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Competition and regulation interface in energy, telecommunications and transport in South Africa

Reena das Nair and Simon Roberts

Introduction

Economic regulation is largely about regulating the natural monopoly parts of value chains and generally involves the regulation of enterprises that are, or were, state-owned. Regulating access to, and pricing of, essential infrastructure, key inputs and bottleneck goods and services that cannot be easily replicated is considered necessary to ensure that fair access is provided and that monopoly prices are not charged (Viscusi, Vernon and Harrington, 1998). Economic regulation is also seen as a mechanism by which significant market failures can be corrected, or entrenched dominant positions kept in check. In certain industries, such as network infrastructure, the private sector will underinvest as the social returns are generally greater than the private returns, given the large externalities generated. In such industries, economic regulation is necessary to ensure sufficient investment. Therefore, the scope of economic regulation is broader than just controlling access and pricing. Dynamic considerations such as the impact on investment decisions, the impact of infrastructure on the development path of the economy, and the creative role of competitive rivalry all need to be part of an effective economic regulatory regime.

While economic regulation is often viewed as the control of market power in instances where competition is either not possible or not desirable, competition policy is about regulating the potentially anticompetitive behaviour of dominant players and addressing structural changes through the merger regime or through conditions. In this sense, economic regulation is predominantly ex ante, where the rules of the game are set out upfront, while competition law enforcement is largely ex post, where past anticompetitive conduct is prosecuted after the fact, except for the merger regime where accretions of concentration which could potentially lead to anticompetitive outcomes are curbed ex ante. However, this dichotomy is imprecise, as even economic regulation mainly uses past conduct and data to determine the future course of action and competition policy aims to influence future conduct through changing past undesirable behaviour. The two are even further interrelated – regulation is required for competition to flourish, for instance, to ensure access to essential facilities or inputs. A regulatory regime that favours incumbents over new entry hinders competitive objectives and it
is important that regulators take into account dynamic gains from greater competitive rivalry in setting the rules of regulation and when making decisions. Similarly, it is important that competition authorities appreciate the rationale for, and forms of, economic regulation and, at the same time, understand that some matters regarding competitive outcomes are more effectively resolved through regulatory intervention.

This chapter draws lessons from experiences in three regulated industries in South Africa: energy, telecommunications and transport (ports and rail). These sectors were selected as part of a national government-funded project aimed at building regulatory entities’ capacity (CCRED, n.d.). The project reviewed the performance of regulators in the wider context of their mandates and powers; the challenges they face in terms of regulatory capacity, accountability, credibility and other constraints, including fiscal constraints; and industry performance in terms of pricing outcomes, investment in the sector and allocative and productive efficiency. The reviews further assessed whether economic regulation in these industries has contributed to, or been in conflict with, other economic development mandates aimed at sustainable development and inclusive growth. We draw on these reviews to identify important lessons for the interface between competition and regulation in these sectors. This is useful for economic regulators in terms of learning from one another, for engagement between economic regulators and competition authorities, as well as for policy makers.

The different industries reflect a diversity of approaches from which insights can be drawn. In electricity we have an integrated state-owned enterprise (SOE) with an independent regulator, and the introduction of new participants in the form of renewable energy generators. In rail freight and ports there is an integrated SOE without a regulator until the recently established Ports Regulator. In telecommunications, the main operator has long been effectively privatised, and there are private operators in mobile telephony, with a long-established regulator and enforcement actions by the competition authorities.

In the remainder of this chapter, we evaluate the outcomes and performance of the electricity, transport (ports and rail in particular) and telecommunications sectors of South Africa, highlighting how certain decisions of the relevant regulator encouraged competitive outcomes while others discouraged it. We conclude by comparing and contrasting the similarities and differences of each regulatory regime and drawing together key lessons learnt.

Energy

The electricity supply industry (ESI) of South Africa is dominated by state-owned utility Eskom, which operates across the entire electricity value chain in generation, transmission and distribution. Eskom generates 95% of the electricity consumed in the country, with independent power producers (IPPs) representing a much smaller portion of electricity generation.

After the corporatisation of Eskom, there were concerns around its dominance in the ESI, and around the poor performance on a technical level throughout
the value chain.\(^3\) Even though Eskom was funded by government, alternative sources of funding were needed to invest in and develop the ESI. These factors culminated in developing a hybrid model in which, on the one hand, Eskom was given the responsibility for immediate new investment, and, on the other, private IPPs were given an opportunity to participate in electricity generation. However, the industry is still dominated by Eskom in terms of the size of its contribution to electricity generation, its ownership and operation of transmission network services and its role in distributing electricity. Eskom distributes around 60% of the country’s power, with municipalities distributing the balance. Although Eskom distributes more power than municipalities do, it serves fewer end users, focusing on long-term contracts with mining companies and other large industry players at more favourable rates.

The ESI has been regulated by an independent regulator since 1995, first by the National Electricity Regulator, followed by the National Energy Regulator of South Africa (Nersa) since 2005. Nersa is tasked with price determination, licensing, dispute resolution and the compliance of electricity suppliers.

Outcomes in the ESI and the regulator’s role

The outcomes observed in the ESI, particularly in terms of the supply and pricing of coal-generated electricity, are linked to investment patterns in generation infrastructure which, in turn, are a product of regulatory decisions. But these outcomes have also been influenced by political pressure, Eskom’s market power and large electricity-intensive user groups. Policy uncertainty and institutional complexity (several players with divergent views involved in decision making and no clear energy policy\(^4\)) have further resulted in certain detrimental impacts on the sector and the economy as a whole, particularly during the 2008 load-shedding crises. However, the success story of the ESI on the generation level has been the Renewable Energy Independent Power Producers Procurement Programme (REIPPPP) (discussed later). The evolution of the renewable energy industry emphasises how challenges can be effectively addressed through proactive regulation that takes into account competition principles.

The key question relating to average and relative prices charged to different electricity customers is how the legacy of overinvestment in generation capacity in the 1980s has influenced the structure of the economy and, in particular, its capital-intensive bias. As discussed below, overinvestment in generation capacity led to power stations being built and then mothballed in the 1980s. This meant that it was worth selling electricity as long as the price earned was above the variable costs of generation and made some contribution to the fixed costs. In a sense, the overinvestment in capacity – which could clearly not be reversed – created the basis for some buyers to receive a subsidised price. The question is which buyers received this advantage. The easiest way to increase demand was by incentivising large energy-intensive industries such as smelters, which is largely what happened. However, the unintended consequence was a skewing of the economy towards a very capital-intensive structure. In effect, the cheap electricity amounted to an export subsidy for these types of businesses, with the knock-on effect of supporting the exchange rate, which in turn made
other producers of traded goods less competitive. The second key implication is that when electricity demand outstrips capacity then new capacity needs to be built, and the rationale for the very cheap pricing no longer exists – pricing needs to cover the costs of building the generation plant and not just the cost of operating the power station. The lack of conditions linking the low pricing to availability meant that the economy was rationed in its electricity usage, and Eskom had to compensate large energy-intensive users for reducing their consumption.

