blackouts that crippled the vital mining industry and the economy in 2008. However, these general electricity price increases have had a negative effect on the growth of the economy and contributed to a rise in inflation (Vecciato, 2013:1).

It's worth noting that Eskom's former low tariffs are not an indication of the power utility's operational efficiency. Previously not much attention was paid to the running of Eskom as it appeared that it was functioning efficiently. However, since the widely publicised electricity load-shedding debacle that gripped South Africa in October 2007, questions surrounding Eskom's monopoly on the electricity supply have been raised interrogating the lack of investment in new power stations.

Civil society questioned why the outages were not predicted and managed prior to the situation reaching the levels of the time. The outcry was further fuelled by government's February 2008 loan of R60 billion to Eskom which appeared to be insufficient for the smooth running of the enterprise (Malefane, 2008:1).

According to Manuel (2008:24), the R60 billion was to support the financing of Eskom's investment programme, in order to assist in meeting the cash flow requirements for Eskom's capital expansion programme. However, this subsidy came with conditions attached to the utility's management. During the 2008 budget speech in Parliament, the minister of finance made it clear that the R60 billion given to Eskom was not a grant but a loan (Manuel, 2008:24). The *Eskom Subordinated Loan Special Appropriation Act 41 of 2008* provided for a multi-year appropriation as follows: R10 billion in 2008/09, R30 billion in 2009/10 and R20 billion in 2010/2011 (DPE, 2009:2). The full R60 billion Eskom loan was withdrawn between 2008/09 and

2010/2011 financial years from the NRF and is reflected under programme 9 of the NT Fiscal Transfers (NT, 2010:158).

In the *Sunday Times* of 11 May 2008, an article was published highlighting the controversial bonuses paid to Eskom's top management despite the enterprise's poor performance (Malefane, 2008:1). There has been much debate on how best to ensure that SOES serve their purpose of provisioning basic services. If similar crises could be prevented in other service sectors such as public transport, telecommunications and water provision, SOES would run more efficiently and would require less financial assistance from the state (Malefane, 2008:1). Following the background of the research, the problem statement is developed in the next section.

1.3 PROBLEM STATEMENT

Electricity is essential for the running of the economy and for human development. South Africa faced electricity supply challenges in 2007 with inadequate generation capacity coupled by ageing electricity infrastructure. In 2008, South Africa experienced an electricity supply crisis, which was followed by widespread load shedding (DBSA, 2012:60).

According to the DBSA (2012:59), the key challenge for South Africa's electricity sector is ageing generation, transmission and distribution infrastructure. New power stations are needed to meet South Africa's growing economy and its demand for more electricity. Electricity or any infrastructure does not come cheap. The South African government (SAGO), as the sole shareholder in Eskom, has a responsibility to ensure electricity infrastructure development.

The problem statement of this research is the lack of clarity on the basis on which the state's financial support to SOES (Eskom in particular) is rendered.

1.4 RESEARCH QUESTION

The research sought to address the following questions:

What is the extent of the financial assistance to SOES by the state in South Africa with specific focus on Eskom? And also how is financial assistance provided, and what policies and procedures are followed?

1.5 RESEARCH OBJECTIVES

The purpose for undertaking this research is to evaluate the financial assistance to state-owned enterprises in South Africa by the state with a specific focus on Eskom.

The objectives of this research are as follows:

- to explain the trend in funding of SOES in South Africa with a specific reference to Eskom;
- to determine policies and procedures on funding towards SOES with specific attention to Eskom and to describe the policy-making process; and
- to explain how the SAGO meets the financial needs of SOES with special attention to Eskom.

1.6 THE NEED AND SIGNIFICANCE OF THE RESEARCH

SOES provide essential public goods and services that are deemed basic needs which are of great economic importance. SOES, like Eskom and Transnet, facilitate economic development and growth by providing transport and electricity services.

The area of enquiry that this research wanted to explore was therefore intended to generate new knowledge in a field where such information was lacking. There was a need to understand the financial assistance to SOES by the state in South Africa and the policies the NT applies in funding SOES, especially the power utility Eskom. SOES policies are important aspects contributing to the country's growth potential. SOES have to function within an environment where resources are scarce and limited whilst the country's needs grow and expand continuously. Technological challenges also provide various opportunities for growth but without proper SOES policies, technology becomes a weakness rather than strength, especially when SOES do not invest in new technology.

The electricity outages and the financial meltdown in October 2008 have resulted in much speculation and accusations about the affairs of Eskom and their use of government resources. This research endeavours to go beyond emotional rhetoric by examining the funding policy towards SOES in South Africa with a special focus on Eskom. The significance of this research is to:

- confirm the necessity of investigating the effect of government loans, guarantees and any other financial support to SOES in South Africa, especially Eskom;
- highlight different sources of funding available for SOES in South Africa with specific reference to Eskom;
- identify possible weaknesses in the current funding policies of SOES in South Africa; and
- provide evidence on government policy making processes regarding SOES funding.

1.7 METHOD OF INFORMATION COLLECTION

The data collection method used in this research was through both primary and secondary sources. The method of referencing used in this research is Harvard referencing technique and all references to legislation means amended. The primary source of information was one to one interviews with National Treasury's financial analyst, Mr Hendrik Oosthuizen, and public hearing meetings arranged by NERSA to discuss Eskom's application to increase their tariffs.

1.7.1 Primary data collection

Primary sources of information provide first-hand information. In this research, primary data was gathered through one-to-one interviews and public hearing attendance.

1.7.1.1 One to one interviews

Most information on government processes that involve financial matters relating to SOES is not always publicly available on the internet and in libraries. One to one interviews were therefore used to collect research information. The researcher requested permission from the NT through a letter provided by the research supervisor and access was granted for one to one interviews. A series of one-to-one interviews were conducted with Mr Hendrik Oosthuizen who, at the time of the interviews, was the financial analyst at the NT under the asset and liabilities unit in 2011, 2012 and also at the end of April 2013.

Semi structured one to one interview questions were used to allow flexibility between the researcher and the participant.

1.7.1.2 Public hearing attendance

The attendance of a public hearing on 29 May 2008 regarding Eskom's application to NERSA for a tariff increase was also used to collect information to understand the role of the energy regulator towards Eskom. Attending the public hearing provided first-hand information on NERSA's tariff review process.

1.7.2 Secondary information collection

The secondary source of information included academic journals, other research projects, and reports from South African national departments' websites i.e. DPE, DME, Department of Energy (DoE), the NT and Eskom.

In the next sections, secondary sources that were consulted for the purpose of this research are discussed.

1.7.2.1 Document analysis

Information collection and information interpretation were undertaken in this study. Most of the documents were not written with the view of research, for example documents aimed at the general public, i.e. newspapers, financial magazines and the national budget, but were written with the view to inform the public or a selected section of the public. However these documents were studied and analysed for the purpose of scientific research.

Document analysis was used as a method of information collection due to its identified advantages which include relatively low cost, access to remote subject areas and it allows the researcher to research documents without making personal contact (Delport, De Vos, Fouche & Strydom, 2003:325). Most of the information consulted stated funding policies towards SOES in South Africa and the trends of financial assistance to SOES by the state in South Africa with Eskom as focus.

1.7.2.2 Official reports

Official reports were used as one of the sources of secondary information collection. These documents ranged from annual reports to departmental or organisational strategic plans and Acts. All these official documents could be accessed through government websites updated regularly. The websites consulted were those of the DPE, NT, DoE, NERSA, and Eskom.

1.7.2.3 Mass media

The use of mass media included information that was freely available to the public, i.e. newspaper articles, journals and financial magazines. This research made use of articles from Business Day, the Mail and Guardian and Financial Mail.

1.8 DEFINITIONS

For the purpose of this research, clarification and definitions of key concepts are provided in this section.

1.8.1 State-owned enterprises

According to Institute for Directors in Southern Africa and PricewaterhouseCoopers (2011:4), *state-owned enterprises* are those organisations under the ownership control of the SAGO.

1.8.2 State enterprises

Black, Hashimzade and Myles (2012:1) define a state enterprise as a firm founded on the initiative of the state and run by it. A state enterprise is likely to exist when there are activities that would be socially beneficial but which are not attractive to private entrepreneurs or activities that will be profitable but which involve natural monopolies. Davies, Lowes and Pass (2005:485) define a state enterprise as the basic production entity that is owned by the state and which operates on the basis of production plans and targets laid down in the country's national plan.

1.8.3 National Public Entity

According to section 1(a, b) of the PFMA, *national public entity* refers to a national government business enterprise, or a board, commission, company, corporation, fund or other entity (other than a national government business enterprise), which is

- established in terms of national legislation;
- fully or substantially funded either from NRF, or by way of a tax, levy or other money imposed in terms of national legislation; and
- accountable to Parliament.

1.8.4 Public Utility

According to Rutherford (2013:488), a *public utility* is an industry or enterprise providing basic services to the public, such as energy, water, postal services or telephones. Davies *et al.* (2005:437) define a public utility as an enterprise that provides certain essential goods and services like water, electricity and gas. In the case of South Africa, goods and services, like water and electricity, are provided by

publicly owned entities. In South Africa, Eskom is a publicly owned utility that provides electricity.

1.8.5 State

Stilwell (2012:1) defines the *state* as the institution of national administration, including government, the public service, the judiciary, the police and the armed forces.

1.8.6 Public Policy

According to Kilpatrick (2000:1), *public policy* can be generally defined as a system of laws, regulatory measures, courses of action, and funding priorities concerning a given topic promulgated by a governmental entity or its representatives. Birkland (2005:19) defines *public policy* generally as a combination of decisions, commitments and actions directed towards implementing and achieving a particular outcome or results, which is deemed in the public interest.

1.8.7 Financial Guarantees

According to Magnusson (1999:2), *financial guarantees* may be described as an undertaking by the guarantor to pay, after the occurrence of certain events which have led to a substantial deterioration of the creditworthiness of the institution promoted by the guarantee, one or more amounts to the beneficiary or directly to its creditors.

Schich (2008:82) defines *financial guarantee* as a situation where insurance provides investors in debt securities with guaranteed payment of interest and principal in the event that the issuer of the guaranteed debt is unable to meet its financial obligations.

1.8.8 Loan

Black (2003:166) defines a *loan* as money lent which has to be returned usually with interest.

1.8.9 Exposure Risk

Black (2003:166) defines *exposure risk* as the extent to which lending institutions would lose if a particular borrower or class of borrowers were to default on their obligations.

1.8.10 Guarantee

Stone (2014:1) defines *guarantee* as a promise by a person (the guarantor) to settle a debt or fulfil the promise of someone else. Shafritz (1985:316) states guarantees often state that the obligation of the guarantor is equivalent to the borrower's obligations. The purpose of a government guaranteed loan is to reduce the risk by a private lender by shifting all or part of the risk to government.

1.8.11 Development finance institutions

Dickinson (2008:1) defines *development finance institutions* (DFIS) as institutions that provide broad financial services in developing countries in the form of loans or guarantees to investors for financing public infrastructure projects. Dickinson (2008:2) further highlights that DFIS offers advantage and capacity to make long term investments at attractive rates in the markets which the private sector finds too risky to commit.

1.8.12 Monopoly

Davies *et al.* (2005:352) define *monopoly* as a type of market structure characterised by one firm and many buyers with a market usually comprising a single supplier selling to a multitude of small, independently acting buyers. Monopoly products lack

substitutes. There are no close substitutes for the monopolist's product, e.g. electricity and water.

1.9 LIMITATIONS OF THE RESEARCH

Most information about government processes on financial assistance to SOES by the state in South Africa is internally kept and confidential. Particularly, National Treasury financial processes are kept secret and inaccessible by the public (Oosthuizen personal interview, 01 November 2013).

During the one to one interviews at the NT with Mr Hendrik Oosthuizen, some questions that came from the discussion were referred to as confidential. Recordings could have assisted the researcher for easy reference to what was discussed in the interview but no recordings were allowed during the interviews.

The time scope of this information collection was between 2008 and 2014, which was a limitation as no generalisation could be made outside this time scope. The research was therefore limited to only Eskom and results are not representative of all SOES in South Africa. The research was limited to Eskom as the biggest monopoly and the sole role player in the electricity sector, and the financial assistance it had received between 2008 and 2013.

1.10 STRUCTURE OF THE STUDY

The research is structured as follows:

Chapter 1 covers the background to the research, the research problem and objectives, the significance of the research, the research design or methodology, and lastly the limitation of the study.

Chapter 2: The literature relevant to SOES in South Africa with a specific focus on Eskom is discussed.

Chapter 3: The macro organisation of the policy making structures on the funding of Eskom is discussed.

Chapter 4: This chapter gives an overview of funding sources for SOES with reference to Eskom.

Chapter 5: The chapter deals with policy versus discretion on funding issues of SOEs.

Chapter 6: This chapter concludes the research report by makes recommendations and proposal.

1.11 CONCLUSION

This chapter has introduced the research by providing a detailed background and identifying the research question. It also stated the objectives of the research and method of information collection. The chapter further provided the basis for exploring and understanding financial assistance to SOES by the state in South Africa with a special focus on Eskom.

The next chapter provides a detailed literature review relevant to SOES in South Africa. To do so, the chapter reviews core theoretical foundations and ideological spectrums necessary to understand financial assistance by the state to SOES in South Africa with a special focus on Eskom.

CHAPTER 2

THE LITERATURE RELEVANT TO SOES IN SOUTH AFRICA WITH SPECIFIC FOCUS ON ESKOM

2.1 INTRODUCTION

It is important to consider the debate around SOES and Eskom in South Africa. This debate is often discussed within an ideological spectrum covering free-market ideas, and the provision of public goods and services within a general debate about socialist and capitalism ideologies. This ideological spectrum is important as it provides a basic understanding of the different views to the approaches within the spectrum.

The ideological spectrum also covers the theories of the regulation of public utilities. The relevant subject areas to this research are Public Administration and Policy Studies. New Public Management and policy studies areas within public administration are also discussed. The use of economic theories of regulation of public utilities is necessary and important, even though the current research falls within the ambit of public administration. The nature of the research topic allowed the use of economics-driven theories and this can, in some ways, be best explained in economics terms.

The discussion here is on a brief identification of the literature gap in state funding to SOES in South Africa with specific reference on Eskom, and a conclusion is given.

2.2 ESKOM AND ELECTRICITY IN SOUTH AFRICA

According to *the PFMA Act 1 of 1999 as amended by Act 29 of 1999*, Eskom is listed as a Schedule 2 public entity. The DPE was initially established as the office responsible for privatising SOES. However, as government's fiscal position shifted and stabilised, government's priorities also shifted, and the role of SOES became redefined beyond privatisation and restructuring (RSA, 2000:19). Instead of privatising SOES in 2000, they were made to remain government-owned to play a

vital role in economic growth. In line with this idea, the DPE mandate is to provide shareholder representatives of the SAGO with oversight responsibility with the aim of achieving economic growth and efficiency in strategically important economic sectors, including defence, energy, forestry, ICT, mining and transport (DPE, 2002:2).

In 2001, the *Eskom Conversion Act 13 of 2001* provided for the conversion of Eskom into a public company. The act provides for Eskom share capital to be incorporated in terms of the *Companies Act 61 of 1973* with its entire share held by the state (RSA, 2008a:69). The *Eskom Amendment Act 126 of 1998* was repealed by the Eskom Conversion Act 13 of 2001.

The building of more power stations resulted in more capital expenditure in the 1970s and 1980s (Green Peace, 2012:5). The capacity that was built then still provided sufficient supply in the 1990s (Green Peace, 2012:8), but this was no longer sufficient for future demands because of increased demand for energy, and it was anticipated that Eskom might start running out of capacity by the year 2007 . Due to the growth in demand for energy and the anticipated shortage, there was a need for more capacity to support growing demands for more electricity (Green Peace, 2012:11).

Because these capacity constraints were not promptly addressed, this led to severe financial implications for Eskom and a power supply shortage characterised by load shedding and blackouts in 2007-2008 (Eskom, 2010:29). In 2004, Eskom reported a profit of R2 billion per annum mainly because it was still the lowest cost producer in the world; however, these profits were not sustainable due to the need to re-invest in further capacity for electricity generation (RSA, 2004:16).

Historically, the South African economy was growing because of mining, which depended on relatively low-cost coal-fuelled electricity. By 2013 the mining value chain, including refined metals and coal-based chemicals, was still contributing well over half of all exports. The transition to an economy that is more diversified, inclusive and provides significant opportunities for growth poses substantial risks and

costs which present themselves in the form of intense demands for electricity and possible damage to the environment (Bvuma & Russell, 2001:247).

The section below focuses on the ideological spectrum.

2.3 IDEOLOGICAL SPECTRUM

The ideological spectrum in terms of politics is a way of modelling different political positions by placing them upon one or more platforms symbolising independent political positions. The discussion of the ideological spectrum will cover free-market ideas on the provision of public goods and services and the socialist versus capitalist debate. It is important to look at both the capitalist and the socialist views because of their different approaches and interpretations of issues of state and private sector involvement in the running of the economy and the provision of public goods and services.

2.3.1 Free-market ideas on the provision of public goods and services

According to Yueyun (2010:137), a free-market economy system, in general, works out better with private goods than public goods and services because:

- consumers make their optimal choices of the type and amount of goods to be consumed based on their marginal utility compared with the price
- firms make their optimal decisions regarding the products they will produce, how many units, and the prices based on their marginal revenues, marginal costs and profit maximising.
- as a result, the market of a private good reaches the equilibrium when the price is set at the level at which its total demand is equal to total supply (Buchholz, Cornes & Rübhelke, 2011:639).

