ARE LOWER PRICES AN ILLUSION OR

REALITY IN A DE-REGULATED MARKET?

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ABSTRACT

The South African energy market being a state-owned entity, has been solely managed by utility company Eskom, accounting for generating, transmitting and in other cases supplying and distributing of energy country wide.

With this in mind, the South African energy market has the prospect of embarking on deregulating the current energy market, allowing for both local and foreign investment, forming a more viable solution to the energy crisis at hand.

In light of this fact, this white paper intend to address the issue of a competitive energy market, and the consequent effect thereof.

THE CURRENT SOUTH AFRICAN ENERGY OUTLOOK

"Free Market Foundation (FMF) Energy Policy Unit (EPU)"

"President Zuma's call for a radical transformation in South Africa's energy sector, in his state of the nation address hit at the core of the country's energy catastrophe. Without energy the National Development Plan (NDP) and all plans for growth are dead in the water along with prospects for jobs. South Africa has an immediate and future energy crisis. We need a radical policy to secure affordable and reliable energy to solve the short-term emergency and the long-term supply to power essential GDP growth."

The National Development Plant (NDP) iterate that the economy urgently needs increased competition in electricity generation, that gas should be explored and new generation capacity should be divided between Eskom and Independent Power Producers (IPP).

"Economic growth and development through adequate investment in energy infrastructure and the provision of quality energy services that are competitively priced, reliable and efficient. Local production of energy technology will support job creation" extract ~ NDP pg. - 140

WHAT IS THE CONSEQUENCES IF SOUTH AFRICA CONTINUES WITH A REGULATED MARKET?

Extract – Eskom Company Website**:** ***"****Eskom Energy Generation Company has been at the heart of the South African Energy market, generating approximately 95% of the electricity used in South Africa and a significant 45% of the electricity used in Africa. Eskom generates, transmits and distributes electricity to industrial, mining, commercial, agricultural and residential customers and redistributors."* Many factors including 'load shedding', begs the question of authorities to devise more than one energy producer and transmission company. Therefore if no alternative to Eskom is established to enter the market and compete, the track record of Eskom will seemingly decline, resulting in South Africa relinquishing foreign trade investment opportunities. The consequences of continuing with a regulated market leads to increased theft, poor revenue collection and increased energy tariffs.

Rapid progress and partnerships must be established with IPPs, ensuring that the demand on the electricity grid is sustained. In the past, one out of every three South Africans had access to electricity. Currently, over 80 percent of the population has access to power. This rapid growth will impact the state-owned utility, resulting in poor domestic and commercial services, support and infrastructure. This alarming issue is evident in today's climate of vandalism and destruction of property by consumers experiencing high tariff increases and 'load shedding'.

***'Are Lower Prices an Illusion or Reality in a De-regulated Environment'*?**

In retrospect of telecommunication giant Telkom, being the only communications company for decades, and no competitors, drastic deregulation was required as the communication company could not sustain the demands of the market timeously. With the correct market competitors and stimulation, consumers now have a wide range of products and service providers to choose from, resulting in a more conclusive communication network and increased customer satisfaction, to mention a few.

Transparency concerns raised in the de-regulation of telecommunication company Telkom:

- How can consumers really check what a particular phone call costs?
- How many minutes they have actually used when the statement arrives more than 30 days later once it is long forgotten?
- What are set-up costs or kick-back rates – and what is breakage?

Similar type of transparency concerns could be posed to Eskom:

- How can Eskom provide key customer service across South Africa in an effective and conclusive manner?
- Transparency relating to costs involved with maintenance call outs, new installations, if we have no alternative exists for pricing comparison.

WHAT IS THE CONSEQUENCES IF SOUTH AFRICA MOVES TO A DE-REGULATED MARKET?

A reliable energy market, which is competitive in pricing and service delivery, will be one of the major driving factors for the success of the NDP. The average household will be able to choose between competitive energy suppliers, resulting in more manageable tariff increases. The consequent factors of a de-regulated market has far reaching beneficial impacting factors i.e. Increased revenue protection, job creation, sustainability and increased productivity.