The result of the historic decisions regarding investment and pricing is that there has been a path dependency on relatively cheap and non-renewable electricity. The adjustment towards new priorities and appropriately priced electricity has been slow and riddled with difficulty. In addition, the costs of the new-build programme and the electricity prices required for the financial sustainability of Eskom demonstrate just how big the effective subsidies have been.

Average real prices declined over the 1980s and 1990s (figure 5.1), although the average price conceals the differences in prices to different users. The steep increases in average prices coinciding with large infrastructure build are also evident.

Figure 5.1 Average electricity prices and increases, 1972–2015

Sources: Eskom (Average nominal prices from http://www.eskom.co.za/CustomerCare/TariffsAndCharges/Pages/Tariff_History.aspx); StatsSA (CPI from http://www.statssa.gov.za/publications/P0141/CPIHistory.pdf); average real prices: authors’ calculations (2015=100)

Note: The average price is a simple average across all tariffs Eskom charges, calculated by taking the total value of sales divided by the number of kilowatt-hours (kWh) sold per year. It is assumed that this includes sales through special pricing deals.

Suboptimal investment decisions in terms of planning, timing, size and technology choices of power plant investments have affected the pricing trajectory. Between 1974 and 1978, electricity prices rose steeply in real terms due to capacity shortage, along with increasingly frequent load shedding up to 1981.
In response, Eskom started a large new-build programme. By 1983, the SOE had 22.26 gigawatts (GW) of generation capacity under construction or on order (Steyn, 2006). Failure to properly plan and oversee investment decisions resulted in an excessive capacity expansion programme and inefficiency in investment by Eskom (Kessides, Bogetic and Maurer, 2007). To service Eskom’s soaring debt, costs were passed on to consumers, leading to steep average nominal price increases in the 1980s while the SOE benefited from a monopoly position, government guarantees, open-ended Reserve Bank forward cover and an exemption from taxes and dividends.

By the late 1980s/early 1990s, Eskom faced severe political pressure to reduce prices as soon as declining debt levels would allow it (Steyn, 2003). Increased internal efficiency and huge excess generation capacity (due to the economic downturn and the commissioning of new power stations in the 1980s) allowed Eskom to reduce real electricity price increases for the following 15 years. Moreover, in the 1990s, Eskom entered into a compact with its customers to keep its prices low and to reduce the real cost of electricity by 20% over the period 1991–1996. A reduction of 16.6% was achieved. This kept prices at a level that was relatively low compared to global standards and, as noted, these low prices did not adequately cover costs or allow for reinvestment.

One solution was to increase demand by incentivising large energy-intensive industries such as smelters and other heavy users. In the 1990s, Eskom entered into favourably priced long-term supply agreements with aluminium smelters (Alusaf, BHP Billiton’s predecessor) and with ferrochrome smelters to ensure offtake of excess electricity capacity and to promote downstream industry. These pricing structures, increasingly favourable to large industrial users, were not amended by Nersa over the years according to changing supply and demand balances and economic conditions. When the balance changed and the country faced an electricity shortage in 2008, these contracts caused considerable controversy. They were seen to favour big foreign-owned business that contributed little to local downstream beneficiation (as they largely exported unbeficiated products) and to employment, at the expense of the local economy which suffered serious electricity shortages and escalating prices. Prices to heavy users of electricity arguably should increase relative to light users in tight supply situations so as to discourage the use of electricity and encourage investment in energy efficiency and renewable energy. While these selected dominant customers received significantly cheaper prices compared to households and smaller industry, partly due to lower costs to supply/serve, there appeared to be few other cost-related reasons for these prices. This practice in effect created a path dependency on cheap, dirty energy by heavy industry. These decisions further had implications for economic participation as they favoured heavy users of electricity and limited participation for those who could not secure these favourable rates.

When demand once again outstripped supply the South African government, through Eskom, started a massive generation expansion programme in 2005. This reaction to the increased demand on the grid was delayed and not in time to prevent the 2008 crisis. Although the programme considered the objectives of the latest Integrated Resource Plan, especially the need to diversify the
technology and fuel mix of generation, technology choices were predominately influenced by the objective of ‘keeping the lights on’ at the cheapest cost (at the time of decision making). Hence, the programme still favoured large coal-fired generation plants.

As in the 1980s, the financing requirements of this colossal investment programme contributed to pushing prices up, ultimately resulting in a trebling of the average price from 2009/2010 to 2017/2018 (Nersa, 2010, 2013). The repetition of a suboptimal investment pattern (over- and underinvestment) could have been avoided through effective (and implemented) policy learnings and prudent investment decisions. A proactive strategy for new generation capacity based on timely progressive building (rather than lumpy, large-scale build) and matching demand trends and forecasts would have delivered a much smoother price trajectory.

However, these outcomes were not because of Nersa’s actions (or inactions) alone. Government made a number of public statements bypassing Nersa, compromising its independence. For instance, government sent out mixed messages on whether Eskom should invest in generation capacity or not. Initially, the blueprint for a competitive ESI, which included a power exchange, the unbundling of distribution and transmission and a partial unbundling of generation, was produced for Cabinet in May 2001. The document recommended that 30% of the generation capacity be sold to the private sector, with Eskom retaining 70% of the market. It was stated that Eskom would not build any additional generation capacity from 2001, thus transferring this to the private sector (Pickering, 2010). But this message was reversed when government then announced that Eskom should build power stations. This created uncertainty for private sector IPP investors about whether or not to invest. Further, with Cabinet approval, Eskom bypassed Nersa’s review process of the construction of Kusile power station, again compromising the regulator’s credibility.

Regarding unbundling, in 2011 the Independent Systems and Market Operator (ISMO) Bill approved by Cabinet envisaged that an ISMO would invest, operate and maintain the country’s high-voltage transmission grid separately from Eskom to ensure that independent generators would receive fair access to the transmission network. The ISMO had the potential to accelerate the development of renewable energy and increase participation of IPPs in the country, empowering them to sell electricity directly to customers without having to be routed through Eskom and allowing for any surplus generation to be sold back to the utility or to third parties. The ISMO Bill was stalled in parliament. This lack of progress in introducing competition can be attributed to vested interests in the industry and an attempt to protect Eskom’s dominant position (das Nair, Montmasson-Clair and Ryan, 2014).

At several points, there has been political pressure in the pricing of electricity. In the 1980s and 1990s, there was pressure on Eskom to suppress prices. In 2004, the minister of public enterprises announced that Eskom was prohibited from increasing prices above inflation. This announcement questioned the independence of the regulator and tarnished the credibility of the administrated pricing system. As the actions of the minister contradicted the principles of the
legislation, it created a sense of unease regarding ‘the government’s respect for the role of independent regulatory processes’ (Steyn, 2003, p. 3).

During the implementation of the Multi-Year Price Determination (MYPD) mechanism,\textsuperscript{11} Eskom did not always receive the price increase it sought through the required revenue pricing mechanism. In some instances, this was because an objective of lowest possible electricity prices was prioritised. In other instances, it was because Nersa more strictly questioned Eskom’s costs submissions (prices were determined based on covering full costs and allowing a rate of return). It is argued that not allowing full cost recovery through the tariff mechanism jeopardised Eskom’s ability to finance new generating capacity (Steyn, 2012). Nersa has nonetheless made significant progress in reducing uncertainty for customers by making different Eskom tariff structures more transparent, user friendly and cost-reflective over the years.