According to Fischbacher and Gächter (2006:5), the free-market economy system fails with public goods. Since consumers are not willing to pay directly for the usage/consumption of public goods and services, private firms have no incentives to produce public goods (Fischbacher & Gächter, 2006:31). As a result, the market

mechanism cannot automatically solve the equilibrium problem. Socialism says that, as a result, it should be government's responsibilities finance and sponsor the production of public goods, i.e. electricity and water (Cowen, 1988:10).

A free-market economy system works well with private goods and services because private producers are willing to produce and supply goods and services to people and they can make reasonable profits. However, consumers who want to benefit from private goods and services must pay for them. There is market failure because of the free rider problem with public goods, and the main reason is that private producers will not supply public goods to people because they are not sure whether they will be able to make reasonable profits (Yueyun, 2010:138).

2.3.2 Reasons why free-market economies fail with public goods

In this section, some of the reasons why a free-market economy system fails with public goods are discussed.

2.3.2.1 Free-rider problem

According to Ulbrich (2003:95), the biggest reason why it is difficult to rely on the market to produce public goods and services is the free rider problem. In the case of public goods or services, free riding would simply mean that there will be insufficient payers to cover the costs of private profit undertaken production. Consumers can take a free ride without having to pay for the public goods or services (Ulbrich, 2003:95). A private producer cannot build street lightings or flood control systems that can be used only by people who pay for them (Fourie & Mohr, 2004:388). All people can benefit from them or directly use them. As a result, no one will be willing to pay for public goods and services, i.e. roads, street lights and subsidised electricity. In the end, no private producer will be willing to supply that product (Cowen, 1988:101).

Besides the free-rider problem regarding public goods, the following factors may lead to market failure of the public goods.

2.3.2.2 Marginal cost of the public good

In a private goods economy, the market or a firm makes its optimal choice of the outputs and price based on profit maximising and marginal cost (MC) equal to its marginal revenue (MR) [MC=MR] (Colander, 2012:9). However, in the case of public goods, the marginal cost of the additional consumption will be zero, i.e. the firm cannot decide the optimal output level based on marginal cost equal to its marginal revenue (Yueyun, 2010:138). The private company can only produce and make goods and services available when they have a clear idea of the marginal revenue or profit to expect (Yueyun, 2010:138).

2.3.2.3 Pareto efficiency and public goods

In economics, an economic system is judged based on whether or not it can achieve its efficiency. Pareto efficiency occurs when no one can be better off without someone else being worse off (Yueyun, 2010:139). According to Pareto optimality means that if you can make a change that will make at least one person better off without making anyone worse off, that change can be made because it will increase social welfare. However if anyone is made worse off to any degree – even if many other people are made better off – one cannot say indisputably that social welfare has improved (Ulbrich 2003:148).

In general, a free-market economic system works with the private goods which can lead to pareto efficiency, although there are some exceptions due to moral hazards. However, the market system cannot lead to the pareto efficiency of public goods (Yueyun, 2010:139). This happens because all consumers want to be free riders although they will all benefit and be better off from producing or using the public goods and paying for that. As a result, no private firms want to supply the public goods and all consumers are worse off (Yueyun, 2010:139).

Given the fact that a free-market economy fails with the provision of public goods and services (Yueyun, 2010:139), it is government's responsibility to help solve the problem since public goods are desirable and society cannot do without them, for example electricity and water.

2.3.3 Ways for government to be involved in the supply of public goods and services

The discussion that follows covers ways in which government gets involved in the supply of goods and services.

2.3.3.1 Fully public financed and managed by government

In this mode, SOE management and finances are fully provided by government (Yueyun, 2010:139). Most global governments provide financial management to SOES as well as other security divisions (Yueyun, 2010:139). Governments finance and manage freeways, electricity and other transportation systems (Yueyun, 2010:139).

2.3.3.2 Regulated by the government but financed and managed by the private sector

Governments pass regulations to allow private firms to build toll freeways or bridges, such as the plan by the South African government to allow independent power producers in the electricity industry to provide capacity for Eskom. In June 2012, NERSA announced the approval of the licensing of the 28 preferred bidders for the first phase of government's renewable energy independent power producer programme (I-Net Bridge, 2012:1).

The functions and roles of government are very important in providing public goods and services (Breton, 1996:6). However, a free-market system holds ideas that there are some potential problems like inefficiency of resources allocations when a government monopolises the production and the provision of goods and services (Breton, 1996:293).

2.3.4 Reasons why government fails with provision of public goods and services

In the next section, the reasons why government fails with the provision of goods and services, in comparison with the private sector, are discussed.

2.3.4.1 Inefficiency of the resource allocations

The purpose of government's involvement in the public goods market is to solve the inefficient allocation of resources to public goods supply, since the private sector has no resources to produce the public goods. But unlike a private firm, which is governed by demand, supply and market equilibrium and profit-maximisation, government may misuse its resources or even waste them in the production of the goods (Fourie & Mohr, 2004:397). This happens because of special interest groups' influence and elected government officials. Who want to please its constituents and bureaucracy (Yueyun, 2010:140).

Adherents of the free-market economy believe that government's decision-making process is usually too slow. It takes too much time to decide whether, where and how to produce public goods and provide specific services (Yueyun, 2010:140). SOES require suitably qualified and experienced directors and chief executive officers (CEOs) to carry out the affairs of the SOES. This may create accountability challenges because in some cases these appointments may be politically influenced, which may negatively impact the execution of the SOES strategy and fulfilment of its mandate (DBSA, IDSA and PWC, 2011:2). The private sector's CEOs and other senior managers have full incentives and responsibilities for the performance of its institution (Yueyun, 2010:140).

2.3.4.2 Corruption

Government's involvement in the supply of public goods and service may result in corruption. Because business people may offer bribes for public contracts, government officials take bribes and award contracts to the bribers. Although such corruption happens in the supply of both private and public goods and services, the

situation is usually more serious in the supply of public goods since the public goods are financed by the government using tax money. The situation is exacerbated in some cases where government tenders might be awarded to companies that do not qualify to do the work (Yueyun, 2010:140).

2.3.4.3 The monopoly

In the supply of electricity in South Africa, there is little or even no competition so the management team of the public goods receives an incentive without any improvements on products or services. A government-owned railway with a monopoly may not want to use new, faster engines or a telecommunication firm owned by the government may not want to adopt new and advanced communication technologies (Yueyun, 2010:140). In the case of electricity supply in South Africa, Eskom dominates electricity generation and transmission which makes it impossible for other distributors to buy from competing generating companies (Njobeni, 2012a:2). This might cause fewer incentives in innovations, research and development (Yueyun, 2010:140). The results of the monopoly may lead to poor service delivery if not managed efficiently (Yueyun, 2010:140). After discussing the role of the market, it is important to go to the next section on the debate between socialism and capitalism.

2.3.5 Socialism versus capitalism debate

The debate between capitalism and socialism has been going on for a very long time and the two systems have dominated the 20th century. Is capitalism superior to socialism? Or is socialism superior to capitalism? There are many people who think capitalism is the best economic system, while many others think there is nothing better than a socialist nation. In this section, the discussion on socialism versus capitalism will look into the definitions of these two concepts and their main approaches to the running of an economy.

Socialism refers to a political system where ownership and control of means of production lies with the state, with significant emphasis on central planning by the state (Newman, 2005:6).

Capitalism refers to a form of political system in which means of production are owned by the private sector and there is a lack of central planning by government, with a lack of involvement by central government in the running of businesses (Newman, 2005:6). Capitalists believe that there should be complete non-interference by government in economic activities (Bowles, Edwards & Roosevelt, 2005:121). They believe that an economy can run efficiently on its own through the market instruments of demand and supply (Bowles *et al.*, 2005:121).

Capitalism also advocates for competition between sellers to supply a particular good or service, and between buyers to get the services or goods (Bowles *et al.*, 2005:130). The sellers compete among each other to make maximum profits; buyers compete among themselves to get the best price while purchasing the goods. The capitalist system also strives for private ownership of means of production (Bowles *et al.*, 2005:130).

Socialists propagate that the state or the government is the one which should be in total control of the planning, production and distribution process of goods and services. The political theory of socialism advocates co-operation rather than competition, which is capitalism's stronghold. Socialists believe that wealth or profits made from means of production owned by the state should be used fairly and for the welfare of all the people, rather than just the elite class (Newman, 2005:6).

According to Weber (Hardin, 2007:5), it would seem that capitalism is determined by material interests and socialism by ideas. Capitalism focuses on production as a means to market profits, whereas socialism regards the satisfaction of needs as the end that production must serve. It therefore appears as if, for socialism, production is an end in itself while for capitalism, it is merely a means. Socialism subordinates production to central planning by the state while capitalism leaves production to the regulation of the market forces' demand and supply (Hardin, 2007:5).

Weber makes us aware of the notion of both capitalism and socialism as they are fleeting and indeed vague as they combine two different dimensions. The capitalism dimension is built around the axis of private ownership versus socialism which rests on collective ownership. What Weber did was to associate capitalism with market

economy and competition, and socialism with household economy and monopoly (Hardin, 2007:10).

All forms of socialism have a certain common view. Firstly, they all reject the classical notion of the harmony of interests, and rather view society as composed of different classes whose interests often oppose one another. Secondly, all socialists oppose the notion of *laissez-faire* (Blackmore & Brink, 2002:209). Thirdly, capitalism is regarded to be in the state of general stagnation. Finally, each form of socialism advocates collective action and ownership of enterprises to improve the conditions of the masses. Marx was the leading theoretician of scientific socialism. Marx believed that the capitalist state oppressed the workers. Marx further believed that this oppression will lead the working class to overthrow the capitalist state (Blackmore & Brink, 2002:209). Marx's critique of capitalism rests on aspects that capitalism is unjust due to the exploitation of labour (Blackmore & Brink, 2002:210).

The section below focuses on theories of the regulation of public utility. Four different theories are discussed.

2.3.6 Theories of the regulation of public utility

This section focuses the discussion on theories of the regulation of public utility. By the end of the 1960s and the beginning of the 1970s, academics from the University of Chicago, lead by Stigler, started to theorise about regulation (Domas, 2003:180). Subsequent work of Peltzman in 1976 and Becker in 1983 gave substantial theoretical development to the theory. A contemporary of Stigler is Richard Posner who identifies the view of regulation that protects the public from monopoly power (Domas, 2003:181).

Several theories have been advanced – public interest theories, capture theory, public equity stability theory and interest group theory– which explain the pattern of government regulation and intervention in economic activities. These theories were proposed either by political scientists or by economists. A major challenge of social theory is to explain the model of government intervention in the market, what could be referred to as economic regulation. Economic regulation is the term that refers to

all types of taxes and subsidies as well as to explicit legislative and administrative controls over rates, entry and any other aspects of economic activities (Posner, 1974:335).

In this section, the four theories of regulation are discussed. Over the years, four major and more often overlapping theories of regulation have been put forth to explain either the rationale or the behaviour of regulatory agencies. These theories are summarised below as set out by Franklin (1984:164).

2.3.6.1 Public interest theory

Stigler was the first scholar at the University of Chicago to articulate the Chicago theory of regulation around 1971 (Domas, 2003:180). This theory was later called the public interest theory. A more contemporary scholar of public interest theory than Stigler is Posner to which was referred above (Domas, 2003:16).

The public interest theory views regulation as the law's substitute for competition with its basic goal being to seek economic objectives. Public interest seeks the protection and benefits of the public at large (Domas, 2003:181).

The argument of the theory was based on two underlying assumptions. The first assumption is that economic markets are extremely fragile and operate inefficiently or inequitably if left to their own means or with no government regulation. The second assumption is "government regulation is virtually costless" (Franklin, 1984:164).

Public interest theory holds the ideas that regulation is supplied in response to the demand of the public for the correction of inequitable market practices and that regulation is undertaken to protect the interests of consumers from the abuses of market imperfections (Posner, 1974:335).

Based on this assumption, it is very easy to argue that primary government interventions in the economy, especially within *public utility*, are a response of government to the public demands for rectification of clear and remediable

inefficiencies in the operation of the free market. Behind each regulation, there could be prominent market imperfection, and that existence provides a complete justification for some regulation believed to operate effectively and without cost (Franklin, 1984:164).

One of the major boundaries and difficulties in promoting public interest is lack of consistent policy standards and the excessive judicialisation procedures (Franklin, 1984:164).

2.3.6.2 Capture theory

The capture theory, espoused by an unusual mixture of welfare state liberals, muckrakers, marxists, and free-market economists, embraces that regulation is supplied in response to the demand of interest groups struggling among themselves to maximise the incomes of their members (Posner, 1974:336). The capture theory of regulation holds two views:

- Firstly, regulatory agencies were created to protect consumers, but they subsequently became captives of the industries they regulate; and
- Secondly, regulatory agencies were created to serve the interests of the industries they regulate, in response to the demands for cartel management placed upon the legislature (Franklin, 1984:165).

Marxists hold the view that economic regulation is not about public interest at all, but an opportunity for interest groups to seek to promote their private interests (Posner, 1974:341).

2.3.6.3 Public equity stability theory

Much of the equity stability theory's emphasis is on social issues as opposed to economic goals (equity and fairness in place of economic efficiency) and stability as opposed to rapid change. The significance of the equity theory is to explain the growth of regulation in terms of the desire of the law makers to replace markets with

more administrative judicial kinds of institutions which are believed to better promote fairness and social values (Franklin, 1984:172).

2.3.6.4 The interest group theory

The interest group theory of regulation focuses on the formation of political coalitions to explain the creation of regulation and the behaviour of regulatory agencies (Posner, 1974:341). He suggests that much regulation may be the product of a coalition between the regulated industry and customer groups, with the former obtaining some monopoly profits from regulation and the latter obtaining lower prices or even better services than what they would in an unregulated market. The interest theory explains some traditional public utility regulation focusing mostly on issues of price discrimination that is permitted as a means of enhancing capacity utilisation and expanding services (Franklin, 1984:170).

The interest group theory as an explanation of regulation has some limitations due to a number of shortcomings. Firstly, it fails to enable a prediction as to which specific industries will be regulated, and secondly, the theory provides insufficient evidence for judging the conditions under which regulation enhances the general welfare of society (Franklin, 1984:169).

Although regulation by NERSA over the energy sector is intended to minimise imperfections and maximise societal welfare, there are costs involved in transactions between the state and the regulatory agencies. In most cases, regulatory agencies are incapable of regulating in practice to maximise society's benefit. This failure is explained by the interest group theory, and the argument of the interest group theory that certain interest groups can control the objectives of the regulatory agencies, because they believe that regulation results from the demand for regulation by the interest groups (Filbeck, Gorman & Vora, 1997:734). In return, government responds by supplying regulation.

Among the interest groups, there are the regulated firms themselves, consumers and the non-regulated firms, which desire protection against additional competition, legislators or organised labour. These groups attempt to use government power to

advance their own interests at the expense of the public interest (Filbeck *et al.*, 1997:735).

The next section deals with various subjects and schools of thought in public administration.

2.4 VARIOUS SUBJECTS RELEVANT TO POLICY STUDIES

The various subjects relevant to policy studies are discussed in this section. This will include public administration, its meaning and historical development. The development of new public management (NPM) is part of public administration and it advocates for a new and reformed public sector which will move away from traditional public administration ideas to a public sector working together with the private sector.

Policy study is very important to understand while dealing with issues of policy on state funding to SOES. The meaning of policy, public policy and the models for analysing policymaking processes must be understood and are discussed in the following sections.

2.4.1 Public Administration

Public administration relates to the activities of the executive branch of government dealing with the formulation and implementation of public policies, and involves issues of human behaviour and co-operative human efforts (Gladden, 1964:12). Historically public administration's main task has been to implement and communicate political policy decisions to society. However one important key change that has occurred over the years is that citizens can now participate in policy making (Pierre & Peters, 2003:3).

Any consideration of public administration begins with political science making political science the mother discipline. For instance, early American public administration theorists were political scientists such as Wilson and Willoughby. Political science has traditionally been the locus of the most complete consideration

of normative and philosophical thought that appears central to public administration (Frederickson, 1976:21).

Woodrow Wilson was concerned with isolating the processes of administration from the potential corrupting influences of politics (Buck, Cox & Morgan, 2011:16). This means that the everyday conduct of government would be isolated from the potentially corrupting influence of politics for a better and more efficient implementation of policies and programmes (Buck *et al.*, 2011:16).

According to Frederickson (1976:20), new public administration (NPA) emerged in the late 1960s and early 1970s as a response to several stimuli, most especially the Vietnam War, a dissatisfaction with the intellectual basis of public administration and the general shift in the social science disciplines. NPA shifts the emphasis from traditional public administration to public management, placing the state towards managerialism (ECA, 2003:6).

The NPA approach goes beyond the separation of politics from administration, and uses the economic market for analysing political and administrative relationships. All that is required is rational inputs and outputs to satisfy the demands of the public. Consideration for the common good is absent from this approach. The market-driven principles and public organisations are made to compete because of the market forces (Frederickson, 1976:30).