Some noticeable benefits experienced by other countries positioned equally as South Africa:

Regulators will no longer be allowed to determine which firms will be given the privilege to serve consumers via exclusive franchising arrangements and other barriers to entry.

- Lower prices for residential consumers by empowering them to choose their electricity supplier.
- Direct competition posed by new firms entering the market, would also develop higher quality of service and innovation within the industry.
- Competition among firms will lead to organizations being more responsive to consumer demands.
- Deregulation means empowering the consumer with options and ultimately trust in the service product.
- Collectively, commercial consumers stand to benefit, especially small power consumers, a large percentage of overall monthly costs is allocated to utility bills, in particular electricity. The most cost-effective service provider will be chosen, within these smaller organizations, ensuring sustainability.

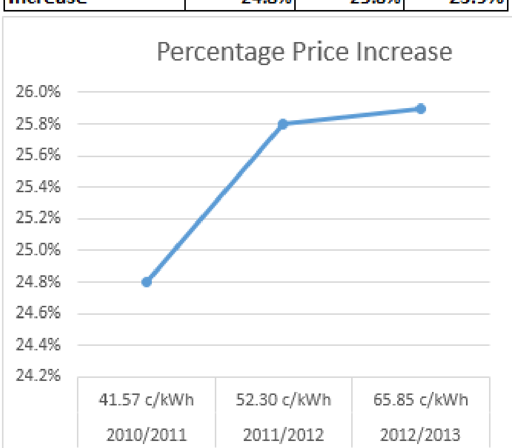
TARIFFS INCREASES IN SOUTH AFRICA

The cost of electricity will most definitely change, based on other use case studies across the world, the impact of deregulating the energy market results in most benefits realized. Tariff increases within a regulated market will always be a challenge, experienced by most countries.

"The 2012/13 tariffs are NERSA approved rates as per the 9 March 2012 NERSA decision on electricity tariff increases averaging 16% that is lower than the 25,9% originally approved by NERSA. The 2012/13 tariffs are effective on 1 April 2012 for non-local authorities and 1 July 2012 for local-authorities. "– Extract from Eskom Tariff Book 2012/13

Multi-year Price Determination (MYPD3):

Standard Average Price and percentage price increases	2010/2011	2011/2012	2012/2013
Standard Average price (c/kWh)	41.57 c/kWh	52.30 c/kWh	65.85 c/kWh
Percentage Price Increase	24.8%	25.8%	25.9%



Standard Average Price and percentage price increases	2010/2011	2011/2012	2012/2013
Standard Average price (c/kWh)	41.57 c/kWh	52.30 c/kWh	60.57 c/kWh
Percentage Price Increase	24.8%	25.8%	16%

Figure 1 - No Intervention (Proposed Increase)

Figure 2 - Government Intervention (New Increase)

The lower electricity price increases are the result of a combined effort by government and Eskom to lessen the impact of higher electricity tariffs on consumers and the economy in the short term without compromising Eskom's ability to keep the lights on and ensure its long-term goal for financial sustainability. If this has not occurred, the result would be that many South Africans will be faced with the reality of not being able to afford electricity.

In the permissible future, this type of intervention displayed by government, might be driven by clients, forcing Eskom or competing firms to lower or decrease tariff increases, largely attributed to competitiveness within a synergized market.

THE NEW ZEALAND DE-REGULATED CASE STUDY:

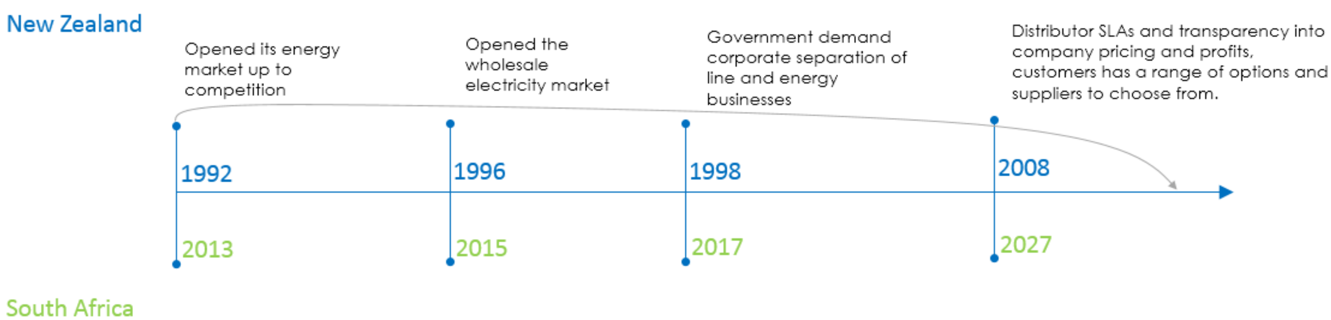
1992 – New Zealand officially opened its energy market up to competition – converted local power distributors into individual companies.

The driving factor and roots for New Zealand's deregulation trace back to the mid 1980's when concerns grew over the country's economy, the proposed way forward was the efficient management of resources and a more transparent market.
The government's Ministry of Energy ran New Zealand's electricity generation and transmission, pricing and investments driven by politics. Operations was plagued by inefficiencies and lack of consumer choice.

1996 – New Zealand opened the wholesale electricity market officially with a state-owned company Contact Energy, being in direct competition with Electricity Corporation of New Zealand.
This resulted in a major breakthrough with generators, purchasers and traders being able to set the market electricity prices.

1998 – Government demand corporate separation of line and energy businesses, preventing cross-subsidies and monopolies of local distribution networks.

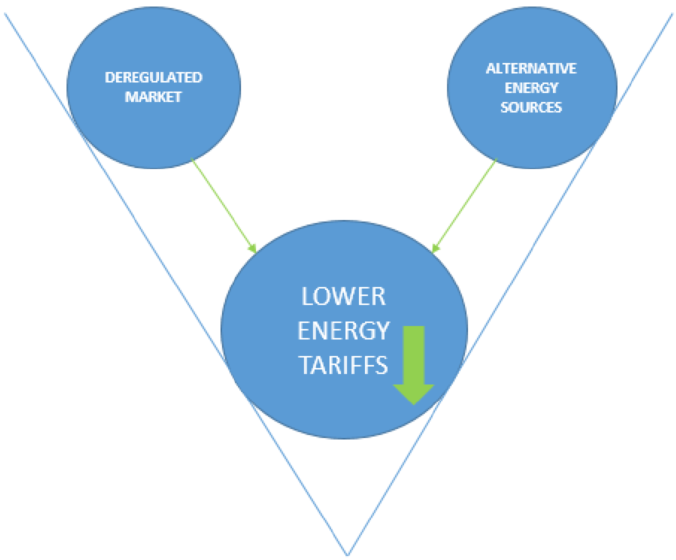
2008 – Ten years later, Distributor SLAs and transparency into company pricing and profits, customers has a range of options and suppliers to choose from.



Based on the above study and timeline, South Africa might meet the set target of the NDP for 2030, with the introduction of IPPs and alternative energy sources.

SUMMARY

South Africa as a country, requires some rigorous market transformation, ensuring longevity and growth. The introduction of IPPs and alternative energy sources will assist in driving down the cost of energy. The envisioned competitive market will bring about much innovation, and initiatives for saving or reducing energy usage. Paramount to reducing South Africa's carbon footprint is the introduction of alternative renewable energy sources.



A fully De-regulated market, supported with alternative sources of energy will be a driving force in lowering costs of electricity.

The De-regulation of the energy market similar to New Zealand, whereby sharing transmission lines or generating power for the same grid, will result in a competitive and resilient market for all parties involved.

This competitiveness as seen within New Zealand market will bring about the much needed makeover, and pricing will seemingly decline for previously regulated 'regular tariff increases'. Henceforth lower prices are not merely an illusion but in-fact a true manifestation as experienced by other countries in a De-regulated market.

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