The pricing of electricity sold through municipalities has been a further area of contention, one in which some headway has been made by Nersa but more could be done in terms of ensuring investment in maintenance and repair of the distribution system. Municipalities are primarily responsible for distribution and retail activities in urban areas, and they purchase power from Eskom for resale to consumers within their boundaries. Households and industry have raised serious concerns that electricity prices are excessively marked up by municipalities, over and above Eskom’s tariffs, with no consistency across municipalities. This is said to impact negatively on the competitiveness of small industrial end users, such as foundries and light manufacturing, supplied by municipalities. Some estimates are that municipality mark-ups can be between 50 and 100\% above the direct Eskom price (Clark and Van Vuuren, 2013), placing those that source from a municipality immediately at a competitive disadvantage to rivals sourcing directly from Eskom.

The reasons for this appear to partly stem from municipality funding models, where funds generated from electricity sales are used to cross-subsidise other municipal activities, creating perverse incentives to inflate electricity tariffs through high mark-ups to earn more revenue to fund other activities. In addition, there is regulatory uncertainty or misalignment when it comes to who is ultimately responsible for regulating municipal activities. The constitution grants municipalities the executive authority and the right to administer electricity reticulation. While Nersa has the mandate to set the tariff at which municipalities can price electricity sales, the constitution allows municipalities the right to apply surcharges or mark-ups over and above this Nersa-determined price for municipal services.\textsuperscript{12}

One of the biggest issues, however, remains the lack of maintenance and investment in distribution infrastructure. Ageing infrastructure operating at maximum capacity is overloading the system, resulting in supply interruptions.\textsuperscript{13} A major refurbishment backlog estimated at R27 billion exists in the ESI and continues to grow at an estimated R2.5 billion per annum (Louw, 2012; Noah, 2012; Rustomjee, 2013). Nersa could potentially play a much stronger role in ensuring that municipalities invest in maintenance and refurbishment of distribution infrastructure.
The renewable energy experience

The REIPPPP is an interesting case study which highlights ways in which challenges in the ESI can at least partially be addressed through effective regulation which proactively introduces competitive rivalry. Gaylor Montmasson-Clair and Reena das Nair provide an in-depth assessment of the renewable energy experience in South Africa in chapter 8 in this volume.

The evolution of the renewable energy programme has been a learning curve for stakeholders. The early programmes to facilitate entry by IPPs were conceptualised, designed and administered by Eskom in 2007/2008. In each of these programmes there were no power purchase agreements (PPAs) between Eskom and IPPs. This made the commercial banks reluctant to finance them as it placed considerable risk solely on the IPPs. Further, there was also reluctance on the part of project developers to participate in the programmes given Eskom’s dual role as the dominant industry player and administrator of the process.

Changing strategy given the poor results of the initial programmes, Nersa developed a Renewable Energy Feed-In Tariff (REFIT) mechanism which sought to procure power output from qualifying renewable energy generators at predetermined prices. Under this programme, IPPs were to sell renewable energy-based electricity to Eskom (as the exclusive buyer) under a PPA, and were entitled to receive regulated tariffs based on the particular generation technology. However, this was also unsuccessful and the feed-in tariff was never implemented as industry considered it to be too low. In 2009, Nersa revised the tariffs to allow greater returns on investment, but subsequently lowered them again in line with international benchmarks. There were significant other teething problems with the REFIT programme, where again it was felt that too much risk was allocated to IPPs. IPPs, developers and financiers insisted on a PPA underwritten by the government to reduce this risk. Because of this and for a range of other reasons, including concerns around Nersa’s ability to coordinate and administer such a system and conflicts with public finance and procurement laws, the REIPPPP, which was a competitive bidding procurement programme, came into being. This programme is run by the Department of Energy (DoE) and the National Treasury.

The auction system designed in the REIPPPP encourages both competitive pricing and local manufacturing, given local content requirements. The programme has been hailed a success in many parts of the world and implementation of the system has been recognised to encourage maximisation of dynamic returns of competition.

Bids are evaluated on their price competitiveness (70%) and a set of economic development/inclusivity criteria (30%). Economic development criteria are designed to advance government policies on socioeconomic development, such as job creation, procurement of locally manufactured inputs and community ownership of renewable energy project companies. Notably, to secure local participation, the project company must comprise 40% participation by a South African entity. The localisation requirements and the funding support from the Department of Trade and Industry (the dti) to local manufacturers have encouraged an important emerging industry in South Africa.
Further, projects that meet a set of minimum requirements (in terms of environmental, land, commercial, legal, economic development, financial and technical criteria) are selected as preferred bidders in the REIPPPP. Following this, various stakeholders, including the DoE, Nersa, Eskom, commercial banks, development finance institutions and IPPs work together to finalise the financial aspects of the project. Then PPAs between preferred bidders and Eskom are signed and underwritten by the National Treasury, which includes details about the terms on which the project company sells electricity to Eskom.

PPAs backed by Treasury greatly improved risk allocation, gave much-needed certainty to financiers and enabled lenders to provide financing on competitive terms to IPPs. Further, the REIPPPP is conducted in a transparent manner, providing detailed feedback to unsuccessful candidates to improve the quality of successive bids. Additionally, the private sector has played an important role in supporting the DoE to develop the PPAs and economic development criteria of the programme.

The positive impact of encouraging competition is seen in the falling tariffs for various sources of renewable energy in successive bidding rounds (table 5.1). In addition to increased competition, this was due to a combination of tariff caps imposed by the DoE, reduced price ceilings for wind and solar, increased experience of bidders in successive rounds, increased maturity of technologies and allocation of a capacity limit for each technology from round 2. The first four rounds of the programme were oversubscribed, revealing the interest in the programme. In total, over 100 projects have been selected, accounting for more than 6 300 megawatts (MW) of nominal generation capacity amounting to close to R200 billion.

<table>
<thead>
<tr>
<th>Technology</th>
<th>Round 1</th>
<th>Round 2</th>
<th>Round 3</th>
<th>Round 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Onshore wind</td>
<td>1.14</td>
<td>0.89</td>
<td>0.66</td>
<td>0.52</td>
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<tr>
<td>Concentrated solar power</td>
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<td>2.51</td>
<td>1.46</td>
<td>n/a</td>
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<tr>
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<td>1.65</td>
<td>0.88</td>
<td>0.66</td>
</tr>
<tr>
<td>Biomass</td>
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<td>n/a</td>
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<td>1.22</td>
</tr>
<tr>
<td>Landfill gas</td>
<td>n/a</td>
<td>n/a</td>
<td>0.84</td>
<td>n/a</td>
</tr>
<tr>
<td>Small hydro (≤10 MW)</td>
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<td>1.03</td>
<td>n/a</td>
<td>0.94</td>
</tr>
</tbody>
</table>

Source: Adapted from Montmasson-Clair, Moilwa and Ryan (2014)

The outcomes of the REIPPPP highlight the importance of proactively encouraging competitive rivalry between producers, as well as the state’s and the regulator’s roles in creating a framework conducive to this. This was a deliberate and coordinated strategy by relevant stakeholders to design the auction such that it introduced ‘synthetic competition’ through the scorecard method (see Ginsburg, 2009, on synthetic competition). Further, the REIPPPP is an excellent...
example of how multiple economic and social objectives can be incorporated into energy policy through appropriate structuring of bidding processes.