2.4.2 New Public Management

The role and institutional character of the state and of the public sector have been under pressure from the late 1970s to be more market-oriented and private sector-oriented, initially in developed countries and later in some developing countries (Larbi, 1999:1).

According to Lane (2000:3), NPM is a theory relating the most recent paradigm changes in the way the public sector is governed. Christensen and Laegreid (2007:43) explain NPM as a label that is used to define a general trend towards changing the style of governance and administration in the public sector. Even

though the ideas of NPM were initiated in the United Kingdom, a number of extensive reforms were carried out in countries like New Zealand and Australia.

The main ideas of NPM on public administration are aimed at the management of government institutions. The emergence and inspiration for NPM were its connection to public-private partnerships (PPPs), which encourage the public sector to work together with private companies (Christensen & Laegreid, 2007:43).

The NPM seeks to offer an alternative way for the day-to-day running of government, which they argue and believe, is an efficient mechanism for delivering goods and services and for raising governmental performance (Kelly, 1998:201).

Some major ideas the NPM subscribe to are:

- structural decentralisation;
- vertical coordination and autonomy within the single agency;
- managerialism and management techniques;
- contractualism and privatisation;
- market-driven techniques, competition and citizens as customers; and
- deregulation and market transactions.

The NPM called for administrative reform that reflected neo-liberal concerns about making public services more efficient, effective and service oriented. The NPM holds the idea that government as a monopoly provides basic services like electricity operating under the support of the Keynesian welfare state, which has become very inefficient. The NPM believes that offering citizens more choice would encourage competition and efficiency (African Development Bank [ADB], 2005:129).

The NPM is based on both the rational and public choice theory assumptions as well as private sector and market assumptions, each of which holds ideas on methodological individualism and on the instrumental conception of individual rationality (Kelly, 1998:202).

The public choice theory is an alternative to the rational choice theory. Public choice theory is concerned with the provision of public goods that are delivered by government rather than the market, e.g. provision of electricity by Eskom. It remains government's responsibility to make sure that those public goods and services are provided (ADB, 2005:128).

Jong (2009:162) states that the notion of efficient management and administration is an important prerequisite for promoting an effective functioning government. Without effective administration, the citizens are unlikely to receive public goods and services.

According to Christensen and Laegreid (2007:179-180) NPM advocates for PPPs. This takes place as co-operative institutional arrangements between public and private institutions. PPPs can be seen as a continuation of the NPM agenda in public management reform. PPPs can also be seen as a continuation of already existing policies that encourage the service delivery by private companies. Using private sector institutions to deliver public services and infrastructure development is viewed as a key part of marketisation of NPM (Christensen & Laegreid, 2007:179-180).

PPPs are distinct institutional models mainly used for infrastructure development. Economic and financial PPPs dominate the study of public administration literature and public service rendering (Christensen & Laegreid, 2007:181).

The private finance initiative side of PPPs has been pursued by Britain since 1992 to attract private funding. The policy was adopted by Tony Blair's labour government in the late 1990s, and has since been amended and refined (Christensen & Laegreid, 2007:181). The advantage of PPPs for government is new infrastructures that can be financed cheaply and erected in a timely manner due to the cross-transfer of public and private sector skills, knowledge and expertise that create innovation and efficiency (A4ID, 2012:5). PPPs are a convenient alternative option for governments to draw on private sector skills and expertise rather than a more direct strategy of privatising or shifting responsibilities to the private sector (Christensen & Laegreid, 2007:181).

A practical example related to South Africa is the 2011 Cabinet approval of the establishment of an Independent System and Market Operator (ISMO), an instrument to support the introduction of Independent Power Producers (IPPs) by creating a non-conflicted buyer of power (DBSA, 2012:69). As part of incentives to encourage investment in renewable energy, the government introduced the Renewable Energy Feed-in Tariffs (REFIT). The REFIT was later replaced by the IPP procurement programme, which calls for competitive bids based on a price ceiling determined by the REFIT guidelines. The first bid process that closed in November 2011 yielded 1415 MW of renewable energy from independent producers (DBSA, 2012:70).

NPM encourages public and private sector actors to form new institutional arrangements that can allow for participation from both sectors. In theoretical terms, PPPs have been interpreted as and associated with the continuation of the NPM agenda in the sense that they advocate for private sector involvement in the delivering of public services (Christensen & Laegreid, 2007:182). This is the assumption of NPM about contracting and outsourcing government services and responsibility. They believe that this will work because a sufficiently competitive market exists to regulate supply and demand. The markets believe that it can be able to help government to be a smarter buyer and as a result improve in the delivery of public goods and services (Kelly, 1998:206).

Post-New Public Management (PNPM) is known as the second generation of reform in public administration. The emergence of PNPM focuses on recent public management and government reform. The best example of PNPM in the case of South Africa and Eskom is the establishment of NERSA in 2004. PNPM advocates for recentralisation and regulation in an attempt to correct the weak aspects of the NPM by strengthening governing capacity (Jong, 2009:162).

2.4.3 Policy studies

Public policy forms the object of policy studies. The conceptual overview of the nature and role of policy and public policy is discussed here. The models for

analysing policy-making processes and public policy processes are also discussed (Roux, 2002:424).

It is important to explore different definitions of policy to have a better understanding of what policy is. Cloete, De Coning and Wissink (2006:3) define policy as "a statement of intent". Policy specifies the basic principles to be pursued in attaining specific goals (Cloete *et al.*, 2006:3). Fox and Meyer (1995:107) define policy as "authoritative statements made by legitimate public institutions about the way in which they propose to deal with problems".

This means that public policy is not only about the substance of the policies but also about the process by which policy choices are made (Brady, Copper, Hardeman, Naff & Ott, 1998:157). It is important to understand the meaning of policy studies. Policy studies is a description of the content of public policy and its impact on environmental forces of the content of public policy (Brady *et al.*, 1998:158).

Cloete *et al.* (2006:36) identify seven models for analysing policy making processes, but for the purpose and relevance of this study, only three models will be discussed below:

2.4.3.1 The elite model

The elite model is based on the assumption that a small, elite group, which is usually government, is solely responsible for policy decisions and the elite governs the masses. The policy decisions that are made by the elite are executed by the official who has direct contact with the people (Cloete *et al.* 2006:36). The emphasis represented by the elite model may be amongst the most relevant to public administration. In the case of South Africa, a group of elites makes policies in Parliament.

The model is also based on the assumption that the elite are firmly in power; that they know more than the masses, and that the consensus on policy exists within the elite group (Knill & Tosun, 2008:8). This implies that the values and interests of the

elite are of primary importance; however, recent literature and experiences show that the masses are not necessarily passive and ill informed (Cloete *et al.*, 2006:37).

2.4.3.2 The group model

Interest group initiatives are referred to as one of the main agents for policy change as they put pressure on and interact with policy makers on preferences and self-interests (Cloete *et al.*, 2006:38). Interest group pressures are of particular importance in policy making processes of a participative nature. The notion of pressure groups and lobbying is highly important and relevant in policy making processes in South Africa (Cloete *et al.*, 2006:38).

The consultative decision-making processes done through public hearings used by NERSA to review tariff applications by Eskom is a good example of interest group participation in policy decision-making processes, because participants are awarded an opportunity to present their views in relation to a proposed tariff percentage and such views are taken into consideration when NERSA makes a final decision on which percentage to approve or reject.

2.4.3.3 The institutional model

The foundation of the institutional model for the study of public policy is that public policy is the product of public institutions (Cloete *et al.*, 2006:39). Public institutions influence the content of public policies and are again the very same institutions that formulated and implemented policies exclusively (Knill & Tosun, 2008:5). The institutional model views public policy as a product of public institutions unlike the elite model that views public policy as a product of elite group.

The institutional model “argues” that public policy is legitimised by government and only government policies apply to all members of society. It should also be taken into consideration that the structure of governmental institutions can have an important bearing on policy results. This viewpoint acknowledges that merely changing the structure of governmental institutions will not bring about dramatic changes to policy (Cloete *et al.*, 2006:39). The section below focuses on the gap in the literature.

2.5 GAP IN THE LITERATURE

After 1994, South Africa was faced with challenges of expanding electricity services to the greater part of its population previously disadvantaged and excluded from electricity services (Winkler, 2007:26).

The electricity sector in South Africa is dominated by Eskom, a fully government-owned monopoly (DBSA, 2012:60). After the introduction of the *White Paper on the Energy Policy* in 1998 (DME, 1998:6), the SAGO considered reforms in the electricity industry through the model of unbundling, competition and privatisation (DME, 1998:21). However, none of the reforms initiated by the SAGO, with the exception of an independent energy regulator in the power sector, have been adopted. This means there was no real competition and limited participation of the IPPs in the electricity sector at the time of this research in 2013.

According to Bogetic, Kessides and Maurer (2007:75), the National Electricity Regulator (NER) was established on 1 April 1995 as the successor to the Electricity Control Board. The NER derived its statutory authority from the *Electricity Act 41 of 1987* as amended by the *Electricity Amendment Acts of 1994 and 1995*. The NER was established to issue licenses and regulate all aspects of the generation, transmission, distribution and retail electricity activities in South Africa. The NER was later replaced by NERSA in 2004. NERSA was mandated with more responsibilities of regulating not only electricity but also piped gas and piped petroleum (Bogetic *et al.*, 2007:75).

According to Eberhard (2005:5309), government's concentration had shifted from power reforms to improving commercial performance and governance relationships through corporatisation, shareholder performance contracts, improved board governance and management and independent regulation.

For a very long time, Eskom was entirely self-financed through internal reserves raised through domestic and international capital markets without explicit government guarantees (Bogetic *et al.*, 2007:6). When South Africa experienced blackouts and load-shedding in 2007, more funding was needed to keep the lights on

and the economy running in South Africa after Eskom had enjoyed an electricity surplus for over two decades due to over-investment done in the late 1970s and early 1990s. By 2007, South Africa was confronted by increasing demands for electricity as the available electricity could not meet the growing demand; hence, the blackouts in several areas of South Africa (Bogetic *et al.*, 2007:7).

At the time of the electricity blackouts in 2007/2008, there was a need for Eskom to meet demands of South Africa's expanding and modernised economy. SAGO had to intervene to make a new investment into the generation, transmission and distribution of electricity possible. In 2008/2009, government intervened with a R60 billion loan to Eskom, followed in 2009 by a R176 billion government guarantee to Eskom, which was increased by R174 billion in 2010. The total amount of guarantees committed by government to Eskom was R350 billion (RSA, 2010c:1).

The R350 billion government guarantee became a major vehicle that made it possible for Eskom to achieve a stable and positive credit rating, and also made it possible to access funding from different local, regional, continental and international financial institutions (Cooke, 2012:1).

Some important policy reforms that took place in the electricity sector in South Africa include the already mentioned NER, which gave birth to NERSA. NERSA was mandated with more responsibilities and independence through the *White Paper on the Energy Policy of the Republic of South Africa of 1998*, which was written to clarify government policy regarding the supply and consumption of energy (Bogetic *et al.* 2007:72).

According to the, the South African government takes the view that the state has a role to play in the development of the economy. The intervention of the state in the economy is informed firstly by the view that the state shapes the structure and output of the economy, and secondly by the political objective of attaining a prosperous, equitable and democratic society. The state can intervene in the economy either directly or through development agencies or the economic actions of SOES (DPE, 2008:5).

SOES as providers of the majority of our basic services must be exceptionally responsive to market conditions. The essential challenge for SOES is to deliver

public goods with attributes of private sector principles with the lowest possible costs (DPE, 2008:6). Since some of the SOES are financed through taxpayer's money, it is imperative to know and understand how much financial assistance, if any, has been given to Eskom by the state through the NT or the DPE.

In 1998, the *White Paper on Energy* was introduced to replace the *1986 Energy White Paper*. The focus of the *1998 White Paper on Energy* was on national priorities at the time of the transition into the democratic South Africa (DME, 1998:8). The national priorities at the time were the *Reconstruction and Development Programme* (RDP) and *Growth Employment and Redistribution* (GEAR). The main objective of the *White Paper on Energy* was to promote access to affordable energy services for disadvantaged households, small businesses, small farms, industrial, commerce and mining and transport and agriculture (DME, 1998:8). The *White Paper on Energy* only covered the funding of the national electrification programme, which was through the electrification levy (DME, 1998:16).

In 2003, a *White Paper on Renewable Energy* was introduced to supplement the *White Paper on Energy*. The main objectives and aim of the *2003 White Paper on Renewable Energy* were to create the conditions for the development and implementation of renewable technology. The *White Paper on Renewable Energy of 2003* identifies the government of South Africa as a funding catalyst to attract the private sector on renewable energy. Funding by government referred to by the *White Paper on Renewable Energy of 2003* comprises financial and fiscal measures, which include budgetary allocation, subsidies, levies and tax rebates (DME, 2003:33).

The limitation of both the *White Paper on Energy of 1998* and the *White Paper on Renewable Energy of 2003* is the lack of outline on how the state will finance the electricity generation through fossil fuels, such as coal, which generates more than 90 percent of electricity in South Africa. Coal is readily available, abundant and offers relatively low-cost energy and South Africa still relies heavily on it.

None of the literature consulted placed an observable emphasis on the area of the state funding to SOES within the South African context. The gap that currently exists

in the literature is the lack of a clear and critical analysis of the financial assistance by the state and state funding policy towards SOES in South Africa.

Eskom has always been a relatively stable institution. According to the Estimates of National Expenditure (ENEs) from 1998 to 2013, there has not been any fiscal injection in the form of re-capitalisation except for loans and guarantees. The gaps that exist in the literature are the means which government has been using to finance Eskom operations. There is a perception that the government pumps money into Eskom every year through transfer payments as well as a confusion about which funding instruments government is using to support Eskom's current infrastructure development.

The most current and relevant scholarly writer on Eskom and electricity issues in South Africa is Professor Anton Eberhard, a member of the National Planning Commission (NPC) and a research professor at the Business School at the University of Cape Town. His research focus is on competition, reform and regulation in the electricity industry in South Africa. In most of his writings, he believes that renewable energy is far more cost effective than investing in nuclear power and an answer to South Africa's energy demands.

2.6 CONCLUSION

The idea of a free-market system in terms of the provision of public goods was discussed and reference was made to the different ideological approaches, i.e. socialism and capitalism, which covered issues of state control of the economy as well as the market-driven economy. Economic theories of regulation and financing were discussed with various subjects relevant to the research which included the discussion on public administration, new public management, and policy studies, and their relevance to policy issues in government institutions and SOES. The last part of the chapter dealt briefly with the gap in the literature on state's policies and procedures in responding to SOES financial needs using Eskom as a case study.

The next chapter provides the macro organisation of policy making on the funding of Eskom, the entities involved in the South African electricity sector is discussed.

Detailed discussion on reasons why government provides loans and guarantees to SOES and Eskom in particular is provided. The oversight management over SOES is also discussed in the next chapter.

CHAPTER 3

THE MACRO ORGANISATION OF POLICY MAKING ON THE FUNDING OF ESKOM

3.1 INTRODUCTION

This chapter covers the macro organisation of policy on the funding of Eskom. The different stakeholders that affect the funding policies of Eskom are also identified in this chapter. A discussion on DPE, the DoE and the NT as well as NERSA is provided. These different stakeholders all relate to each other in some way. The DPE is a shareholder in Eskom and the DoE deals with energy and electricity policy matters. The NT provides guidelines on financial management and borrowing requirements.

This chapter goes on to cover the structure and classification of SOES. The purpose of this section is to understand where the PFMA places Eskom as a public entity, which helps to know who is responsible for funding Eskom.

Chapter 3 further explains the reasons why government provides loans and guarantees to SOES with a focus on Eskom. Still in the same light of government loans and guarantees, Eskom's need for international funding is discussed.

Eskom is subject to direct and indirect oversight by government. Eskom needs to interact across all areas of government regarding the regulatory environment within which it operates, and it has the benefit of a number of relationships with various departments (Eskom, 2011b:37). The chapter concludes by looking at the oversight role over the SOES.

3.2 THE ROLE OF THE DEPARTMENTS OF PUBLIC ENTERPRISES AND ENERGY TOWARDS ESKOM

Eskom is governed through a shareholder compact with the DPE with the overall energy and electricity policy in the domain of the DoE. Formal policy for the South African electricity sector was recorded in the White Paper on Energy Policy published in 1998 (Eberhard & Newbery, 2008:15).

DPE is the shareholder representative of the South African government and has an oversight responsibility over Eskom. This relationship is governed by a shareholder compact. The shareholder compact sets and agrees on Eskom's strategic intent, key performance areas and targets. The compact includes strategic objectives, policies, financial, technical and other key performance indicators and reporting requirements. Eskom provides quarterly and annual reports to the DPE on its performance against the compact. Eskom's responsibilities, approvals and reporting in terms of the PFMA are managed through the DPE (Eskom, 2011b:32).

SOES have a crucial role to play in advancing economic growth since they are mandated to give effect to government priorities of developing key infrastructure and manufacturing capacity for South Africa. Infrastructure investments are a core part of the accelerated growth strategy, and SOES are implementing comprehensive investment programmes to ensure that significant and sustained opportunities for investment are created (RSA, 2011a:92).

SOES play a strategic role on the South African economy through driving investment in economic infrastructure, and in intermediate and advanced manufacturing capabilities. The DPE is the shareholder ministry responsible, on behalf of government, for ensuring that the SOES reporting to it operate efficiently and effectively, and deliver on their respective mandates (RSA, 2009b:5).

