# How Eskom fell apart

By Nicholas Woode-Smith

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The government has repeatedly failed to engage the private sector in alleviating rising poverty and the declining economy, despite the protestations of policy-makers and bureaucrats. This is very much the case when it comes to electricity generation and distribution. Currently, electricity is monopolised by the state-owned enterprise Eskom, which came under fire for the series of major blackouts in 2008 and since revealed mismanagement.

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Eskom is an excellent case study of why the public sector is not an ideal supplier, having failed to produce an adequate amount of electricity to fuel the economy and satisfy consumer demand.

In 1998, South Africa had the opportunity to avoid the contemporary mess by privatising the electricity industry. But it did not.

## Just expected to keep the lights on

Originally founded to regulate power companies into providing cheap power to mines, what was then called Escom evolved into a state company with the exclusive right to provide electricity for the entire country. As this new entity, it was forbidden from generating a profit. Without any incentive provided by private competition and the chance of personal enrichment to do well. Instead, it was expected to just keep the lights on at the cheapest possible price.

The problem, of course, was that with market signals disrupted, Eskom could not know what an appropriate price should be. This became so ludicrous that from the 1980s into the 1990s, its effort to keep electricity prices low led to it charging less than its production costs.

Freed from its government-imposed price controls in the 1980s, Eskom continued to lower prices, and, to compensate for the lack of revenue, sold off assets and generating capacity, and laid off staff.

## Pricing

Understanding Eskom's prices is crucial to understanding why it failed and why privatisation of the industry failed. By pricing its product far below the natural cost, Eskom was over-stimulating demand which it eventually could not fulfil.

In 1998, in line with a brief foray into pro-market policies, a *White Paper on Energy Policy* was produced, which, among other things, called for increased competition in the energy market, increased transparency and the removal of market distortions so to allow for realistic pricing.
These policies could have saved the industry. But they were not implemented effectively.

In anticipation of possible privatisation and an end to the electricity monopoly, the government forbade Eskom from constructing new power stations. But it was already involved in expanding electrification across South Africa, raising demand higher and higher. Construction was eventually renewed in 2004 when it was much too late.

## Why, then, did the private sector not enter the market to provide the extra generating capacity?

Government advertised for private competitors to enter the market, but none were forthcoming. This was not because of the failure of the market, but because Eskom's unnaturally low prices prevented any rational, profit-seeking enterprise from trying to compete with it. The government tried to find good alternatives without removing the cheater in its midst.

State companies can easily undercut private companies. They have increased access to capital through taxation and have skewed incentives. Private enterprises need to deliver a high-quality product or service to be sustainable and to profit and keep profiting. The public sector has no such framework to define its behaviour.

Cheap prices are not necessarily a characteristic of a free market. Realistic prices are. Markets do not have the distortions of free money and odd agendas to skew their behaviour. While Eskom may have been cheap, it did not, and could not, last. Bad pricing led to a failure to move to a more sustainable model of electricity production with privatisation, and has resulted in a situation where, if our economy starts growing again, we will have insufficient power generation.

Pro-market economic policies came under fire from trade unions and socialist politicians in the late 1990s. These policies were not implemented, or were implemented so half-heartedly as to ensure their failure. Eventually, pro-market measures like the 1998 *White Paper* were replaced by contemporary notions of "state-led development", giving us less than one percent of economic growth.

The private sector is often the whipping boy of many South African policy-makers and public intellectuals. It is true that the economy has been underperforming, but what is also clear is that this is not the private sector's fault. The government is no friend of business or economic prosperity.

South Africa had the chance to move toward a private sector-led and sustainable electricity sector. Due to ideological restraints, undercutting and bad implementation, it failed. Now, we are living with the consequences.

## ABOUT THE AUTHOR

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