Freight rail and ports

The regulation of ports and freight rail (see Baloyi, 2014; TIPS, 2014a) shares much in common with electricity in that the provision is under an SOE which has been corporatised, and operates within a policy framework determined by a line department. There are also similarities in terms of the historic investment patterns which were oriented to heavy, mining and energy-intensive industry (Fine and Rustomjee, 1996). Rail infrastructure was also developed for grain farmers, with rail sidings linked to silos built for the agricultural cooperatives.

Transport infrastructure exhibits very substantial externality effects, however, given its network and partial public-good nature. This is why the state has constructed the transport infrastructure in almost all countries. The returns from the infrastructure investment are realised across the economy in the activity that is enabled and thus it is appropriate to finance the investments out of tax revenues.

In competition terms, elements of the transport infrastructure can be considered essential facilities as they cannot be easily replicated and access is required to provide a good or service. The provision of the infrastructure and the terms of access are therefore critical to participation in the economy by different groups and by location. In South Africa, excellent infrastructure was constructed for the prioritised groups under apartheid. To evaluate the regulatory framework and its implications for competition, it needs to be considered in light of the historical context. How has the regulatory framework taken the inherited structure into account and incorporated social returns and incentives for investment? Has it opened up opportunities for increased participation and, if so, how?

We specifically consider rail freight and ports, both of which form part of state-owned corporation Transnet. The evaluation is thus how the governance framework has impacted on the decisions of Transnet, including the resources at its disposal.

The 1996 Transport White Paper envisaged an intermodal transport system with a greater role for general rail freight and greater private participation in the system as a whole. It was based on the potential gains from a more diversified and open national economy. As such, it had to be understood in terms of the wider economic and industrial policy goals of the first democratic government.

At the same time, in 1996 the shift in fiscal policy signalled by the Growth, Employment and Redistribution strategy meant that funding was not made available for investment in transport infrastructure and, indeed, government investment in infrastructure overall was cut back sharply (Roberts, 2004). This was compounded by the pension fund deficit which Transnet had to cover on its own balance sheet for former employees of the South African Transport Services.

Over the last two decades, the outcome has been that general freight movements have shifted significantly away from rail to road. General freight prices
have been increased to levels which are above road freight charges (figure 5.2). Port charges (discussed below) have been far above international norms for general cargo. By comparison, the transport costs for primary commodities such as coal and iron ore remained relatively low. The outcomes have thus not been consistent with the objectives set out in 1996.

![Figure 5.2: Average revenue per tonne for freight rail and road, 2008–2015](source)

Transnet is responsible for setting rules on access, tariffs and investments. The state, as owner, monitors performance and sets objectives for Transnet, with this responsibility lying with the Department of Public Enterprises (DPE). The governance of Transnet as a state corporation is the responsibility of the Transnet board. The policy framework lies with the Department of Transport, and the widespread linkages of transport with economic activity mean there are substantial coordination challenges with, for example, industrial policy. The DPE sets objectives through the shareholder compact. These objectives can in principle be set with a view to the longer-term economic objectives, which would require careful specification and monitoring of non-financial measures of performance, alongside consideration of investment plans.

From the late 1990s the main objectives were focused on the financial performance of Transnet. Not surprisingly, this meant that the Transnet focus was not on investments which would yield returns in the future, through enabling new economic activity, and where the economic returns could not be captured by Transnet. Instead, the focus was on where revenues could be earned from the existing infrastructure. This implied that the focus on the mining sector was effectively increased, rather than being reoriented to more diversified economic activities. Upgrades and expansions to the coal and iron ore lines were made.

The historic investments in the existing coal and iron ore lines naturally made incremental expansions more financially profitable, in a simple path dependency effect. Cost-reflective tariffs further meant that historically privileged interests locked in their advantages as the costs of these lines were lower.
given the existing base and the volumes already being transported. Considering pricing and investment in a mature rail infrastructure, which simply needs to be maintained and upgraded, is different from the investment decisions for an industrialising economy where much of the infrastructure needs to be constructed with a view to the changing structure of the economy.

The apparent lack of coordination between the DPE and the Department of Transport, greater emphasis on short-term financial measures and lack of public finance for investment meant that governance and decision making were not consistent with the wider needs of economic development. For example, the proportion of citrus moved by rail fell from 80% in 2005 to 5% in 2013 (Baloyi, 2014, p. 31). Even grain has seen a substantial fall, from 90 to 30%. The one sector of manufacturing aside from heavy industries such as basic metals and basic chemicals that has seen growth is automotive. It also relies on local and international transport for inputs and finished vehicles. While there have been some improvements in transport of built-up models, automotive components (not contained in completely knocked-down packages) are not well catered for by rail freight.

With regard to the pricing of different cargoes at ports, a somewhat different picture emerges since 2009. This may be at least partly attributed to the establishment of a Ports Regulator.

Outcomes in the ports sector and the role of the regulator

South Africa’s geographic location and size means that access to efficient port infrastructure is of critical importance for growth. Approximately 96% of South Africa’s exports (by volume) are by sea, so the competitiveness of the country’s ports has a direct bearing on the competitiveness of its industrial and export activities. There have been concerns around the skewed pricing and high tariffs of South African ports, highlighted in recent government economic policy documents.

The ports infrastructure in South Africa is 100% state-owned through Transnet National Ports Authority (TNPA). The majority of port operations are run by Transnet Port Terminal (TPT). Until 2002, almost all infrastructure and services were provided by public sector entity Portnet, owned by Transnet. In 2002, the port infrastructure was separated from the services to form the National Ports Authority (NPA) and the South African Ports Operator, later renamed TPT, both continuing to be owned by Transnet.

As was the case with rail freight, port tariffs were used to improve the income of Transnet as a whole, cross-subsidising other activities. However, this had serious negative consequences on investments in port infrastructure and competitiveness of tariffs, and has been to the detriment of promoting industrial policy objectives. Tariffs in South Africa were higher than those internationally, efficiency levels lower and ports provided fewer and lower quality services. Further, the prices charged at the different ports within South Africa, for equity reasons, are fairly uniform despite their different locations, demand drivers and features. This limits competition between ports, as well as for services within ports, and reduces the incentive to invest in infrastructure and increase
productivity. Competition between ports remains weak, largely because TNPA is the only entity permitted to develop, manage and set tariffs for ports in South Africa. Intra-port competition is also low given the dominance of TPT in service provision, such as in cargo handling and for highly specialised terminals, and, in most instances, traffic volumes are insufficient to support more than one terminal of any type. Competition in container freight/handling is also weak.

Many of these problems stem from the conflict of interest in Transnet owning both the landlord company (NPA) and the company that is the main user of the ports (TPT). That conflict, linked to the approach of Transnet to use the profit generated by the ports operation to subsidise other operations in the group, led to underinvestment in port infrastructure, again highlighting the short-sighted outlook on developing facilities through investments.