The DPE's primary objective is to ensure that the state's shareholdings in these enterprises are financially viable and sustainable and deliver on government's strategic objectives in owning the enterprises (RSA, 2009b:5).

Before the announcement of President Jacob Zuma's cabinet in 2009, Eskom's policy management was vested within the Department of Minerals and Energy (RSA, 2005b:1). In May 2009, the president requested the establishment, reorganisation and renaming of some of the national departments to support ministers in the execution of their mandates. Eskom was then moved under the policy leadership of the newly established Department of Energy (DoE) (RSA, 2011b:1).

The DoE is the entity that develops policy measures for the electricity sector, and was involved in policy initiatives such as the proposed 2009 electricity pricing (The World Bank, 2010:89). The activities of the electricity sector in South Africa are mainly governed by the 2006 Electricity Regulation Act 28. The DoE is responsible for setting energy policy and planning. But in reality, formal and informal influence over many decisions made by the DoE is exerted by national entities such as Eskom, NT, the DPE, metropolitan and municipal governments, and the Inter-Ministerial Committee on Energy (Barker, 2011:11).

There are other stakeholders such as the Energy Intensive User's Group of Southern Africa, i.e. BHP Billiton SA Ltd and Transnet Ltd, which consume around 40 percent of the electricity sold in South Africa (Barker, 2011:11).

The *2003 White Paper on Renewable Energy* envisioned an energy economy in which modern renewable energy increases its share of energy consumed and provides affordable access to energy throughout South Africa, contributing to sustainable development and environmental conservation (Diemont, Nowak, & Van der Poel, 2011:593). After Cabinet approval of the White Paper on Renewal Energy in 2003, the DoE progressed with the development of its renewable energy strategy. With the White Paper's target of 10 000 gigawatt renewable energy from renewable energy sources such as biomass, wind, solar energy and small-scale hydro power contribution to final energy consumption by 2013 was confirmed to be economically viable with subsidies and carbon financing (DoE, 2014:1).

By 2014 renewable energy independent power producer procurement (REIPPP) process have been great successes, with 21 renewable projects, which intend to produce 1,076 Megawatt. The renewable programme is seen as important means to

help close the power gap in a period when South Africa's energy supply is extremely constrained (Paton, 2014:1).

Creating an investment climate for the development of a renewable energy sector was another important objective of the 2003 White Paper (Diemont *et al.* 2011:593). In August of 2014 the DoE continued to be actively involved in electricity policy through draft regulations in a document titled Electricity Regulations on New Generation Capacity (Marguard & Trollip, 2014:5).

The absence or lack of sufficient competition in the electricity sector in South Africa is a good reason to allow economic regulation of the industry to ensure that the interests of customers, licensees and other stakeholders are balanced, while also ensuring the industry's sustainability (Eberhard, 2005:5312).

A discussion on the role of NERSA towards Eskom follows in the next section.

3.3 THE ROLE OF THE NATIONAL ENERGY REGULATOR OF SOUTH AFRICA TOWARDS ESKOM

With Eskom dominating the electricity market and the absence of competitive wholesale and retail companies, it is vital that the entire value chain from generation to retail is regulated (Eberhard & Newbery, 2008:74).

Section 2 of the *National Energy Regulator Act 40 of 2004* establishes a National Energy Regulator for the regulation of the electricity, piped-gas and petroleum pipelines industries. NERSA is a regulatory authority established as a juristic person in terms of Section 3 of the *National Energy Regulator Act 40 of 2004*.

Eskom is regulated by NERSA in accordance with the *Electricity Regulation Act 4 of 2006*. The *Electricity Regulation Act 4 of 2006* has the following key objectives:

- efficient, effective, sustainable and orderly development and operation of electricity supply infrastructure in South Africa;
- long-term sustainability of the industry;

- investment in the industry;
- universal access to electricity;
- diverse energy sources and energy efficiency;
- competitiveness and customer choice; and
- a fair balance between the interests of customers and end users, licensees, investors and the public.

Section 8(1)(a)(b)(c) of the *Electricity Regulation Act 4 of 2006* states that all electricity generation, transmission, distribution, the import/export of any electricity and trading activities need to be licensed by NERSA. NERSA is concerned with issues such as pricing, consumer interest and industry issues (Du Toit, 2005:10). Although in the case of South Africa, NERSA is a state agency carrying out a government role, the relationship of a regulator with the SOE can be and should be an independent and objective one.

According to the *National Energy Regulator Act 40 of 2004*, NERSA's key powers include:

- issuing of licences for the operation of generation, distribution and transmission facilities;
- regulating of imports, exports and the trading of electricity; and
- determining and approving electricity prices and tariffs and the conditions under which electricity may be sold.

Eskom is regulated by separate licences for the generation, transmission and distribution of electricity (Eskom, 2011b:32). It also has a nuclear licence from the National Nuclear Regulator, which regulates the operation of its Koeberg nuclear power station in the Western Cape and all elements of its nuclear value chain (Eskom, 2011b:45).

SOES are categorised or classified under different schedules of the PFMA. Below is a discussion of three different classifications of SOES which range from the level of independence to generation of own profits.

3.4 THE STRUCTURE AND CLASSIFICATION OF SOES

SOES are classified into different schedules based on their nature and level of autonomy. A brief review of the different categories of these public entities is provided below.

3.4.1 Schedule 2 public entities

Eskom is a schedule 2 public entity and, as a listed schedule 2 public entity, its financial affairs and governance are guided by the PFMA. The PFMA applies to subsidiaries and entities owned and controlled by Eskom, which are also classified as schedule 2 entities.

All schedule 2 entities are referred to as the major public entities, which are intended to generate profits and declare dividends. Schedule 2 entities have the most autonomy of all the public entities as they operate in a competitive market and are run in accordance with general business principles. Section 66(3) (a) of the PFMA (as amended) states that entities may also borrow money through their accounting authority, which implies that they also have extensive borrowing powers.

Eskom has to generate its own profit and fund its own operations. Eskom is able to seek financial support from government or may borrow money from local markets and multinational institutions based on its balance sheet.

Section 66(7) (a) and (b) of the PFMA (as amended) states that a public entity authorised to borrow money must annually submit to the Minister of Finance a borrowing programme for the year, and may not borrow money in a foreign currency above a prescribed limit in the borrowing plan, except when that public entity is a company in which the state is not the only shareholder. In the case of Eskom, the government is a 100% shareholder through the DPE, therefore Section 66(7)(a) and (b) of the PFMA applies fully.

Below is a list of schedule 2 public entities as listed in the PFMA.

Table 3.1: List of Schedule 2 major public entities

1.	Air Traffic and Navigation Services Company Limited
2.	Airports Company of South Africa Limited
3.	Alexkor Limited
4.	Armaments Corporation of South Africa Limited
5.	Broadband Infrastructure Company (Pty) Ltd
6.	CEF (Pty) Ltd
7.	DENEL (Pty) Ltd
8.	Development Bank of Southern Africa
9.	ESKOM
10.	Independent Development Trust
11.	Industrial Development Corporation of South Africa Limited
12.	Land and Agricultural Development Bank of South Africa
13.	South African Airways (Pty) Limited
14.	South African Broadcasting Corporation Limited
15.	South African Express (Pty) Limited
16.	South African Forestry Company Limited
17.	South African Nuclear Energy Corporation Limited
18.	South African Post Office Limited
19.	Telkom SA Limited
20.	Trans-Caledon Tunnel Authority
21.	Transnet Limited

(RSA, 2012b:1-2)

3.4.2 Schedule 3 public entities

Schedule 3 public entities include schedule 3A, 3B and 3D entities. Schedule 3A entities (also referred to as national public entities) include, to name only two, the South African National Energy Development Institute and the South African Revenue Service. Schedule 3B entities, also referred to as national government business enterprises, include to name only two, the SA Bureau of Standards, and the Public Investment Corporation Limited (RSA, 2011d: 6). These entities are normally extensions of a department with the mandate to fulfil a specific economic or social

responsibility of government (Auditor General, 2009:27). They rely on government funding and public money, either by means of a transfer from the Revenue Fund or through statutory money. As such, these entities have the least autonomy (Auditor General, 2009:27).

Schedule 3B entities are also referred to as provincial public entities, and they include provincial public entities from across all nine South African provinces (Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga, Northern Cape, North West and Western Cape).

The remaining classifications of public entities under schedule 3 are 3D entities. 3D entities are referred to as government business enterprises. These entities generate income, but may be either substantially self-funded or substantially government-funded. As a result, they have less autonomy than the schedule 2 public entities even though they are still run in accordance with general business principles. These entities also have limited borrowing powers (Auditor General, 2009:27). Schedule 3D entities are also referred to as provincial government business enterprises across seven provinces (Eastern Cape, Free State, KwaZulu-Natal, Limpopo, Mpumalanga, North West and Western Cape) (RSA, 2011d: 10).

3.5 THE PRINCIPAL ENTITIES INVOLVED IN THE SOUTH AFRICAN ELECTRICITY SECTOR

Below is a list of the electricity sector and the role players involved in the South African electricity sector:

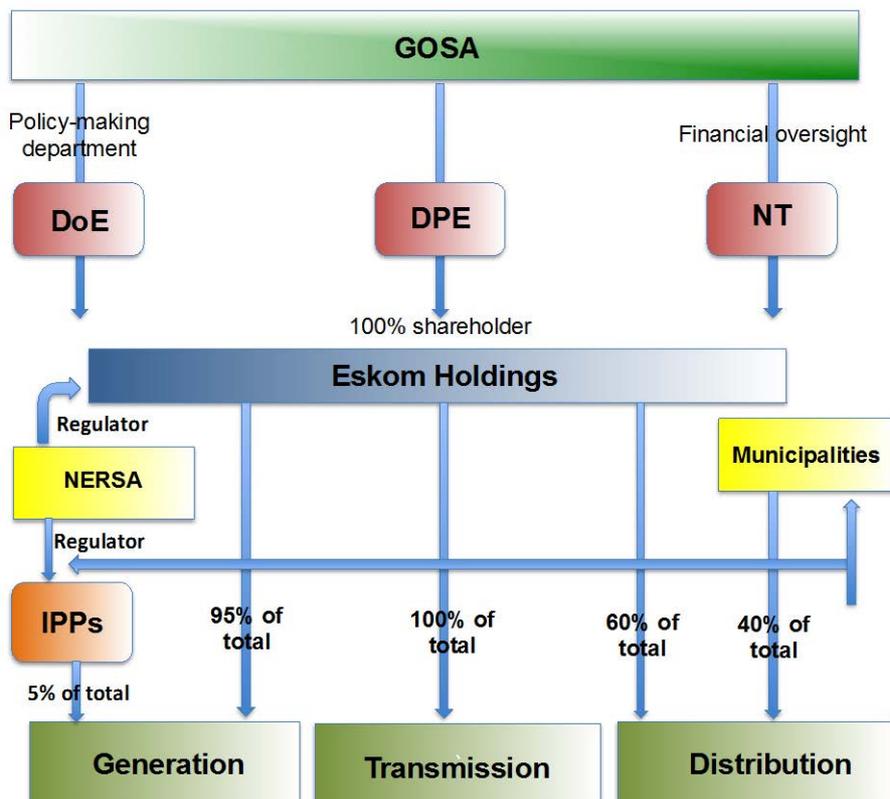
- DPE is the national government department responsible for the shareholder representative of the SAGO
- DoE is the national government department responsible for developing policy for the electricity sector and formerly a part of the Department of Minerals and Energy (DME).
- NT provides oversight over the funding/borrowing programmes of SOES.
- NERSA is the regulatory authority in the electricity sector.

- Eskom Holdings Ltd. (Eskom), is the publicly owned vertically integrated utility company, and
- municipal electric utilities (MEUs) provide distribution services to about 60 percent of the power customers in South Africa.

Figure 3.1 below represents the stakeholders involved in the electricity sector in South Africa. The government of South Africa is the sole owner of Eskom through the leadership of the DPE with the DoE as a policy department which determines electricity policies in consultation with the Eskom board. The NT provides financial oversight over government institutions that utilise public funds, i.e. Eskom Holdings and its oversight role is guided by the Constitution as the supreme authority and PFMA as the financial management law (DBSA, IoDSA & PWC, 2011:7).

Figure 3.1 below demonstrates the relationship between the stakeholders in the electricity sector.

Figure 3.1: Electricity sector structure in South Africa



Eskom as an SOE needs financial support to carry its government's mandate. The next section covers a discussion on the reasons behind the provision of loans and guarantees by government.

3.6 REASONS WHY GOVERNMENT PROVIDES LOANS AND GUARANTEES TO SOES AND ESKOM IN PARTICULAR

It is difficult for SOES to access financial markets on the strength of their own balance sheets, because of the declining profitability of SOES after the 2008 global financial crisis and the growing demand for electricity. These factors increase the need for government support and the use of government guarantees towards SOES. As part of supporting capital infrastructure programmes, government provides cash injections, loans and guarantees to ensure the continued availability of funding for SOES at the lowest possible cost both in the domestic and international markets. SOES listed under schedule 2 of the PFMA must function sustainably as they need to borrow mainly on the strength of their balance sheets. States issue financial guarantees and loans in order to promote projects that are deemed to be in the public interest financially. The guarantees are used as economic incentives for the capital market to finance the projects in the public interest. Financial guarantees by the SAGO promote energy supply, rail infrastructure and road infrastructure (RSA, 2011a:92).

Government also provides loans and guarantees to reduce borrowing costs for SOES and ease pressure on the domestic capital market, because for Eskom to borrow money without government's guarantee will be very expensive (RSA, 2010c:97). The NT carries the responsibilities to provide support to SOES in accessing finance or funding from multilateral institutions and export credit agencies and through project financing arrangements (RSA, 2010b:97).

Government guarantees, although not the sole determinant, play a crucial role in influencing the cost of capital for SOES. Government provides guarantees to SOES to enable them to go out in the domestic or international market to borrow funds using the guarantee as collateral (RSA, 2010b:97).

Another major reason for government to give guarantees to public entities like Eskom is because SOES carry out government's mandate to accelerate development and job creation. Eskom has capital expenditure to carry out, and without government support through guarantees and loans it will not have the necessary cash to finance its projects (RSA, 2009a:83).

According to Oosthuizen (personal interview, 15 November 2011), based on a low debt/equity ratio and low tariffs, Eskom's credit rating was downgraded by Standard and Poor's in August 2008 during the global financial crisis. However, the support provided by government to Eskom in the form of a subordinated loan in 2008 and a government guarantee has enabled Eskom to obtain funding more easily and at more competitive rates. Ratings agency Standard and Poor's affirmed Eskom's BBB+ foreign currency and A- local currency corporate credit ratings in January 2010 based on the above government loan (RSA, 2011a:80).

Due to the large amount of funds required by Eskom for the building programme for its electricity infrastructure development, the money available locally from government or private lenders is not sufficient to meet Eskom's funding gap.

The next section discusses in detail the need for Eskom to seek international funding assistance. The discussion below provides an overview of government's governance oversight over SOES; governance oversight over SOES vests in Parliament, the executive authority and the boards of SOES.

3.7 THE OVERSIGHT OVER THE MANAGEMENT OF SOES

The purpose of this section is to provide an overview of government's governance oversight over SOES. The role players involved in the oversight process are also discussed below.

3.7.1 The line minister

The line minister as representative shareholder in Eskom is the executive authority concerned with appropriate returns on investments and ensuring the financial

viability of SOES (Du Toit, 2005:5). Section 1(b) of the PFMA (as amended) defines executive authority in relation to a national public entity, which means the Cabinet member who is accountable to Parliament for that public entity or in whose portfolio it falls. With Eskom the Line minister will be from DoE and DPE.

In addition, government is also the policy maker concerned with policy implementation of service delivery. These responsibilities are vested in Cabinet as policy maker. Oversight by the executive authority rests in and largely on the prescripts of the PFMA. The PFMA governs or gives authority to the executive authority for oversight powers with particular reference to the corporate plans, shareholder's compacts and quarterly reports (Du Toit, 2005:5).

3.7.2 Parliament

The constitutional oversight of the performance of SOES rests with Parliament. Parliament is composed of the National Assembly and the National Council of Provinces and its portfolio committees, public accounts committees and joint committees (DBSA, IoDSA & PWC, 2011:8).

According to Du Toit (2005:2), Parliament exercises its role through evaluating the performance of SOES by interrogating their annual financial statements.

However since the introduction of the *Money Bills Amendment Procedures and Related Matters Act 9 in 2009*, Parliament has a more visible role. Section (2) (a) and (b) of the Money Bills Amendment Procedure and Related Matters Act 9 of 2009 state that every person interpreting this Act must:

- Do so in a manner that gives effect to the constitutional authority of the National Assembly and National Council of Provinces in passing legislation and maintaining oversight of the exercise of the national executive authority; and
- Take into account the relevant fiscal framework submitted to and adopted by Parliament.

Parliament has instruments to utilise in order to achieve its oversight function over the management of SOES. In case of Eskom the two portfolio committees that play an oversight role are Portfolio Committee on Energy and Portfolio Committee on Public Enterprises. The two portfolio committees hold regular meetings in Parliament to discuss issues ranging from electricity prices, demands, coal reserves and energy policies. Section 55(2) (a) and (b) of the Constitution gives Parliament and its committees to have authority oversight over the executive and any organ of state. Section 56 (a) and (b) of the Constitution provides for Parliament and its committees to summon any person to appear before it to give evidence on oath or affirmation, or to produce documents and also to report to it.