In 2002, the gazetted National Commercial Ports Policy laid out the framework for the role of the different players in the sector, the challenges that needed to be addressed and the approach to regulation. The policy highlighted the strategic importance of ports in contributing to the growth and development of the South African economy and put forward key principles for effective ports regulation. The core of these was the need for the NPA, which was within Transnet, to be separated from Transnet and to be established as a new, independent state-owned corporate entity. This was to ensure that the ports operate in the best interests of the country, in line with the mandate spelt out in the legislative framework, rather than in the narrower, profit-maximising interests of Transnet. The NPA would then report to the DPE.

Recognising the complexity and financial implications for Transnet in setting up separate institutions, a National Ports Regulator was established in 2009 as an interim measure until the full separation could take place.

The Ports Regulator has made significant progress in reducing tariffs through changing tariff structures to different user groups. This it started implementing without a full staff complement or sophisticated pricing mechanisms. While the approach taken by the Ports Regulator in the initial years was to limit the tariff increases to below or at inflation levels, the 2013 tariff decision saw a significant reduction in key tariff lines. This is in contrast with the approach of the regulator in the electricity supply industry, where, although Nersa has tried to keep tariffs at cost-reflective levels, it has done little to change the pre-existing relative tariff structures to different user groups. The result is that historically prioritised industries are still favoured with regards to lower electricity pricing.

The Ports Regulator decreased the tariff on cargo dues in certain areas. For instance, container full export cargo dues were reduced by 43.2% and container full import cargo dues by 14.3% (TIPS, 2014a). It also undertook a tariff comparator study or benchmarking exercise in April 2012, called the Global Port Pricing Comparator Study, which revealed that the total general cargo tariffs at the ports of Durban and Cape Town were very high by world standards. For instance, TNPA charges US$275 000 for an average vessel, while the global average is US$150 000. The average cost per vessel call in Durban and Cape Town was around US$450 000 compared to around US$200 000 for Singapore. The study, which also looked at specific sectors, found that the tariffs for export
of primary commodities, mainly coal and iron ore, were well below the global average, while the tariffs on containers and automotive were significantly higher than the average (table 5.2). A specific study on the automotive sector in South Africa was undertaken by the regulator, comparing South African ports to 16 other ports. It found that Durban was considerably higher-cost than most of the others, even after rebates and discounts. This again highlights the historic bias towards certain industries, which is at odds with the present-day developmental agenda of the country.

Table 5.2 South Africa’s ports tariffs deviation from the global average, 2012

<table>
<thead>
<tr>
<th>Sector</th>
<th>Deviation from global average (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Containers (total ports authority pricing including cargo dues with rebates)</td>
<td>294</td>
</tr>
<tr>
<td>Containers (cargo dues with rebates)</td>
<td>721</td>
</tr>
<tr>
<td>Automotive sector (ports authority tariffs with rebates)</td>
<td>212</td>
</tr>
<tr>
<td>Automotive sector (cargo dues with rebates)</td>
<td>710</td>
</tr>
<tr>
<td>Coal (TNPA costs faced by cargo owners)</td>
<td>−50</td>
</tr>
<tr>
<td>Iron ore (TNPA costs faced by cargo owners)</td>
<td>−10</td>
</tr>
</tbody>
</table>

Source: TIPS (2014a) citing Ports Regulator of South Africa (2012, p. 6)

The Ports Regulator and the National Association of Automobile Manufacturers of South Africa engaged with each other regularly to find a solution to high port tariffs. The Association highlighted the significance of the automotive sector, which contributes 12–15% to South Africa’s manufacturing industry output and 6% to the country’s GDP (TIPS, 2014a). A reduction in the automotive manufacturing sector’s port charges would directly improve the export competitiveness of the automotive industry, in turn resulting in increased exports as well as the opportunity to secure contracts from within the global operations of their members. Improved port tariffs would therefore contribute to the economic development objectives of the country to create jobs and increase investment. The Ports Regulator continues to consider these submissions seriously. In the tariff year 2013/2014, it reduced the automotive tariff charges in the tariff book adjustments, with motor vehicles exported ‘on own wheel’ cargo dues reduced by 21.1%. Although tariffs need to reduce further to bring them closer to international levels, this is a positive movement towards aligning tariffs while taking into account government economic (and social) policy objectives. According to the Ports Regulator,

It is clear from the data that South African cargo owners and logistics operators face significantly higher infrastructure costs than the rest of the sample when using containers to move cargo. With the bulk of
South Africa’s manufactured goods arguably exported through containers is clearly contradictory to current industrial policy aiming to incentivise value addition, broadening of the manufacturing base and increasing manufactured exports. (TIPS, 2014a, citing Ports Regulator of South Africa, 2012, p. 9)

The revised pricing strategy has been in effect since 2015 and has enabled ongoing investments in the maintenance and extension of the South African ports system, ensuring cost recovery across all national ports. There is one basic rate for cargo dues for each different cargo handling type (i.e., containers, dry bulk, break bulk, liquid bulk, automotive), replacing the previous differentiation of cargo dues by commodity. Cargoes moving in large shiploads, such as dry bulks, continue to pay lower cargo dues per tonne than cargoes using smaller vessels such as general cargo ships. Further, deviations from the base rates for cargo dues were introduced in line with government priorities for promoting exports and beneficiation industries, but these reductions have been determined fairly arbitrarily. Beneficiation rebates have also been introduced, where lower tariffs are charged for exports produced through the beneficiation of South Africa’s natural resources. This is in line with the dti policy objective of increasing local value addition. TNPA’s beneficitation contributions for the metals sector are that iron ore, a raw material, would receive no rebate, while pig iron would receive a 10% discount, rolled steel and pipes a 60% discount, and structural steel, machinery and white goods an 80% discount. The broad principles of this pricing mechanism are set to continue in 2017, although situation-specific variations have been introduced, such as discounts on the cargo dues for maize for the first five million tonnes in 2016/2017, given the drought.20 These developments are due to dynamic and bold steps by the Ports Regulator to increase the competitiveness of South African ports and align pricing to support other industrial policy objectives. The regulator has achieved this in a short space of time and faced with substantial limitations in resources and regulatory capacity. Through relatively simple benchmarking exercises and proactive decisions, it has reduced tariffs and reversed past asymmetry in a short time period.

The issues in rail and ports are essentially the same and yet changes have been made in ports through the introduction of a regulator. However, lest this be interpreted simplistically as an argument for regulation, the ports case contrasts with electricity where the regulator has not adjusted the relative prices of heavy mineral processing and diversified industry to rectify the historical bias.

Another contrast, in the opposite direction, is that the REIPPPP example in electricity demonstrated the potential learning from opening up access, even while pursuing non-financial objectives. In ports, access to facilities could be widened. This is not only about private ownership – some of the terminals are private (such as for bulk chemicals) and have been bottlenecks undermining competitors. Separating different levels even while maintaining state ownership can change the incentives of managers (as was intended with the NPA and contemplated in the ISMO for electricity).
Telecoms

Telecommunications is often used as an example of where technology change means that what was once a natural monopoly (and in almost all countries state-owned, due to the need to invest in a fixed-line network) is no longer so. Mobile telephony is not subject to the same utility-type cost structure and provides an alternative to relying on the fixed-line network. It was even proposed that the need for regulation would wither as competition took root (Cave, 2006). South Africa has followed the orthodoxy in this regard with relatively light regulation of mobile telephony and an expectation that as this segment expanded, coupled with entry into fixed-line, competition would generate efficient economic outcomes.

Reflecting these prior beliefs, regulation has been focused on interconnection to ensure that newer participants can link with the existing networks so that their subscribers can make and receive calls with subscribers on other networks. However, the call termination rates were simply to be set between the parties subject to broad principles. There are also provisions for facilities leasing so that entrants can gain access to the facilities in existence but, similarly, the terms and mechanisms for this were not specified.

On the face of it, the issues appear to be quite different from those in transport and energy. After reviewing the outcomes and assessing the role of economic regulation and the links to competition, we point to areas of common concern. In particular, we argue that the South African experience of telecommunications regulation points to the need to regulate for increased competitive rivalry and participation in the economy, recognising the implications of the past state investment.

Outcomes in telecommunication

In terms of South Africa’s rankings in the information and communications technology (ICT) sector, the World Economic Forum’s Network Readiness Index ranked South Africa 65th out of 139 countries in 2016, while the International Telecommunications Union ICT Development Index ranked South Africa 88th out of 175 countries. These indices combine a number of measures but to a large extent these outcomes reflect relatively poor broadband coverage, speeds and pricing. The number of broadband internet subscribers is substantially below South Africa’s peers (figure 5.3). This could be attributed to the very unequal income distribution in South Africa. However, in terms of broadband speeds, South Africa has also been falling behind other BRICS countries, aside from India (figure 5.4). Prices for fixed broadband are also substantially higher in South Africa, and four times those in India (figure 5.5).

Mobile phone prices have also been relatively high, and above the Southern African Development Community (SADC) average until the reductions in prices from 2008 (Hawthorne, 2014a). There were larger reductions from 2010 onwards following the reductions in call termination (voluntary at first), with the largest reductions in 2013 following the imposition of lower call termination charges.
Figure 5.3 Fixed broadband internet subscribers per 100 people, 2015

Source: World Bank (n.d.)

Figure 5.4 South Africa’s broadband speeds compared to those in Brazil, China, India, Russia and Turkey


Note: Mbps = megabits per second
Regulation and competition in mobile telephony: Interconnection and call termination

South Africa appears to have relatively strong rivalry in mobile telephony, with four operators in 2014. And, there have been three operators for more than a decade following the entry of Cell C. Why then have South Africa’s mobile rates remained higher than in many other countries which have a similar number of competitors? Developments in recent years reveal the importance of strong regulatory action for smaller rivals to be effective competitors. It is well established in economic theory that a duopoly may well not mean vigorous competition, even without there being an explicit collusive agreement. In the case of mobile telephony, the historic South African model of two-year contracts and the obstacles to number portability meant subscribers were unlikely to switch, dampening price competition (ICN, 2006). Cell C’s entry was thus meant to be competitively significant.

The mobile-to-mobile call termination rates were originally set at R0.20/minute between Vodacom and MTN by their mutual agreement, when the mobile operators were licensed in 1993 (Hawthorne, 2014b; Knott-Craig, 2009). Prior to Cell C’s entry in 2001, however, the call termination rate had been increased to R1.19/minute for peak hours and R0.65/minute for off-peak. This effectively placed a floor under the price that Cell C could offer to attract subscribers, as with a small subscriber base a majority of the calls made by Cell C subscribers would be terminating on the networks of other operators. The call termination

Figure 5.5 Prices for fixed broadband, US$, 2014

Source: Analysis of ITU (2014)

Note: Mbps = megabits per second
charges reinforced network effects, as the charges are obviously not payable for on-net calls. When combined with the existing obstacles to switching, Cell C remained a marginal player with an insignificant impact. Competition did not work in terms of prices to consumers.

Regulation has an important role to play in understanding these outcomes. The interconnection guidelines of 1999, 2000 and 2002 under the Telecommunications Act required major operators to set their call termination rates at the long-run incremental cost of call termination (Aproskie, Hodge, Lipschitz and Sheik, 2008). But, MTN and Vodacom were not declared major operators by the Independent Communications Authority of South Africa (Icasa). Under Chapter 10 of the Electronic Communications Act (No. 36 of 2005) Icasa can, in general, regulate prices where markets are characterised by ineffective competition. It is also specifically empowered under section 41 to prescribe regulations for wholesale interconnection rates. After a public inquiry into interconnection in 2006 and 2007, Icasa decided it had to develop regulations for Chapter 10 before it could regulate interconnection. This effectively stalled the process until regulations were published in November 2010 to come into effect in March 2011. Icasa stipulated that MTN and Vodacom would charge call termination rates of R0.40/minute from 1 March 2013, while Cell C and Telkom Mobile could charge 10% more.

Actual call termination rates were reduced earlier than stipulated in the regulations. The Parliamentary Portfolio Committee on Communications held hearings in 2009 which led to reductions being agreed by the operators with the minister of communications, to reduce peak rates to R0.89/minute (McLeod, 2009). This political pressure then provided the base for Icasa’s subsequent regulations. While the agreed reductions in 2009 supported Cell C, in particular, in being a somewhat more effective competitor, reflected in increased subscribers and some competitive pressure on prices, the really big change in prices towards those at the lower end of SADC countries was only in 2013 (figure 5.6), after the Icasa regulation came into force.

Figure 5.6 Prepaid mobile prices, US$, 2011–2016

Source: Analysis based on data prepared by Research ICT Africa (n.d.)

Note: OECD = Organisation for Economic Cooperation and Development
Subsequent final regulations in 2014 lowered termination rates further and increased the asymmetry (figure 5.7). The new regulations also, however, lowered the rates that Cell C and Telkom Mobile are able to charge Vodacom and MTN, down from R0.44 to R0.31. Cell C subsequently objected to this (Paelo, 2015).

A number of lessons can be drawn from the South African experience over the past two decades. First, competition requires appropriate regulation. This includes incorporating principles related to addressing market power and the ability to enforce. Second, competition does not equate to the number of competitors and we cannot be complacent about technology changes meaning competition will blossom of its own accord, even while technical natural monopoly factors become less significant. Third, entrenched first movers can protect their advantages. This motivates for asymmetry in call termination between incumbents and entrants, although only for a relatively short time (Hawthorne, 2014b). In other words, regulation is required to change the rules of the game to foster effective competitive rivalry. Fourth, the de jure independence of institutions is less important than their mandate, powers and political support. In this case, the change appears closely linked to a shift in the balance of interests evident in the portfolio committee hearings. This is possibly linked to the interest of Telkom as a new mobile entrant. The change in call termination certainly contrasts with the developments in facilities leasing where Telkom is the incumbent.