Below are the instruments used by Parliament in its function to make oversight over SOES possible.

3.7.2.1 Annual reports

Annual reports are key reporting instruments for SOES and departments to report against the performance targets and budgets outlined in their strategic plans (NT, 2005:3).

Section 92(3)(b) of the Constitution requires Cabinet to provide Parliament with comprehensive and regular reports on the activities under its jurisdiction. Annual reports allow Parliament to evaluate the performance of SOES at the end of a financial year (NT, 2005:3).

The enactment of the PFMA requires the ministers of all departments, who might also be the executive authority of an SOE, to table an annual report in the legislature within six months of the end of each financial year (NT, 2005:5). *Section 65 of the PFMA* requires the executive authority to table the annual reports for SOES for which they are responsible by 30 September of each year, which is six months after the financial year end of the SOE (Du Toit, 2005:3). This implies that annual reports should be tabled by Parliament a month after the accounting officer of the shareholding department had received it from the SOE.

3.7.2.2 Parliamentary committees

Because it would be impossible for the National Assembly to exercise proper oversight over their executives (ministers representing departments and SOES by reviewing all performance aspects of the 35 national departments and around 250 public entities, parliamentary committees were established to facilitate the oversight role. This division of labour enables committee members to become experts in different fields, and to spend more time doing the actual oversight work (Du Toit, 2005:3).

Two important parliamentary committees that play an oversight role over SOES through the review of financial and non-financial aspects of SOES are discussed below.

3.7.2.3 Standing Committee on Public Accounts

The Standing Committee on Public Accounts (SCOPA) acts as Parliament's watchdog over the way taxpayers' money is spent by the executive. Every year, the Auditor-General tables reports on the accounts and financial management of the various government departments and state institutions (RSA, 2012a:1).

SCOPA fulfils the responsibility of reviewing the audit reports of the Auditor-General (AG). This committee plays an important and specialised role as protector of public monies (Du Toit, 2005:3). In fulfilling this role, the committee focuses on the following:

- issues raised in the general report of the AG on audit outcomes;
- issues of financial probity as highlighted in the audit report and disclosed in the management report or notes to the financial statements;
- interrogation and evaluation of instances of over-expenditure and instances of unauthorised expenditure;
- interrogation of instances relating to irregular, fruitless and wasteful expenditure;
- the functioning of risk management systems; and

- corporate governance of departments, public entities, and constitutional institutions.

3.7.2.4 Portfolio Committees

All portfolio committees in the National Assembly process legislation and conduct oversight over the departments they are responsible for. Both the portfolio committee on energy and the portfolio committee on public enterprises play a role within Eskom since Eskom's oversight is shared between the DoE and DPE.

Given their involvement in the legislative, budget and in-year monitoring processes, portfolio committees exercise oversight of the service delivery performance of SOES. Portfolio committees fulfil the responsibility of reviewing non-financial information contained in the annual reports of SOES. These committees should exercise oversight as to whether entities have delivered on the service delivery commitments they made in their corporate plans. They must also consider the SOES financial performance in order to develop a holistic understanding of the SOES performance (Du Toit, 2005:3).

3.7.3 Auditor-General

The Auditor-General of South Africa (AGSA) was established in terms of section 181(1)(e) of the Constitution as a state institution supporting constitutional democracy, by enabling oversight, accountability and good governance in the public sector through auditing.

The AGSA is accountable to Parliament and must provide audits on SOES performance. In terms of section 188 of the Constitution, the AGSA must audit and report on the accounts, financial statements and financial management of all government entities (DBSA, IoDSA & PWC, 2011:8).

3.7.4 Boards of Directors of SOES

The primary task of the SOES board of directors is the performance of the SOES. Its duty is to ensure that the SOE meets the strategic objectives as agreed with the line minister (DBSA, IoDSA & PWC, 2011:8). The board also ensures that the management of SOES acts in the interest of the shareholders (Vagliasindi, 2008:2).

The board of directors of an SOE is the governing body of the SOE. The board has absolute responsibility for the performance of the SOE and is fully accountable for the performance of the SOE. Governance principles regarding the role and responsibility of SOE boards are contained in the PFMA and the Protocol on Corporate Governance. The board of an SOE also carries certain responsibilities in terms of the *Companies Act 61 of 1973 and the PFMA* (DBSA, IoDSA & PWC, 2011:11).

Boards constitute a fundamental base of corporate governance of SOEs (Du Toit, 2005:10). Each SOE should be headed and controlled by an effective and efficient board, comprising executive and non-executive directors of whom, preferably, the majority should be non-executive directors in order to ensure independence and objectivity in decision-making processes (DPE, 2002:9).

The board should also ensure that the SOE is fully aware of and complies with applicable laws, regulations, government policies and codes of business practice and communicates with its shareholders and relevant stakeholders openly and promptly on issues affecting the SOE (DPE, 2002:10).

The board's oversight function also takes place through formulating, monitoring and reviewing corporate strategy, major plans of action, risk policy, annual budgets and business plans for the SOE. They regularly identify key risk areas and key performance indicators based on both financial and non-financial aspects (DPE, 2002:11).

The board should ensure that financial statements are prepared for each financial year and must fairly present the affairs of the SOE. In addition, they must maintain adequate accounting records, ensure that suitable accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates, have been used in the preparation of the financial statements, and they must also ensure that relevant accounting standards have been applied (DPE, 2002:12).

3.8 CONCLUSION

In this chapter, attention was focused on the roles of the DPE as a shareholder department and the DoE as a policy department towards Eskom. The role of the energy regulator in the electricity sector in South Africa was discussed.

Another section of this chapter dealt with the structure of SOES in terms of schedules relevant to this research as defined by the PFMA. The principal entities involved in the South African electricity sector were also discussed.

As was clearly indicated from Chapter 1 of this research, Eskom is a solely public-owned entity. This chapter covered government's support of Eskom through loans and guarantees. The need for Eskom to access international funding to meet its funding gap was discussed. The last section of Chapter 3 discussed the oversight over the management of SOES, the role of the executive, parliamentary committees and board of directors of SOES.

Chapter 4 will discuss the overview of the funding sources for SOES with reference to Eskom. Eskom has managed to go beyond depending on only government funding or local sources of funding to explore the international funding sources.

CHAPTER 4

AN OVERVIEW OF FUNDING SOURCES FOR SOES WITH REFERENCE TO ESKOM

4.1 INTRODUCTION

Chapter 4 deals with the overview of funding sources for SOES with reference to Eskom. The policies that guide the funding of SOES including the PFMA, treasury regulations and any other relevant Acts will be discussed. The question of government providing funding to Eskom will be discussed under sources of funding and government guarantees to SOES. It is also relevant to make a distinction between policy and legislation.

Different sources of funding will be discussed covering both domestic sources, which include government loans, and international sources such as the African Development Bank loans and The World Bank loans. The need for Eskom's international funding, tariff increases, Eskom financial performance and government credit guarantees to SOES are also discussed. The last part of the chapter covers Eskom financial performance, impact of Eskom loans and guarantees on the fiscus and Eskom's credit rating.

4.2 LEGISLATION THAT GUIDES FUNDING ON SOES

A policy means a plan of action or strategy. A policy may either be the outcome of some process or it may be a plan designed specifically to further some goal (Dwyer, 1993:4) whereas legislation is a process of making law, another term for statutory law. The laws are passed by a legislature or the governing body of a country.

It is important to consider the policies that guide the SOES on issues dealing with funding like guarantees and loans from the South African government, other governments and from other financial institutions. The current study took into consideration the legislation, namely the PFMA and the South African Constitution. Below is the discussion of the roles and the functions that the PFMA and the Constitution play in the management of financial commitments by SOES.

4.2.1 Public Finance Management Act 1 of 1999 (as amended)

The *Public Finance Management Act 1 of 1999 (as amended)* is one of the most important of legislation passed by the first democratic government of South Africa. The Act promotes the objective of good financial management in order to maximise service delivery through the effective and efficient use of the limited resources.

The PFMA states that its key objectives are to:

- modernise the system of financial management in the public sector;
- enable public sector managers to manage, but at the same time be held more accountable;
- ensure the timely provision of quality information; and
- eliminate the waste and corruption in the use of public assets.

For the purpose of this research, there are specific sections in the PFMA that are important and relevant when dealing with SOE funding issues namely section 54(1), (2), 66(1), (3), (7)(a)(b) and 70.

Section 54(1) of the PFMA states that the accounting authority for a public entity must submit to the Treasury or the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as the Treasury or the Auditor-General may require. Section 54(2) (d) states that before a public entity concludes specified transactions (i.e. acquisition or disposal of a significant asset), the accounting authority for the public entity must promptly and in writing inform the treasury of the transaction and submit relevant particulars of the transaction to its executive authority for approval of the transaction.

Section 66(1) of the PFMA dealing with restriction on borrowing, guarantees and other commitments of the PFMA, states that an institution to which the Act applies may not borrow money or issue a guarantee, indemnity or security, or enter into any other transaction that binds or may bind that institution or the Revenue Fund to any future financial commitment, unless such borrowing, guarantee, indemnity, security or other transaction,

- is authorised by the Act; and
- in the case of public entities, is also authorised by other legislation not in conflict with this Act.

Section 66(3)(a) of the PFMA states that public entities may only, through the accounting authority, borrow money or issue a guarantee, indemnity or security, or enter into any other transaction that binds or may bind that public entity to any future financial commitment.

In the case of Eskom, which is a listed schedule 2 public entity, the accounting authority will be the one to facilitate the borrowing of money or issuing of guarantees or who enters into any other transaction that binds or may bind that public entity to any future financial commitment.

Section 66(7) (a) of the PFMA states that a public entity authorised to borrow money must annually submit to the minister of finance a borrowing programme for the year; and section 66(7) (b) of the PFMA states that a public entity authorised to borrow money may not borrow money in a foreign currency above a prescribed limit, except when that public entity is a company in which the state is not the only shareholder.

Section 70(1) (a) of the PFMA states that guarantees, indemnities and securities by cabinet members may only happen with the written concurrence of the Minister of Finance (given either specifically in each case or generally with regard to a category of cases and subject to any conditions approved by the minister), may issue a guarantee, indemnity or security which binds the NRF in respect of a financial commitment incurred.

The next section reports on the different sources of funding to Eskom from government loans to international loans, bonds, equity injections and capital market.

4.3 SOURCES OF FUNDING TO ESKOM

In order for Eskom to meet its objective of a capacity expansion programme, the company must tap into different kinds of sources of funding to raise the money they need. Since 2008, Eskom is tapping into a mixture of sources of funding to fund its building programme. The discussion below includes the sources of funding, the amounts received to date and reasons for the receiving such funds.

4.3.1 Equity Injections

Equity is the amount left for the borrower if the asset e.g machinery, vehicles and property concerned, is sold and the lender repaid (Bannock, Baxter & Davis, 2003:122). *Equity injection* could refer to government inserting capital or cash for the purpose of lowering debt to stimulate growth. In the case of Eskom, there has been a lot of talk surrounding the R20 billion equity injection by government since 2008, which remained under discussion at the time of the writing.

In February 2011, the Minister of DPE, told media reporters during his trip to France as South African Airways was taking delivery of a new Airbus, that the SAGO was looking into the possibility of capital equity injection into Eskom. The South African government had proposed an equity injection of R20 billion into Eskom (Laurent, 2011:1).

Eskom said it welcomed government's support for a proposed R20 billion equity into Eskom over the next three years, because it would strengthen Eskom's balance sheet to ensure the completion of its building programme while remaining in a good financial position (25 degrees in Africa, 2011:1).

The R20 billion equity injection was also mentioned in the funding plan released by Eskom in March 2011 as a proposal (25 degrees in Africa, 2011:1). This means at the time of writing, Eskom had not yet received any equity injection from government and it remained a proposal.

4.3.2 Shareholder loan/government loan

In 2008, government agreed to inject a R60 billion loan into Eskom over three financial years. Funding was provided in the form of a loan over a 30-year period and Eskom would ultimately be required to repay the principal loan with interest (RSA, 2009a:85).

According to the *Eskom Subordinated Loan Special Appropriation Act 41 of 2008*, the funding to Eskom was to be provided in the following manner, R10 billion in 2008/09, R30 billion in 2009/10 and R20 billion in 2010/11. The Eskom Subordinated Loan Special Appropriation Act provides for this multi-year appropriation (RSA, 2008b:15).

4.3.3 Capital market

According to ECA (1999:4), capital markets are markets for long term loans and distinct from the money markets, which deal in short-term funds. Capital market loans are mainly used by industry and commerce for primarily fixed investments.

The capital market includes cash raised through domestic and international bonds by Eskom. Eskom issues bonds both on the domestic and international market. Stilwell (2012:54) defines a bond as a financial asset, the purchase of which entails making a loan to a government or corporation, entitling the owner of the bond to the receipt of regular interest payments.

Eskom issued their first United States of American (USA) dollar bond in early January of 2011, which was a strong boost to Eskom's capital expansion programme. They sold \$1.75 billion (approximately R12 billion) of their 10-year bonds on the international market (Creamer, 2011:1). The issuing of international bonds is a sign that the international investor appetite for emerging markets was increasing or improving. The money would be added to Eskom's general funding pool. Eskom had last sold international bonds in 2006. The monies raised through these bonds were raised under government's R350 billion guarantee. The monies will be paid back after 10 years to the companies that bought the bonds (Creamer, 2011:2).

4.3.4 Development finance institutions

SOES pursue funding opportunities in domestic and foreign capital markets. DFIS from whom SOES have received funding included the World Bank, the European Investment Bank, the African Development Bank, AFD and *Kreditanstalt für Wiederaufbau*. Some of the DFIS or multilateral agencies from which Eskom has received funding are discussed in the sections below.

4.3.4.1 The African Development Bank

On 25 November 2009, the SAGO welcomed the approval of a EUR1.86 billion (approximately R20.7 billion) loan from the African Development Bank (ADB) for the Eskom Medupi Power Station in Lephalale, Limpopo. The power station is part of Eskom's capital expenditure programme aimed at reducing the country's electricity generation capacity deficit. The Medupi power station will provide additional generation capacity of 4 764 megawatts. In 2012, the total cost of the Medupi project was estimated at R124.42 billion, and the ADB funding was to be used to fund the supply and installation of boilers and turbo-generators (RSA, 2009c:1).

This is a direct loan to Eskom with a sovereign guarantee of R174 billion from the government of South Africa (RSA, 2009c:1). At the end of August 2009, the ADB had approved the funding of 16 projects in South Africa. The Eskom loan is the biggest project that the ADB had financed in South Africa, and also the biggest loan ever approved by the ADB. In November 2008, Eskom secured a 20-year loan for US\$500 million (about R5.08 billion) through the ADB private sector window (RSA, 2009c:1).

4.3.4.2 The World Bank

In April 2009, the SAGO welcomed the decision by the World Bank to grant a US\$3.75 billion (approximately R28 billion) project loan to Eskom (Roberts, 2010:1). The loan was brought about due to unique circumstances, including the country's energy crisis in late 2007 and the early 2008 global financial crisis that exposed the country's vulnerability to the energy shock and the severe economic consequences (Roberts, 2010:2).

The construction of the Medupi power station will provide much needed base-load capacity to be commissioned in 2017. This will ensure that the country's economic development objectives remain on track and that security of electricity supply is restored. Investment in energy remains a cornerstone of government's economic strategy (RSA, 2010a:96).

South Africa receiving the grant from the World Bank was also made possible by its commitments in meeting its long-term climate change mitigation objectives, and in pursuing an energy strategy compatible with commitments made in Copenhagen and the economic development plans (RSA, 2010d:1). The Medupi power plant, for example, is the first in Africa to use the cleaner coal supercritical technology, the same technology used in developed countries for new coal power generation (RSA, 2010d: 2).

4.3.4.3 Development Bank of Southern Africa

In November 2010, the Development Bank of Southern Africa (DBSA) became the first domestic DFI to approve a R15 billion loan facility to support Eskom's capacity expansion programme (DBSA & Eskom, 2010:1). This loan is a structured facility to be drawn over five years and does not utilise the R350 billion guarantees from the South African government (DBSA & Eskom, 2010:1). Eskom's capacity expansion projects will add 12 300 megawatt of additional generation and transmission capacity to the national grid by 2017 enabling Eskom to keep up with South Africa's growing demand for electricity (DBSA & Eskom, 2010:2). The loan is to support the Medupi and Kusile coal-fired power stations as well as the Ingula pump storage scheme and associated transmission (DBSA & Eskom, 2010:3).

4.3.4.4 *Agence Française de Développement*

In August 2011, Eskom received a massive boost by signing a EUR100 million (approximately R980 840 000) credit facility agreement from AFD. The AFD is a bilateral development finance institution that works on behalf of the French government, and its mission is to finance development according to France's overseas development assistance policies (Staff Reporter, 2011:1).

The loan facility of 20 years is for financing Eskom's 100 megawatt Sere Wind Project in the Western Cape. The loan facility will fund the two critically renewable energy projects, i.e. wind and concentrated solar power. This is also a good sign for South Africa in making a commitment to reduce its carbon footprint and making the transition to a cleaner energy mix (Staff Reporter, 2011:1).