**Figure 5.7** Reductions in call termination rates, 2010–2015

Source: Research ICT Africa. Lowest available retail prepaid voice prices (off-net, peak), 2010–2015 (data not available publicly)
Regulation and competition: Facilities leasing

If anything, the competition and regulation issues related to the position and market power of the fixed-line incumbent Telkom have been longer running than those of the mobile operators. They are also arguably more important as they underpin the poor ICT performance of the South African economy. There have been many reviews of these issues (e.g., Aproskie et al., 2008, Gillwald, Moyo and Stork, 2012; Makhaya and Roberts, 2003). The South African fixed-line telecommunications utility, Telkom, was incorporated in 1991 as an SOE governed by the Department of Posts and Telegraphs. The privatisation of Telkom was presented as a solution to attract investment and to assist a financially ailing SOE, through a 30% stake sold to a consortium (Thintana) comprising Malaysia Telecommunication and SBC Communications as ‘strategic equity partners’.

The privatisation of these entities coincided with the extension of Telkom’s monopoly in voice telephony for five years, from 1997 to 2002, justified by the imposition of universal service obligations. The monopoly period was also seen as necessary for Telkom to prepare itself for the onslaught of competition. Competition was effectively delayed by a further five years to 2007, due to various factors including a protracted licensing process (Horwitz and Currie, 2007). The Second National Operator, Neotel, was licensed in 2005, launched in August 2006 and commenced services in 2007.

As with the entrant into mobile telecommunications, the presence of a competitor to the incumbent did not realise apparently competitive outcomes. While the competition authorities have taken on a number of matters, these are ex post evaluations of past conduct and the rulings are many years after the conduct being complained of. They relate to conduct by Telkom which undermined downstream competition (see Hawthorne, 2014a; Makhaya and Roberts, 2014). One rationale for this conduct is to inhibit the growth of the upstream rival as downstream firms may support and provide custom to the upstream entrant.

Facilities leasing, on which we focus here, is a more direct challenge for an entrant. To address the incumbent’s position, regulators have developed means of separating the upstream and downstream divisions of vertically integrated upstream incumbents and have developed open access frameworks – local loop unbundling (LLU) – for third parties to make use of monopoly inputs. In South Africa, the facilities-leasing regulations under the telecommunications legislation are designed to ensure that new entrants are able to gain access to the existing facilities in order to build their own infrastructure linked into the existing infrastructure and thus to climb the ‘ladder of investment’ (Hawthorne, 2014a).

The Electronic Communications Act of 2005 makes provision for the leasing of Telkom’s facilities by other parties. However, Telkom declined to conclude an infrastructure-sharing agreement with Neotel, favouring a case-by-case approach to managing access. In 2007, a policy decision was taken to commence with LLU. According to the Ministerial Policy Directive of 2007, Icasa was given until November 2011 to publish LLU regulations. In 2010, Icasa issued regulations for general facilities leasing, but not for LLU. By 2011, Icasa had not instituted any significant steps to effect the orderly implementation of LLU,
save for issuing a discussion paper and holding public hearings into the matter. The discussion paper outlined various methodologies to effect the policy directive on LLU. Telkom raised various objections to this process. In its Findings Note, \textsuperscript{31} issued after its hearings on LLU, Icasa found that the obligation to lease facilities applies to all licensees providing electronic communications network services. The Findings Note also sets out a timetable for fixed-line LLU, with numerous steps including further industry consultation and engagement, a regulatory impact assessment on the costs and benefits of the various forms of LLU, followed by market reviews and the introduction of supplementary LLU regulations. The Department of Communications (DoC) set a deadline for Icasa to implement LLU by the end of 2011 but Icasa did not achieve this target and has not to date implemented LLU.

In the midst of this vacuum, in December 2011, Neotel made a request to Telkom to lease local loop infrastructure at two specific sites. Neotel framed this request under the provisions of the Electronic Communications Act. Telkom rejected this approach by Neotel on the basis that the regulatory framework envisages a separate process for LLU and, in any event, Neotel had not framed its request according to the provisions of the Act. Neotel’s subsequent complaint against Telkom\textsuperscript{32} was referred by Icasa to the Complaints and Compliance Committee (CCC).\textsuperscript{33} The CCC\textsuperscript{34} is a mechanism for resolving disputes. Alternatively, Icasa could impose a remedy unilaterally or negotiate with the parties to resolve a matter. The CCC issued an interim order that acknowledges that Neotel’s request is legally valid and holds that Telkom’s response to Neotel is inadequate. Thus Telkom has contravened Regulation 3(2) of the Act’s Facilities Leasing Regulations of 2010. However, as a matter of practicality, the CCC decided that it would be necessary for the LLU regulations to be in place to enable the leasing of copper infrastructure.\textsuperscript{35} The CCC instructed Icasa to develop terms and conditions consistent with Chapter 8 of the Act within a period of three months from its decision, which was taken on 18 May 2012.

The LLU process, and the dispute between Telkom and Neotel regarding the leasing of infrastructure, demonstrates the privileges of incumbency enjoyed by Telkom and the difficulties faced by an entrant in competing with such an incumbent. It also illustrates that the rules have not properly addressed the conduct they were meant to, while more attention needs to be paid to the way institutions work in practice.

The actions of the state as owner have been contradictory to its aims as a reformer and economic policy maker. Unlike with entities such as the transport and electricity parastatals, the government shareholding in Telkom is held by the DoC, which is also responsible for the policy framework. This compounds the conflict of objectives and adds to the inclination to retard the development of Icasa into a strong regulator. For example, Telkom’s long battle to keep competitors from offering voice services was assisted by DoC delays in providing clarity regarding the extent to which value-added services providers could also provide voice services.\textsuperscript{36}
Common lessons drawn: What is the role of competition in economic regulation?

The reviews of the different regulated industries expose both similarities and differences in the approach to regulation, particularly regarding consideration of competition principles in implementing regulatory rules. Important lessons from the interface between competition and regulation in these sectors can be drawn. These are useful for economic regulators in terms of learning from one another, for engagement between economic regulators and competition authorities, as well as for policy makers.

There are clear differences in regulator structure, capacity and experience, yet some of the most effective decisions which promoted increased participation have been made by relatively new regulators with very limited capacity.

In terms of structure, in electricity the fully integrated and corporatised SOE, Eskom, is regulated by independent regulator Nersa. In rail freight and ports there is also an integrated SOE but without an independent regulator until the recently established Ports Regulator. All operate within a policy framework determined by a line department. In telecommunications, the main operator has been privatised with a long-established regulator and enforcement actions by the competition authorities.

The industry reviews have shown that entrenched interests have frustrated investments in infrastructure that would have otherwise increased participation in line with government’s economic and social objectives. Favourable treatment of powerful industries and groupings such as mining and metal smelters (justified by short-term financial performance measures) has resulted in similarities in terms of the historic investment patterns which were oriented to these industries. Regulators in many instances have not taken into account diversified users’ needs.

An exception is in the renewable energy sector, where a proactive and coordinated approach by the state and the regulator in the REIPPPP led to introducing greater participation in electricity generation by IPPs, the benefits of which are evident in falling tariffs and encouraging local content. While there are also private operators in mobile telephony, the benefits of increased participation have not resulted in the desired outcomes. Entrenched market power of the incumbent has been protected historically and there is a need to regulate more for increased competitive rivalry and participation in the economy.