The next section of this chapter considers export credit agencies' facilities that support Eskom's building programme. Three export credit agencies are discussed below.

4.3.5 The export credit agency facilities/funding

An export credit agencies (ECAS) are institutions that undertakes official export credit activities for or on behalf of governments. An export credit is an insurance, guarantee or financing arrangement that allows a foreign buyer/borrower of exported goods and/or services to delay payment over a period of time (OECD, 2008:5).

According to the OECD (2008:6), there are many different types of ECAs: they can be government departments or agencies, or commercial institutions administering an account for or on behalf of government, separate from the commercial business of the institution.

The primary objective of ECAS is to remove the risk and uncertainty of payments to exporters. ECAS take the risk away from the exporter and shift it to themselves, at a premium. ECAS also underwrite the commercial and political risks of investments in overseas markets that are typically deemed to be high risk (OECD, 2008:6).

Below are some of the ECAS that have provided loans, guarantees and insurance for Eskom's suppliers for their materials for their expansion programme mainly for the Medupi project (OECD, 2008:6).

4.3.5.1 *KfW-IPEX*

In September 2008, Eskom secured a EUR 250 million (approximately R2.8 billion) export credit financing loan from Germany's *KfW-IPEX* to fund part of its capital

expenditure activities (Sapa, 2008:1). The ECA facility loan is to finance the six boilers that the Hitachi Power consortium would supply for the construction of the Medupi coal-fired power station.

The export credit financing loan would be payable over 12 years after the commissioning of the units at Medupi power station. *KfW-IPEX* and financial services group HSBC jointly arranged the export finance cover from the German federal government (Sapa, 2008:1).

4.3.5.2 Compagnie Française d'Assurance pour le Commerce Extérieur

On 28 December 2009, Eskom announced that it had signed a loan agreement of R13 billion covered by the *Compagnie Française d'Assurance pour le Commerce Extérieur* (COFACE), the French ECA . The export credit facility loan was intended to be used to fund part of the eligible foreign content of the Medupi and Kusile turbine contracts with Alstom S&E Africa. The facility was an agreement between Eskom and French banks as lenders, namely BNP Paribas, Calyon, *Société Générale*, Natixis and CIC (25 degrees in Africa, 2010:1).

The loan is re-payable over 12 years after the commissioning of the relevant units of the Medupi and Kusile power stations (25 degrees in Africa, 2010:1).

4.3.5.3 Japan Bank of International Cooperation

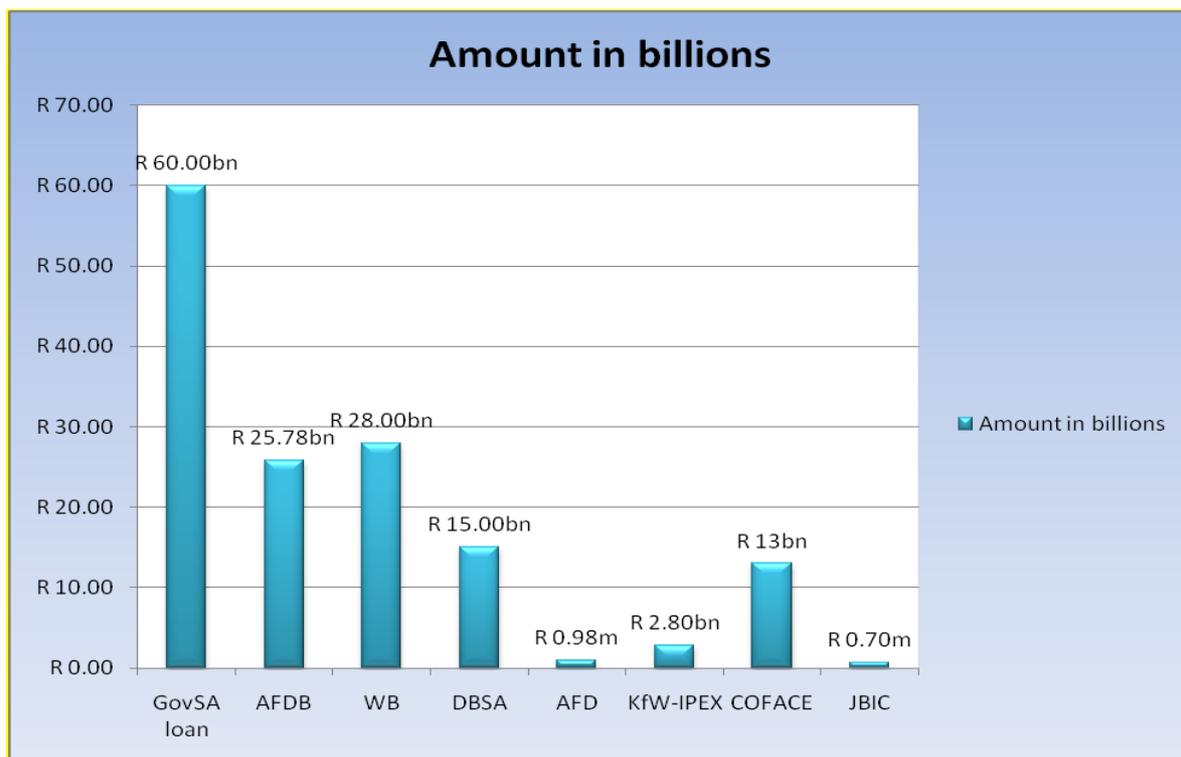
In July 2008, the Japan Bank for International Cooperation (JBIC) signed a loan totalling up to 7.5 billion yen (approximately R700 000 million) with Eskom. The loan is co-financed by the Bank of Tokyo-Mitsubishi UFJ (lead arranger), and Sumitomo Mitsui Banking Corporation. The loan was intended to finance the projects undertaken by Eskom for its northern grid transmission projects in Limpopo which aim to strengthen the existing transmission network and to expand it (JBIC, 2008:1).

The bar chart below (Figure 4.1) represents the funding Eskom has received from the South African government, DFIs and ECAS. The bar chart shows that Eskom has managed to secure funding from a mix of sources ranging from domestic to international DFIs. The biggest funding Eskom received was from the SAGO, which was a R60 billion loan and the smallest funding was received from the JBIC worth R700 000 million. According to the ADB (2009:1), it is crucial for Eskom to use a mixture of funding sources; hence, the project is being funded through a combination of measures, namely:

- increased tariffs (revenue) approved by NERSA;
- issuing of bonds;
- government loans;
- funding from the multilateral development banks (MDBS); and
- borrowing from the export credit agencies (ECAS).

The chart below gives a summary of most of the loans and facilities funds Eskom received from various institutions for its expansion programme.

Figure 4.1: The sources of funding Eskom received locally and internationally between 2008 to 2013



4.4 THE NEED FOR ESKOM'S INTERNATIONAL FUNDING

South Africa was forced to resort to load shedding in 2008 to mitigate shortages and to meet medium-term high demands for electricity (ADB, 2009:2).

During the early part of 2010, Eskom secured a mandate from its shareholder (government) to formally pursue a much broader range of potential financing solutions, and they engaged advisors to evaluate funding options available as well as specific funding opportunities around the Kusile power station that is currently under construction near eMalahleni in Mpumalanga (Eskom, 2010:44).

The financial resources required for Eskom to increase the electricity capacity are vast. It is very challenging for Eskom to fund its capital programme expenditure (CAPEX) using only domestic sources of funding, i.e. the Medupi project needed R125.63 billion as estimated in 2009, with costs constantly increasing due to material prices and inflation increases (ADB, 2009:2).

The international funding support to fund Eskom's projects is required to fill the financing gap. It is in Eskom's best interest to borrow on the international market. The international banks and export credit agencies offer a comparative advantage due to their ability to offer loans with a long tenure at attractive interest rates as compared to other sources of funding. International sources of funding also offer access to large amounts of cash not available on the domestic market (ADB, 2009:2).

According to Eskom (2010:44), it has identified some initiatives in order to close the funding gap:

- Eskom expects to fund a significant portion of the capacity expansion programme in various debt markets, notably the bond and loan markets, domestic and particularly international.
- These markets offer Eskom access to large pools of competitive term funding but it will need to maintain a strong investment grade rating and

strong financial ratios to maximise its market access at the least cost to the business.

- Eskom is therefore working with government to use the existing government guarantee in a way that directly strengthens its credit profile. In turn, it will be able to access the debt markets on a stand-alone basis going forward to complete the capacity expansion programme as a strong investment grade borrower.

4.5 TARIFF INCREASES GRANTED TO ESKOM BY NERSA

The tariff (or price) is the fundamental means through which investment is rationed towards any sector of a market economy, and the delivery of a service is sustained (RSA, 2009a:5).

From 2007 to 2008, South Africa experienced steep annual increases in tariffs for electricity as a result of the need to fund the massive building programme that Eskom had embarked on in order to increase its generation capacity. NERSA's responsibility is regulating electricity tariffs. It sets the tariffs that Eskom can charge for generating electricity and that municipalities and Eskom can charge for distribution (RSA, 2011c:151).

For many years, it was a norm for the energy regulator to grant Eskom single-digit increases. In February 2006, NERSA approved a 5.1 percent tariff increase for 2006, 5.9 percent for 2007, and 6.2 percent for 2008. However, the tariff increases were not enough to meet the requirements of Eskom's capital expansion programme (Njobeni, 2012b:1).

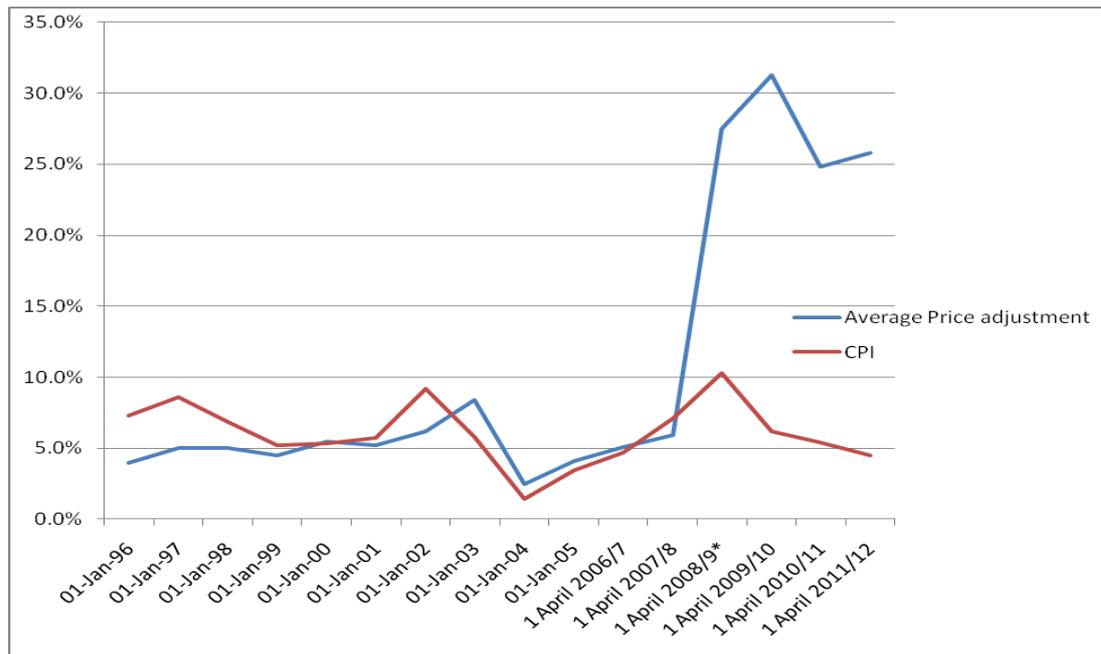
In March 2007, Eskom asked NERSA to raise the tariff for the 2007-2008 financial years from 5.9 percent to 18.7 percent. This was mainly because the utility's primary energy costs had grown, specifically the costs of the Medupi and Kusile power stations had increased from R97 billion to R150 billion at the time (Njobeni, 2012b:1) Since 2007, Eskom has not had a problem to ask for double-digit tariff increases. Later in 2007, Eskom went back to NERSA. At that time, the utility was asking the

regulator to revise a tariff increase for the 2008-2009 financial years from 14.2 percent to 60 percent (Njobeni, 2012b:2). The reason was that the capital programme for Medupi and Kusile and associated transmission and distribution infrastructure had more than doubled from R150 to R345 billion (Njobeni, 2012b:2)

The graph below (Figure 4.2) shows the increases granted by NERSA to Eskom since 1996. Between 1996 and 2006/2007, the electricity prices and the consumer price index (CPI) did not show much difference since they were more or less on the same level as indicated in the graph below. From the time Eskom requested for double-digit increases in 2007/2008, the prices of electricity started increasing sharply with the CPI falling behind due to high increases in electricity tariffs. From the graph, it is clear that from 2007/2008, the average price adjustment went high with the CPI dropping sharply a year later. This graph shows Eskom's average tariff adjustments for the past 16 years.

In the section below, tariff increases granted to Eskom by NERSA and the history of tariffs in South Africa in relation to Eskom are discussed. The percentages increases granted to Eskom are discussed by taking specific years into account. Eskom average tariff adjustments for the past 16 years (1996-2012) are demonstrated using a graph Figure 4.2 on below.

Figure 4.2: Eskom's average tariff adjustments for the past 16 years (Njobeni, 2012b:2)



The next section provides a discussion on Eskom's financial performance since the 2008 power crisis.

4.6 ESKOM FINANCIAL PERFORMANCE

As discussed in Chapter 3, Eskom is a schedule 2 public entity required to generate its own profit and declare dividends. Eskom's strong financial performance has strengthened since massive increases of electricity tariffs had been granted by NERSA after the power crises in 2008. The revenue growth was driven mainly by higher electricity tariffs, reflecting the 25.8 percent increase in 2010, including the environmental levy Eskom charged from 1 April 2011 (Styan, 2012:1).

Eskom reported two and a half years of strong financial performance in 2010 and 2011, and increased its revenue by 29 percent for its financial year ending March 2011, driven primarily by the tariff increases it imposed in 2010. The group's revenue was R91.4 billion, up from the previous R71.1 billion in 2010 (Styan, 2012:2). The strong financial performance is essential for Eskom to raise the funding it needs to invest in South Africa's future electricity infrastructure.

The major strong financial performance Eskom posted in the results for the six months till the end of September 2011 reflects increased net profit of R12.8 billion (R9.5 billion in 2010), on revenue which increased to R63.9 billion (R51.1 billion in 2010). Eskom's strong financial performances turn out to be highly seasonal, which is usually the winter months when electricity demand is higher (Styan, 2012:3).

There is a controversial pricing agreement between Eskom and BHP Billiton, the biggest consumer of electricity, which was signed in 1992. It was revealed in court papers that Eskom is selling electricity to BHP's smelters, Hillside in Richards Bay and Mozal in Mozambique, for half of the 41c it costs the utility to produce one kilowatt-hour (kWh) (Paton, 2013:1). The court application submitted by Eskom in April 2013 negotiated a pricing agreement that the company pays 23c/kWh at Hillside, while at Mozal it is 34c, and that this was compared with R1.61 paid by factories and R1.40 paid by households (Paton, 2013:2).

When and how government credit guarantees to SOES, with the focus on Eskom, was made available and for what reason, are discussed below. The different levels of guarantees provided by government are also discussed.

4.7 GOVERNMENT CREDIT GUARANTEES TO SOES

It is important to understand what government credit guarantee is and what its significance to SOES in South Africa is, especially as regards Eskom. In the South African budget review and the national budget prepared by the NT, guarantees are referred to as "contingent liabilities". The NT defines a guarantee as a legal document that acts as a support to SOES to facilitate access to funding (Oosthuizen personal interview, 15 November 2011). According to Mikesell (1991:418), credit guarantees are explicit promises by the state to a unit bondholder. According to Oosthuizen (personal interview, 15 November 2011), two important forms of guarantees are provided by the South African government, namely implicit and explicit guarantees. An implicit guarantee means that no legal obligations exist between government and the SOE concerned which means that should a SOE that had received funding through a government guarantee default on its payments with the lender, the government might step in to assist but it is not legally bound to do so.

An explicit guarantee would mean that a legal obligation exists between the government and the SOE concerned (Oosthuizen personal interview, 15 November 2011). Should an SOE that had received funding through a government guarantee default on its payment to the lender, government has a legal obligation to step in and carry on with the payments until such times as the SOE can continue with the payments (Oosthuizen personal interview, 15 November 2011).

Magnusson (1999:4) identifies the benefit of guarantees as flexible interest structure and terms of repayment which are made possible by wider access to diverse financial markets.

Mikesell (1991:418) identifies three types of guarantees, namely state credit guarantee, bank letters of credit and municipal bond insurance. This research only focuses on the first two types of guarantees as the relevant ones. A state credit guarantee is defined as an explicit promise by the state to the borrower that any shortfall or default in payments will automatically be assumed by the state. This type of a guarantee may take the form of state insurance, usually with conditions placed on the backing.

According to Mikesell (1991:418), the second form of guarantee is referred to as a bank letter of credit, which is defined as an unconditional pledge of the bank's credit to make principal and investment payments of a specified amount and terms on issuer debt. Unlike the state credit guarantee which places conditions on the guarantee, the bank letter of credit may be valid even in a situation of issuer default, as it will act as a guarantee of the debt. This kind of guarantee works well with domestic banks that have strong ratings.

When Eskom experienced power failures in 2008, government made it a priority to step in with financial interventions. In February 2009, government approved explicit guarantees valued at R176 billion to support Eskom in the construction of new power plants (RSA, 2011a:94). The guarantee was increased by R174 billion in October 2010 (RSA, 2010c:94), to a total of R350 billion as mentioned earlier in this chapter. The additional state support has led to the cancellation of an Eskom credit watch in 2010 (RSA, 2011a:94).

The guarantee has enabled Eskom to continue the capacity expansion programme it has committed to until 2018, for the Medupi, Kusile and Ingula power stations as well as for the associated transmission infrastructure. The guarantee is intended to deepen financing options available to Eskom and to reduce its cost of funding. The assistance provided to Eskom is only one of the measures that government has taken to ensure long-term energy security (RSA, 2010a:1).

Government continues to recognise Eskom's critical role in the economy and the need to maintain energy security. For this reason it is imperative that Eskom completes its planned building programme (RSA, 2010a:1). Having acknowledged the support that government provides to SOES, it is imperative to understand the policy stance on guarantees for SOES (RSA, 2010b:96). Government's stance on guarantees for SOES states that under normal circumstances, SOEs should operate and borrow mainly on the strength of their balance sheets (RSA, 2010b:96). However, if a clear need for shareholder support is identified, a guarantee to provide security for borrowing can be considered, provided that a sound business plan is in place to ensure long-term financial sustainability (RSA, 2009a:85).

4.8 THE IMPACT OF ESKOM LOANS AND GUARANTEES ON THE FISCUS

Both loans and guarantees provided by government to SOES, specifically to Eskom, have a certain degree of impact on the fiscus. A brief discussion of the impacts that exist as a result of government providing financial support to SOES is provided in the following sections.

The R350 billion worth of guarantees provided by government to Eskom has an impact on government's credit worthiness which is reflected in the rates at which the country borrows money. With guarantees, the impact will largely depend on future events. Should Eskom honour the terms of condition of the loans they receive from a DFIs like the World Bank, no impact will be made on the fiscus (RSA, 2011a:8).

The impact of the R60 billion loan had an effect on government's ability to service its debt deficit, which affects the overall credit worthiness of the country as the loan forms part of the government's budget allocation (Manuel, 2008:24).

Relevant factors in determining a rating include the ability of the economy to generate foreign currency, the magnitude of short-term debt, total debt stock, and the level of international reserves as well as the ratio of external debt to current account receipts (RSA, 2005a:102).

Rating agencies dealing with sovereign risks seek to assess the capacity and willingness of a sovereign government to service its debt within the maturity dates and in accordance with the conditions agreed upon with creditors at the time the loans were contracted. The outcome of such an assessment is translated into a certain rating (RSA, 2005a:102).

According to Oosthuizen (personal interview, 01 November 2013), even though credit ratings play a crucial role in determining government's credit worthiness to borrow money, investor sentiment is not only driven by credit rating action alone, but is also influenced by other global and domestic economic, financial and political factors of which the 2007/2008 financial crisis serves as the best example. The 2007/2008 global financial crisis changed the degree of borrowing cost due to a credit re-rating and also proved that credit rating cannot be looked at in isolation (RSA, 2010a:92).

To minimise the impact of loans and guarantees on the fiscus, it remains government's position that SOES should largely borrow on the strength of their balance sheets to reduce government's gross contingency liabilities towards SOES in order to discourage wasteful investment (RSA, 2010a:95).

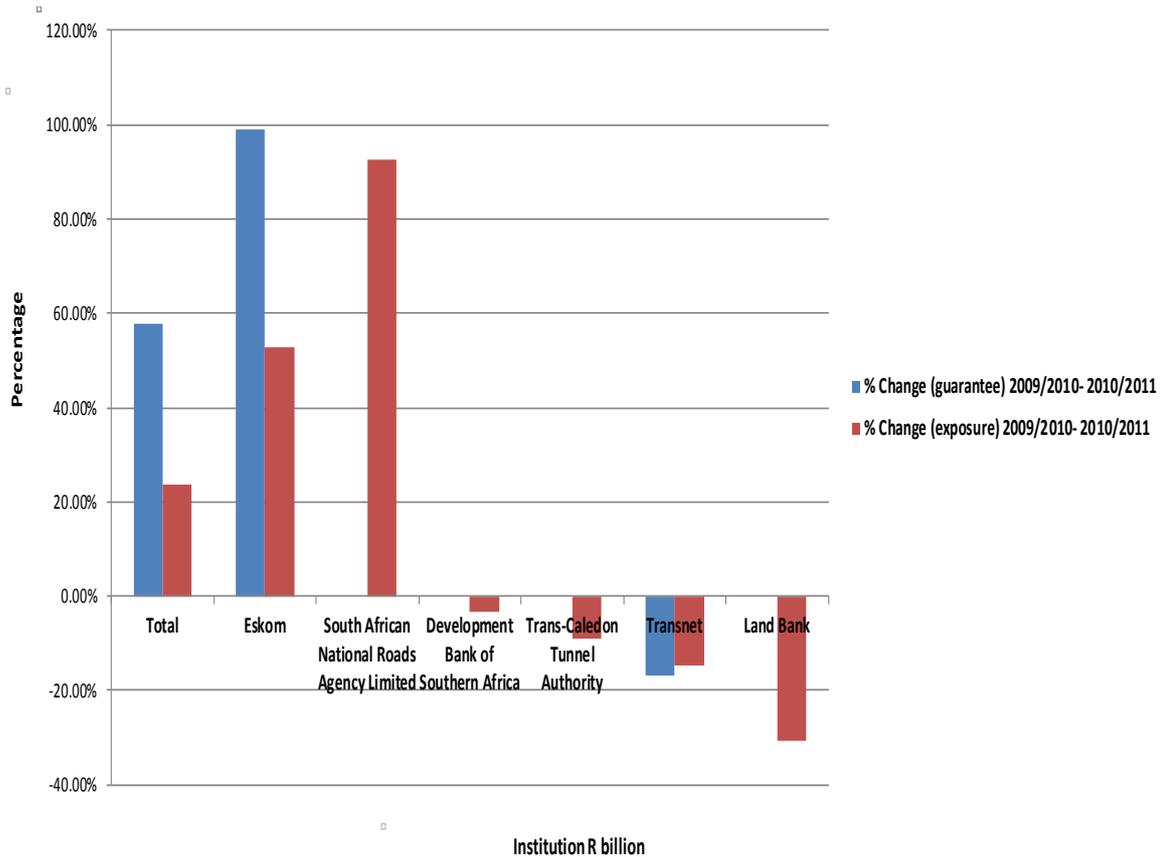
The increase of the government guarantee towards Eskom in 2010 by R174 billion brought the utility's total government guarantee to R350 billion. From Table 4.1 and Figure 4.3 below, it is clear that Eskom has received the highest amount of guarantee from government as compared to the other SOES. The total amount of guarantees government has committed between the 2009/2010 and 2010/2011 financial years amounted to R470.5 billion. Of the R470.5 billion, Eskom has taken the biggest cut with R350 billion worth of guarantees. The percentage increase for Eskom guarantees went up by 98 percent due to the additional R174 billion in 2010. Government's exposure to Eskom's debt went up from R46.7 billion in 2009/2010 to

R71.3 billion in 2010/2011, which is the highest compared to all other government institutions listed in Table 4.1 and Figure 4.3.

Table 4.1: Guarantee exposure against major SOES and development finance institutions by the SA government, 2009/10-2010/11 (South Africa, 2011a:94).

Institution R billion	2009/2010		2010/2011		2009/2010-2010/2011	
	Guarantee	Exposure	Guarantee	Exposure	% Change (guarantee)	% Change (exposure)
Total	298.4	129.1	470.5	159.8	57.70%	23.80%
Eskom	176	46.7	350	71.3	98.90%	52.70%
South African National Roads Agency Limited	38.9	12.3	38.9	23.7	0.00%	92.70%
Development Bank of Southern Africa	29.3	26.6	29.3	25.7	0.00%	-3.40%
Trans-Caledon Tunnel Authority	25.4	20.7	25.4	18.8	0.00%	-9.20%
Transnet	11.4	11.6	9.5	9.9	16.70%	-14.70%
Land Bank	3.8	2.6	3.8	1.8	0.00%	-30.80%

Figure 4.3: Change in guarantee exposure against major SOES and development finance institutions by the SA government, 2009/10-2010/11 (RSA, 2011a:94).



4.9 ESKOM'S CREDIT RATING

There are many factors that obtaining funding, especially from international institutions, depends on and a good credit rating is a major factor. Besides financial support from the shareholder (government) and the tariff increases from NERSA. Eskom also needs funding from international financial institutions due to the nature of their infrastructure development projects as shown in previous sections of this chapter.

Eskom's ability to raise funds beyond the shareholder's loan and beyond the tariff increases is limited by its credit rating as assigned by the various rating agencies.

The approved capital expenditure requires significant funding to be raised (Eskom, 2011a:1). There are three major rating agencies namely Standard and Poor's rating services, Moody's Investors Services and Fitch Ratings (Eskom, 2011b:82).

The credit rating for Eskom is mostly dominated by Moody's Investors Services and Standard and Poor's rating services. On 2 December 2010, Moody's Investors Services announced a change in outlook from negative to stable (same Baa2 rating) (Eskom, 2011a:1). Unfortunately, due to a change in methodology for rating government-related entities (not Eskom-specific), Standard and Poor's lowered both Eskom's local currency rating and national scale ratings each by one notch to BBB+ and ZaAA respectively (Eskom, 2011b:82).

The international foreign currencies rating remained unchanged at BBB+ in 2010 (Eskom, 2011b:82). However, during January 2011, standard and Poor's improved its ratings for both the government and Eskom from negative to stable (Eskom, 2011b:57). A negative rating means Eskom will find it hard to access loans from financial institutions as opposed to a positive rating or investment grade which will make it much easier for Eskom to access funding from diverse financial institutions. Ratings by credit rating agencies influence Eskom's ability to raise funding, and the interest it pays on its borrowing of money locally and more importantly on the international borrowing markets (Eskom, 2011b:83).

4.10 CONCLUSION

Chapter 4 discussed the sources of funding Eskom has been tapping into since 2008 to support its electricity expansion programme. The sources of funding for SOES discussed ranged from funding sources from the proposed 2008 R20 billion equity injection to the R60 billion loan provided in 2008 which is to be paid over 30 years. Capital markets covered the issuing of an international dollar bond, the first of its kind issued in 2011.

Chapter 4 also discussed the development financing institutions which included the World Bank's US\$3.75 billion loan to Eskom, the first of its kind; a loan by the ADB, DBSA and ECAs facilities. Chapter 4 further covered a discussion on tariffs granted

to Eskom by NERSA. A tariffs comparison was made from 1996 to 2012. In the 16-year period, the prices of electricity increased sharply since 2007/2008 due to the increase in tariffs which had a positive impact on Eskom's financial performance. Government's provision of R350 billion worth of guarantees and a R60 billion loan had an impact and implications on government's ability to service its debt.

Lastly, Chapter 4 covered the discussion on Eskom's credit rating and the way rating agencies impacted on Eskom's ability to borrow money on local or international markets.

The next chapter provides a debate on policy versus discretion in decision making process, it also highlight the basis on which funding for Eskom is decided. The chapter further discuss the policies used in approving funding plans submitted to DPE, DoE and NT with special focus to Eskom.

CHAPTER 5

POLICY VERSUS DISCRETION

5.1 INTRODUCTION

Chapter 5 focuses on policy versus discretion in the funding of SOES by the state, with specific reference to Eskom. The focus of this chapter is on the existence, and in some instances, the absence, of written policy in relation to the funding of SOES. It is also important to consider the role of the three departments – the DPE, the NT and the DoE – on SOE funding policy with specific reference to Eskom. The submitted funding plans as they are received by the NT and the processes followed by the shareholding departments representing a specific SOE, i.e. the DPE representing Eskom, are discussed.

5.2 POLICY VERSUS DISCRETION

The central point of this research was the financial assistance to state-owned enterprises by the state in South Africa, using Eskom as a case study. Some economists in monetary policy hold the view that rules and regulations can reduce policy mistakes, improve transparency and end political influence on policymaking (Van Lear, 2000:29).

It is important to understand that discretion allows for freedom to act in accordance with one's own judgment whereas a rule or policy involves the exercise of control over discretion in a way that puts restrictions or limitations over the objectives it pursues (Dwyer, 1993:4).

There is strong consensus among some economists that discretionary monetary policy leads to economic instability. This, therefore, implies that rules that commits the monetary authority to non-discretionary policy leads to a stable economy (Van Lear, 2000:30).

This research concurs with the pro discretionary policy economists who believe that changes in circumstances will mean that decision makers need flexibility to respond to judgements (Van Lear, 2000:32). The research is of the view that a balance between policy and discretion must exist, because if policy is rigid and exists in the absence of discretion it may lead to failure.

5.3 ON WHICH BASIS IS FUNDING FOR ESKOM DECIDED?

The PFMA 1 of 1999 (as amended) stipulates the rules and regulations governing the funding of SOES. The PFMA is an Act used as a guideline instead of a policy for funding SOES in South Africa. Parliament has the final decision-making power to appropriate money. The *Eskom Subordinated Loan Special Appropriation Act 41 of 2008* appropriated additional money for the requirements of the NT to provide a subordinated R60 billion loan to Eskom for the 2008/09 to 2010/11 financial years.

Funding plans for Eskom are drafted by Eskom's financial director and through the internal approval processes, in consultation with the DPE (Oosthuizen personal interview, 1 November 2013). Each year Eskom, in consultation with the minister of public Enterprises, agrees on its performance objectives, measures and indicators in line with the PFMA (Eskom, 2012:35). The performance objectives together with the funding plan are agreed on by Eskom and the DPE in the form of a shareholder's compact. After the DPE's approval, the funding plan is submitted on behalf of Eskom to the NT. The NT subjects the funding plan to a series of analyses by way of internal and confidential memorandums. The finance minister has the authority to approve or reject the memorandum based on all the analyses about the submitted funding plan (Oosthuizen personal interview, 1 November 2013).

Guarantees to SOES are issued and guided by the PFMA under sections 66 and 71 as discussed in Chapter 4 of this research. The executive department (in the case of Eskom, the DPE) initiates guarantees on behalf of Eskom in consultation with the Minister of Finance. The NT approves guarantees in consultation with both the executive and the policy departments of Eskom (Oosthuizen personal interview, 1 November 2013). Parliament gets involved because the minister of finance, who approves the guarantees, must appear before the Parliamentary Portfolio

Committees on Energy and Public Enterprises to justify the granting of financial assistance, i.e. guarantees or loans (Oosthuizen personal interview, 1 November 2013). However, Parliament has the ultimate power when it comes to the granting of financial assistance to SOES.

The decision-making process is an important part of public utilities or any institution (Cloete *et al.*, 2006:17). The process of decision making always requires capability, experience, creativity and discretion. According to Cloete *et al.*, (2006:17), to become a better decision maker, one has to stop focusing on the decision itself and concentrate on the policy-making process.

The decision making processes must be supported by sound policy to simplify the decisions to be taken and provide a strong point of reference for the decisions (Cloete *et al.*, 2006:17). The absence of written policy results in a higher level of discretion; and the inverse is also true – the preponderance of written policy results in a lower level of discretion.

In the case of the state's funding policy to SOES in South Africa there is no written policy thus more discretion. The funding of SOES through loans or guarantees and capital injections is supported by an insignificant amount of written policy; the PFMA only provides sections of procedures (Oosthuizen personal interview, 8 August 2012). With the South African government's financial assistance to SOES, with a special focus on Eskom, the minister of finance carries a higher level of discretion with Parliament having unlimited discretion within the bounds of the Constitution (Oosthuizen personal interview, 8 August 2012).

The NT and Parliament carry high levels of discretion. The NT analyses funding plans and funding requests whether in the form of loans, guarantees or capital injections, and writes a memorandum (of which the NT processes are not open to the public) to present before Parliament (Oosthuizen personal interview, 8 August 2012). The parliamentary Committee meetings which discuss submissions by the NT are open to the public, but may be closed if there is a good reason to make them private (RSA, 2014:1).

Then Parliament has the final decision-making power on whether to grant a loan, guarantee or capital injection to a particular SOE (Oosthuizen personal interview, 8 August 2012).

5.4 POLICIES FOR INFORMING OR USED FOR APPROVING FUNDING PLANS SUBMITTED FOR APPROVAL TO THE NATIONAL TREASURY

Eskom's funding plan is prepared by the financial director and is approved by the executive committee before a risk sub-committee makes recommendations to the board of directors (Oosthuizen personal interview, 1 November 2013). According to him, the point of reference for handling funding plans submitted by SOES to the NT is through their respective shareholder departments. There are memos that are handled by analysts at the NT to analyse the submitted funding plans. The minister of finance, assisted by advisors who have analysed the submitted funding plans from a particular SOES executive department, decides on the submission. According to Section 213(2) (a) (b) of the Constitution, money may be withdrawn from the NRF only

- in terms of an appropriation by an Act of Parliament; or
- as a direct charge against the NRF, when it is provided for in the Constitution or an Act of Parliament.