With regard to rail and ports, many of the problems of underinvestment need to be understood in terms of the wider fiscal framework and corporatisation of Transnet as owner, user and self-regulator of the infrastructure (until recently for ports), along with the governance exerted by the state as owner through the DPE. These factors are related to the practice of Transnet using the profit generated by the rail and ports operation to subsidise other operations in the group, and have led to underinvestment and inappropriate (and uncompetitive) pricing, especially for diversified container freight. Unlike with other entities, the government shareholding in Telkom is held by the DoC, which is also responsible for the policy framework. This compounds the conflict of objectives
and adds to the inclination to retard the development of Icasa into a strong regulator in the telecoms industry.

A lesson from this would be to separate regulators from their line departments. And although the interim Ports Regulator has still not seen a full separation of powers, the benefits of independent regulation in ports are seen in the significant progress made by the Ports Regulator in reducing tariffs through changing tariff structures to different user groups. This contrasts with the approach of the regulator in the electricity supply industry, where Nersa has done little to change the pre-existing relative tariff structures biased to historically favoured user groups.

Also markedly different are the different rates of reform in the sectors reviewed. Positive and pro-competitive outcomes were achieved much faster in renewable energy and in ports compared to rail and telecoms. Further, in the case of ports, this was done with limited capacity. Therefore, it is not necessarily about the capacity and experience of the regulator – effective decisions can be taken quickly with limited capacity.

What is also evident is that there is limited transfer of learning between the regulators from their respective failed or successful experiences. For instance, useful lessons from the auction system design of the renewable energy programme could potentially be adopted in other regulated industries. One way in which this transfer could be achieved is to consider merging the regulators into a single economic regulator, possibly including even the competition authorities.

It is apparent from the sector reviews that effective regulation is necessary to ensure that the competitive space remains open and to govern aspects such as access to critical infrastructure. Even in industries where scale economies would advocate that only one firm operate, regulation that is conducive to creating ‘synthetic competition’ by ensuring the participation of several competitors has shown positive outcomes in terms of the dynamic gains from rivalry.

Notes
1 All outputs from this project can be accessed at http://www.competition.org.za/regulatory-entities-capacity-building-project/.
2 The energy sector reviews (electricity and renewable energy) were undertaken by Trade and Industrial Policy Strategies (TIPS) on behalf of CCRED – das Nair, Montmasson-Clair and Ryan (2014) for electricity and Montmasson-Clair, Moiwa and Ryan (2014) on renewable energy. There was also a study of liquid fuel, which is not included in this chapter.
3 Transmission and distribution losses averaged 20% compared to the global average of 5%. Eskom was strapped for cash and debt coverage ratios were high. Below-cost tariffs significantly contributed to poor technical and financial performance (Eberhard and Gratwick, 2008).
4 Some of the many key stakeholders in the ESI include the departments of Energy, Public Enterprises, Environmental Affairs and Water Affairs; National Treasury; Nersa; Eskom; IPPs; the Energy Intensive Users Group of Southern Africa; the South African Local Government Association; the Association of Municipal Electricity Undertakings and municipalities.
5 Special/negotiated pricing agreements, where prices to the smelters were fixed in terms of international aluminium prices and exchange rates.

6 The ferrochrome smelter agreements were terminated, but certain of the BHP contracts are still in effect, even after its aluminium operations were sold off to South32.

7 General industrial customers pay Megaflex rates, which are also cheaper than what households pay, although not as favourable as what BHP Billiton pays.

8 There were also interruptability provisions in the contract with BHP that allowed Eskom to cut supply to the smelters when the grid was under stress, which was to the disadvantage of the smelters – pricing has to reflect this.

9 Valued at R340 billion, excluding capitalised borrowing costs. By 2018/2019, the programme will add 17.1 GW of capacity to the 2005 nominal generation capacity of 36.2 GW (Eskom, 2013).

10 While the ISMO Bill has been discussed and agreed on by the Portfolio Committee on Energy on two occasions at least, it was stalled in parliament, being removed from the National Assembly Order Paper twice, in June and November 2013 (Pressly, 2013).

11 The pricing methodology has historically been, and is currently, one of full cost recovery in principle. Nersa currently employs the mechanism of an MYPD method to set electricity prices. The MYPD is essentially a rate of return method of price regulation where price level is set to cover all costs and to allow a fair rate of return on the cost of capital.

12 Through the Municipal Fiscal Powers and Functions Act (No. 12 of 2007). Other legislation governing municipalities includes the Municipal Finance and Management Act and the Municipal Systems Act.

13 The international benchmark for distribution losses (as electricity moves through the network) is 3.5%. Distribution losses in South Africa’s best-run metros are significantly above the international benchmark. In 2011/2012 the most efficient municipality, eThekwini, achieved a distribution loss of 5% (National Treasury, 2011), whereas the two largest metros in South Africa, the City of Johannesburg and the City of Cape Town, achieved 11% and 9.3% respectively (National Treasury, 2011).

14 This section draws from TIPS (2014b).

15 Pilot National Cogeneration Programme, the Medium Term Power Purchase Programme and the Multisite Base-load Independent Power Producer Programme.

16 In fact, the DoE and Treasury considered that Nersa was acting beyond its mandate in being the custodian of this programme.

17 This section draws from TIPS (2014a).

18 The New Growth Path emphasises the need to have competitive pricing in ports and the Industrial Policy Action Plan states that high ports charges remain a significant constraint and a threat to the manufacturing industry and employment. The fact that South African ports’ charges are among the highest in the world is also highlighted in these documents.


20 Record of decision, Tariff Application by the National Ports Authority for the Tariff Years 2016/17–2018/19.

21 This section is drawn from Hawthorne (2014a).

22 The Independent Communications Authority of South Africa Act (No. 13 of 2000) provides for the establishment of the industry regulator, Icasa, as well as for the Complaints
Competition and regulation interface in South Africa

and Compliance Committee. The Electronic Communications Act and the Competition Act provide an economic regulation mandate to the competition authorities and Icasa in a number of areas, including interconnection and facilities leasing, spectrum management and universal service and access, and competition and price regulation.

Brazil, Russia, India, China, South Africa.

The rates were subsequently increased to R1.25 for peak hours by 2005 (Aproskie et al., 2008).

Cell C made an application to have Vodacom and MTN declared major operators but later withdrew it.

As per the Post Office Amendment Act (No. 85 of 1991). Before this, telecommunication services were provided by the Department.

SBC is an American company spun out of the AT&T stable.

By the end of the period of exclusivity, there was a net decline in fixed-line and internet penetration (see Makhaya and Roberts, 2003).

Tribunal case no. 11/CR/Feb04. See CCSA (2013) for the settlement of the second case.

These remained outstanding in February 2014.


Under s43(5)(c) of the Act.

The matter was heard on 16, 17 and 18 May 2012. Case no. 59/2011, Neotel (Pty) Ltd vs Telkom SA Ltd.

Established in terms of s17A of the Icasa Act of 2000 as amended.

In accordance with s(44)(3)(m) of the Act.

Only when Altech brought a case through the courts was it confirmed that under the Electronic Communications Act value-added network service providers can convert licences into individual electronic communication services and roll out their own networks, as there is no legal monopoly held by Telkom.

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