Section 5(2) of the PFMA states that the minister of finance, as the head of the NT, decides on the policy and other pronouncements of the NT, while Parliament carries final deciding powers on issues of guarantees, loans and capital injections (Oosthuizen personal interview, 8 August 2012). Parliament is informed by means of memorandums presented by the NT.

According to Oosthuizen (personal interview, 1 November 2013), there is no policy that deals with funding plans that are submitted by SOES through their respective shareholding departments. Section 66(7) (a) of the PFMA states that a public entity authorised to borrow money must annually submit to the minister a borrowing programme for the year. The NT has the power in approving or rejecting funding plans submitted by SOES with Parliament holding final deciding powers. The asset

and liability unit of the NT handles the SOES funding requests through its internal process which is not open to the public. From the DPE's initial submission of a funding plan to the approval or rejection stage, the whole process is handled via the internal memoranda of the NT. The memorandum submitted by the DPE to the NT goes through financial risk analysis done by financial analysts at the NT and is informed by the shareholder compact plan in line with the PFMA (Oosthuizen personal interview, 1 November 2013).

All approved funding plans for SOES are subjected to review by Parliament through the seating of the portfolio committees on energy and public enterprises on an annual basis to check if the initial conditions when the funding plan was approved have not changed. Eskom's funding plan was initially approved in 2011 and is for a period of seven years from 2011 to 2017. Section 70(b)(4) of the PFMA states that the responsible Cabinet member must report annually on the circumstances relating to any payments under a guarantee, indemnity or security issued in terms of subsection (1)(a) or (b) for tabling in the National Assembly.

By 2013, Eskom had raised approximately 75 percent of the funding it required for its projects in its funding plan approved in 2011.

5.5 THE DPE AND DOE, NT POLICIES ON FUNDING OF SOES WITH SPECIAL FOCUS ON ESKOM

The role of DPE, as the sole shareholder of Eskom, is crucial in facilitating funding plans, since a funding plan is incorporated into a shareholder compact plan (Oosthuizen personal interview, 1 November 2013).

The shareholder compact plan comes about through yearly consultations between Eskom and the minister of Public Enterprises in an agreement on Eskom's performance objectives, measures and indicators informed by the PFMA (Oosthuizen personal interview, 1 November 2013).

The nature of the energy sector affects the environment. The DoE comes in to ensure that the decisions taken for energy developments are within environmental considerations. When Eskom received the World Bank loan in 2009 there was opposition from non-governmental environmental organisations and a lack of support from the United States of America, the Netherlands, United Kingdom, Italy and Norway, who abstained from voting for the granting of the loan due to environmental concerns. This is a clear indication that funding policies and funding plans for SOES responsible for the provision of energy must take into consideration the environmental impact and low-carbon economic development for any infrastructure developments and electricity generation (Goldenberg, 2010:1).

Section 216 (1) of the Constitution gives power to national legislation to establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government. The NT is therefore responsible for managing South Africa's national government finances. The Constitution mandates the NT to ensure transparency, accountability and sound financial controls in the management of public finances. The NT with its role as government's finance manager is in the forefront of receiving and analysing all the financial requests from SOES. The NT ensures that all financial requests from SOES are in line with the PFMA (RSA, 2011d: 1).

5.6 CONCLUSION

This chapter focused on policy versus discretion on issues of financial assistance to SOES by the state in South Africa, with a specific focus on Eskom. The state's funding policy to SOES was also discussed. A discussion ensued focusing on more written policy instead of less written policy. More written policy results in a low level of discretion and a low level of personal interference and human influence and *vice versa*. It is ideal to have a balance between policy and discretion to ensure rationality in a difficult situation.

The research also considered the basis on which funding for SOES, with specific reference to Eskom, is decided.

Funding plans or funding requests from SOES are submitted to the NT by the shareholder department, which in the case of Eskom is the DPE. The NT will subject the submitted funding plan to its internal processes supported by the PFMA and treasury regulations relevant to SOES. There are different stakeholders that are involved in influencing financial assistance by the state to SOES; in the case of Eskom the three main influential stakeholders are the DPE, the DoE and the NT.

In the next chapter, an overview is given of the previous chapters, but more importantly, recommendations are made and a conclusion will be drawn from this discussion pertaining to this research.

CHAPTER 6

CONCLUSION AND PROPOSAL

6.1 INTRODUCTION

Chapter 1 detailed a discussion on the need to evaluate the financial assistance to state-owned enterprises in South Africa by the state with a specific focus on Eskom. It provided a background discussion, the history of SOES in general and more specifically regarding Eskom's dominance in the electricity sector in South Africa since 1948.

The research highlighted that, in the absence of a single policy that deals with issues of funding affairs of SOES in South Africa, the PFMA is the legislation used as a point of reference. The research also comprised of a series of personal interviews with Mr Oosthuizen from the National Treasury.

The purpose of the interviews was to understand the internal processes used by the NT to deal with matters relating to SOE funding. The personal interviews were used to collect information about the NT's internal funding processes towards SOES. As most of the information relating to SOES is confidential and publicly unavailable, the interviews with Mr Oosthuizen assisted in understanding some of the NT's internal processes used to handle SOE funding issues.

6.2 THE LITERATURE RELEVANT TO SOES IN SOUTH AFRICA WITH SPECIFIC FOCUS ON ESKOM

The purpose of Chapter 2 was to highlight different theories and ideological spectrums on SOES in relation to South Africa. The main discussion of Chapter 2 was around the ideological spectrum and on how it relates to SOES and provision of goods and services in public or private ways.

The debate on SOES in South Africa and Eskom was discussed, followed by the free-market debate on the provision of public goods and services. In Chapter 2, it was reported that socialism argued that a capitalist economy fails in terms of the

provision of public goods and services due to the problem of free riders. The free rider problem is described as consumers or citizens who benefit from the provision of public services and goods like streetlights and free electricity without contributing a cent. A free-market economy is unable to provide free services as it exists to make a profit.

Capitalist argues that a government-managed economy also fails with the provision of goods and services because of factors such as corruption and monopoly. In the light of this discussion on the control of the economy and factors of production, economic theories cannot be ignored. The economic spectrum in Chapter 2 dealt with issues of government regulation and intervention into economic activities. Public administration and new public management were discussed. New public management was the advocate of new ideas in the public sector by encouraging co-operation between the public and private institutions through public-private partnerships, is believed to attract more funding for infrastructure development, which leads to improved service delivery. Even though the partnership between Eskom and the private sector exists it is mostly in funding and at a minimal on the electricity generation side.

The discussion on the state's funding policy to SOES in South Africa would be incomplete without a discussion of public policy. In Chapter 2, different public policy models for analysing policy processes were discussed, including the elite and institutional models that are based on the premise that government has a monopoly on policy decisions processes. The last section of Chapter 2 considered the gap in the literature of the funding policy of SOES in South Africa. It was found that there is no single funding policy in South Africa that deals with financial assistance by the state to SOES. However, procedures are stipulated in the PFMA and supported by white papers and parliamentary discretions. This makes the level of discretion in financial decision-making processes much higher in the absence of a single policy on financing SOES in South Africa.

6.3 THE MACRO ORGANISATION OF POLICY ON THE FUNDING OF ESKOM

Chapter 3 considered the reporting structure and the stakeholders involved in the management of Eskom. The stakeholders involved with Eskom as discussed in Chapter 3 were found to be the Department of Public Enterprises (DPE), the Department of Energy (DoE) and the National Treasury (NT) as well as the National Energy Regulator of South Africa (NERSA).

Eskom falls under the responsibility of two departments: the DoE and the DPE. The DPE is a shareholder on behalf of government with oversight responsibility over Eskom, and the DPE has 100 percent ownership control over Eskom on behalf of the SAGO. All policy matters related to Eskom's electricity generation and development of policy measures for the electricity sector are vested with the energy department.

Eskom is a schedule 2 public entity and all subsidiaries, and entities owned and controlled by Eskom are subject to the PFMA. All schedule 2 entities are expected to generate their own profit and can, and are, permitted to borrow money against their own balance sheet.

The Chapter 3 discussion also covered issues of regulation of the electricity industry and the entire energy sector. Regulation of the electricity sector is vested with NERSA and includes pricing, consumer interests and industrial issues. Regulation of the electricity sector in South Africa is necessary as there is a monopoly with Eskom dominating the generation, transmission and distribution of electricity.

The reasons why government provides guarantees and loans to SOES were highlighted. These reasons include, but are not limited to, reducing borrowing costs for SOES and easing pressure on the domestic capital market. It will be very expensive for Eskom to access international funding without the financial backing from government. Eskom will be subjected to high interest rates with short-term payment arrangements in the absence of state financial assistance through guarantees.

Above all, since SOES make use of public funds, they are subject to oversight by different state institutions such as the Standing Committee on Public Accounts (SCOPA) and the respective parliamentary committees.

6.4 OVERVIEW OF FUNDING SOURCES FOR SOES WITH REFERENCE TO ESKOM

Funding is a key factor for Eskom's infrastructure development, and Chapter 4 dealt with Eskom's sources of funding in detail. The discussion on Eskom's sources of funding included proposed equity injections estimated at R20 billion, which had remained a proposal from government since 2008 until at the time of this research in late 2014. The R60 billion subordinated loan from government, which was approved in July 2008 remains the biggest amount received to date by Eskom as part of its 2017 funding plan towards achieving the R450 billion target for infrastructure development.

Besides Eskom's dependence on financial support from government, Eskom has access to other sources of funding. Such sources include – but are not limited to – capital market that offers a long-term payment arrangement and attractive interest rates. In 2011, Eskom issued international dollar bonds to the amount of \$1.75 billion to raise funds for its infrastructure development in order to increase electricity capacity.

In 2010, Eskom received approximately R28 billion from the World Bank for the Medupi power station, which is the biggest loan compared to other loans received by Eskom between 2008 and 2013 from different funders. The loan was granted even though it was met with criticism from Western powers like the USA and non-governmental environmental institution in terms of environmental concerns for the use of coal to generate electricity. From the African Development Bank, Eskom also received an amount of approximately R25.78 billion towards the realisation of R450 billion target for electricity infrastructure development. Export credit agencies from Germany and France also formed part of Eskom's source of funding towards the Medupi and Kusile projects.

Electricity tariffs form an important part of Eskom's income generation. Since the 2007/08 financial year, just after the power crisis hit South Africa, Eskom submitted tariff increase requests to the energy regulator NERSA. The increases moved from single-digit increases of 5.9 percent to double-digit increases of 18.7 percent. Since 2007/2008, the tariffs have returned to the lower-digit days. Eskom has continued to apply for more tariff increases from NERSA in order to support its infrastructure development estimated at R450 billion. Chapter 4 also demonstrated the trend of tariff increases from 2006 to 2012 and the effect this had on the CPI.

Shareholder support is an important factor for any private or public company to survive. The same theory of shareholder support applies to Eskom as an SOE. Shareholder support is crucial for Eskom in accessing funding for its capacity expansion programme. Between 2009 and 2010, the SAGO through the DPE supported Eskom with guarantees to the amount of R350 billion. The first guarantee of R174 billion was allocated in 2009 and later increased by R176 billion, which brought the total amount to R350 billion. The increase came about because government continues to recognise Eskom's critical role in the economy and the need to maintain energy security.

Between 2009 and 2013, the guarantees enhanced Eskom's ability to achieve a positive credit rating from rating agencies for easy access to diverse sources of funding at attractive interest rates with long-term payments periods. If Eskom defaults in paying its loans and if required, government would have to step in to pay the debt in its entirety or step in and continue to make payments on behalf of Eskom. The guarantees provided by government to Eskom or to any other public entity could have dire implications for government's credit ratings and its ability to service its debt. Chapter 4 discussed the guarantee exposure against major SOES and DFIs by the SAGO. Eskom came top of the list in terms of the receiver of government guarantees with R350 billion and in the process exposed government to 71.3 percent of debt.

6.5 LIMITATIONS OF THE RESEARCH

The researcher identified the following limitations in respect to the study:

- Access to information on financial assistance to SOES, with reference to Eskom and the internal funding processes followed by the NT, to award financial assistance is kept internal and cannot be accessed by the public.
- This research cannot be generalised to other countries' SOES other than in South Africa. The problem statement of this research was centred on financial assistance to SOES by the state in South Africa with specific reference to Eskom. The research objectives focused mainly on the extent of state financial assistance to SOES by means of loans and guarantees and other forms of financial assistance from the state with special focus on Eskom.
- The different concepts associated with the research topic were defined for the purpose of this research only.

Based on the findings for this research, recommendations and proposals are made in the next section.

6.6 PROPOSALS AND RECOMMENDATIONS

This part of the discussion deals with proposals and recommendations for the research on financial assistance to SOES by the state in South Africa, a case study of Eskom. Below is a list of proposed recommendations for this research.

- There is a need for a single policy document that deals with issues of state funding of all SOES in South Africa. Therefore, this research proposes a single policy document for state funding of SOES.
- As there are often calls for the supply of electricity to be privatised under private sector control, this research proposes that basic services must not be privatised but remain under state control. The study further recommends best possible ways for improved basic service delivery through private-public partnerships (PPPs). To improve basic services like electricity, it is best to partner with private companies through independent power producers for effective and efficient service delivery and electricity security for South Africa.

- Government should continue to provide financial support through guarantees; however, it should always encourage SOES to borrow money against the strength of their balance sheets, in order to reduce SOES over-dependence on state guarantees, loans and high tariffs. Financial support may be provided in the form of a loan that must be paid back with interest within a stipulated number of years. It is further proposed that capital injections towards SOES must be limited or avoided.
- Tariff is one major instrument to raise money for Eskom through electricity sales. This researcher agrees with the notion of tariffs as an instrument to raise funds to meet Eskom's construction of new power stations. However, the study proposes that tariff increases should be allowed over a longer period of time rather than a short period of time. The rationale behind the proposal of tariff increases over longer periods as opposed to shorter periods is that higher tariffs over a shorter time has a negative impact on the economy. Higher tariffs result in high inflation, which leads to a drop of the CPI, thus devastating the key drivers of economic growth such as industry and manufacturing, and forces many industries to retrench workers.

6.7 CONCLUSION

The extent of financial assistance by the state in South Africa to SOES with specific reference to Eskom is not supported by any single funding policy. This is evident since 2007/2008 when the Eskom power crisis and financial needs become serious. The financial assistance provided to Eskom in the form of loans or guarantees were decisions taken by Parliament and the National Treasury guided by the prescripts of the PFMA. Even though the PFMA acts as a prescript to the National Treasury and Parliament it is very important to have a single funding policy that guides all financial assistance by the state to SOES in South Africa. Yes it is important that the state provides financial support to SOES however a single policy in funding of SOES could assist in ensuring consistency in financial assistance of all SOES in South Africa.

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ANNEXURE A
LETTER REQUESTING PERMISSION TO CONDUCT INTERVIEWS AT THE
NATIONAL TREASURY SOUTH AFRICA



The Director-general
National Treasury
Vermeulen Street
PRETORIA

Interviews with Mr Martin Sadiki

Mr Sadiki is a Masters student at the Department of Public Administration at Unisa. He is currently doing research on the financial support of SOEs by the State.

Any assistance that your Department may offer will be appreciated greatly.



J.C. Pauw Co-supervisor

2011-03-14



ANNEXURE B
LETTER OF CONFIRMATION OF THE INTERVIEWS AND
LIST OF QUESTIONS ASKED DURING ONE TO ONE INTERVIEWS AT THE
NATIONAL TREASURY SOUTH AFRICA

Confirmation of interviews that took place between H Oosthuizen and M Sadiki between the period 2011, 2012 and 2013

I hereby confirm that the interviews with M Sadiki took place between the periods mentioned above. The purpose of the interviews was to assist M Sadiki in his research for his Masters degree.

I also confirm that at no point did I divulge any confidential or sensitive information to M Sadiki during the period mentioned above. Discussions only centred on the questions asked of which a copy is attached.



H Oosthuizen

Questions asked in one-to-one interview between Mr Martin Sadiki (University of South Africa Master's student) and Mr Hendrik Oosthuizen Senior Analyst: Treasury Operations, Governance and Financial Analysis Asset and Liability Management Division: at the National treasury South Africa) between 2011, 2012 and early first four months of 2013.

Q1.What is the role of National treasury towards state owned entities?

Q2.What are the reasons why government provides loans and guarantees to State owned enterprises (SOEs) and Eskom in particular?

Q3.Why does Eskom need international funding?

Q4. What are legislations that guide funding of SOEs in South Africa?

Q5.What is the role of the PFMA on funding issues of SOEs?

Q6.What is the role of the PFMA on guarantees provided to SOEs?

Q7.What is the main sources of Eskom funding for Eskom's build up project?

Q8.What are government guarantee?

Q9.Are there different kinds of guarantees that are used to support SOEs?

Q10.10Why was Eskom giving guarantees?

Q11.Why did the government reach the decision to increase Eskom's guarantees from R176 billion to R350 billion in 2010?

Q12. Are there any impacts in providing guarantees to SOEs to the fiscus?

Q13. On what basis is funding for SOEs decided?

Q14.Are there policies to inform or procedures that are used to handle submitted funding plans?

Mr Martin Sadiki

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.....*Hendrik*..... 17-05-2013

Signature

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Signature