POLICYBRIEF 2025

FINANCIAL AND FISCAL COMMISSION
For an Equitable Sharing of National Revenue

How policy shifts shaped South Africa's rail and electricity sectors

Introduction

South Africa's rail and electricity sectors are key enablers of economic activity. However, these industries are currently facing significant operational and financial challenges. This policy brief delves into the historical shift in responsibilities within South Africa's rail transport and electricity sectors. By examining this evolution, we aim to gain valuable insights into how the changing structure of ownership and management has coincided with the decline in both sectors' productivity. These insights can, in turn, help inform future policy decisions aimed at revitalising these sectors.

Evolution of the rail transport system

Established in 1860, rail experienced rapid expansion, fuelled by the discovery of minerals like gold and diamonds in the country. The established rail network has gone on to serve as an important means of transporting the nation's mineral wealth, coal and agricultural products for export, while serving as an affordable mode of transportation for the population, particularly low-income commuters.

1980s: A period of consolidation, state protection and road sector deregulation

Before the 20th century, railway lines were primarily built by private companies who were focused on mineral extraction and transportation. In 1910, the Union of South Africa was formed, leading to the establishment of the South African Railways and Harbours (SAR&H) administration. SAR&H combined the independent colonial railways into one national railway organisation. SAR&H had a dual mandate: to invest in and improve the country's rail and port infrastructure and services, and to use these improvements to unlock the country's agricultural and industrial potential. Although the entity was expected to be financially self-

THE FINANCIAL AND FISCAL COMMISSION

The Financial and Fiscal Commission is a body that makes recommendations and gives advice to organs of state on financial and fiscal matters. As an institution created in the Constitution of the Republic of South Africa, it is an independent juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997) (as amended) and relevant legislative prescripts. It may perform its functions on its own initiative or at the request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between national, provincial and local spheres of government. This relates to the equitable division of government revenue among three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly to both Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual national budget in February each year.

The Commission consists of commissioners appointed by the President: the Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government and two other persons. The Commission pledges its commitment to the betterment of South Africa and South Africans in the execution of its duties.

sufficient (by using its revenues to cover its costs), the government could provide funding for significant investments deemed strategically important for the nation, even if they would not generate immediate revenue.

According to the Roadmap for the Freight Logistics System of the South African Department of Transport (DoT), the nation's rail and port network boasted a turnover of R24 million upon the formation of the Union of South Africa. This figure accounted for 8 per cent of total gross domestic product (GDP) and surpassed the government's entire expenditure at the time.

Recognising the need for improved efficiency, the government mandated a business-oriented restructuring of SAR&H during the 1970s. In 1981, SAR&H was restructured into units and divisions and renamed the South African Transport Services (SATS). SATS remained under state control and continued to manage and operate both freight and passenger rail transport in the country.

At the same time that this consolidation was taking place, the growth of South Africa's rail transport sector (particularly freight) was being supported by heavy government intervention, which protected it against competition from other modes of transport. Freight rail transport benefitted from legislation (clause 127 of the Act of the Union of South Africa, 1909), which called for agricultural and industrial development to be supported by means of cheap transport. This resulted in cross-subsidisation, which led to low tariffs (and, as a result, low transport costs) on agricultural and mining products compared to industrial freight. The rail transport sector was also protected against competition from road transport through the regulation of long-distance road freight transport. Surveys undertaken estimate that between 170 and 184 million tonnes of freight was moved on the South African rail network between 1985 and 1990.

The 1986 De Villiers Commission report had a profound impact on the trajectory of South Africa's rail sector. It identified inefficiencies in the existing SATS model, particularly the practice of subsidising passenger services with freight profits. The report advocated for a more commercially focused approach, emphasising areas where rail held a natural cost advantage, primarily freight transportation. Significantly, the report recommended that SATS prioritise maximising existing assets rather than making new rail investments. This stemmed from the report's view that the sector was unprofitable and struggling to compete with other modes of transport. This contributed to the deterioration of the country's rail infrastructure, the under-utilisation of the network and inefficient operations.

Several years after the De Villiers report, in 1989, the road transport sector was deregulated. This facilitated a modal shift, with high-value, low-density freight migrating from rail to road. Passenger ridership exhibited a similar trend. This was further bolstered by the expansion of minibus taxi operations into informal settlements. This expansion was enabled by the promulgation of the Road Transport Act in 1977. This modal shift, as highlighted in research by the Department of Forestry, Fisheries and the Environment (DFFE), coincided with a decline in investment in rail infrastructure. Political instability during the waning years of apartheid, sanctions and war spending in the 1980s all played a role in constraining investment in South Africa's rail infrastructure.

1990s: Restructuring and the birth of state-owned entities

During the 1980s, a series of commercial reforms was undertaken that targeted rail. This culminated in the Legal Succession to the South African Transport Services Act of 1989, which created the mechanism to corporatise SATS. Corporatisation was aimed at curtailing political interference and enhancing business practices within the rail sector. Following eight decades of direct government control, SATS was transformed into a limited liability company named Transnet Limited (with the state as its sole shareholder). Transnet became a holding company for five unincorporated divisions, including Spoornet (rail). Spoornet would go on to be renamed Transnet Freight Rail (TFR) in 2007.

The corporatisation process further entailed the separation of passenger services from freight operations. Commuter rail services were entrusted to the newly formed South African Rail Commuter Corporation (SARCC). However, during the immediate post-legal succession period, Transnet continued to provide commuter services through a yearly management contract. To streamline operations, Transnet established a dedicated division, Metrorail.

Over time, resources were increasingly concentrated within this division. Towards the end of the initial five-year period following legal succession, a significant project was launched to formally isolate and transfer the division to the SARCC. Long-distance passenger services remained under Transnet's purview within a division called Mainline Passenger Services. The transfer of operations and rolling stock (coaches) to SARCC only occurred in 2008. In the same year, SARCC was renamed the Passenger Rail Agency of South Africa (PRASA). As a result, Metrorail and Mainline Passenger Services were consolidated into PRASA.

The 1980s witnessed a confluence of factors that ultimately led to a modal shift away from rail. The deregulation of the road transport sector, coupled with the expansion of taxi services and investments by the newly elected democratic government in building a world-class road network, presented increasingly attractive alternatives for both freight movement and commuter trips. Furthermore, the deregulation of the airline industry resulted in the emergence of affordable air travel, which dealt a blow to long-distance passenger journeys by rail.

Compounding these external pressures was a critical lack of investment in ageing rail infrastructure. This neglect hindered operational efficiency and reliability, further diminishing the competitiveness of rail transport. The consequences were stark. By 1993, an estimated 400 million tonnes of goods was being transported by road compared to only 175 million tonnes by rail. Passenger ridership mirrored this decline, with a 30 per cent drop in metropolitan rail journeys between 1980 and the mid-1990s. This represented a decrease from 710 million passenger journeys to 410 million.

2000s to the present: Addressing challenges through reform: Private sector participation and devolution

Years of a lack of long-term strategic direction, infrastructure neglect, management turmoil, infrastructure theft and vandalism, and alleged corruption have led to the precarious situation in which South Africa's rail transport sector finds itself in 2024. This toxic mix has resulted in a steep decline in the financial and operational performance of TFR (Transnet's largest division) and PRASA, and further loss of market share for rail transport.

TFR's total freight volumes (general freight business, export coal and export iron ore) have fallen from a peak of 226.6 million metric tonnes in 2014/15 to 149.5 million metric tonnes in 2022/23 due to operational challenges. Furthermore, the entity lost R37.6 billion in potential revenue in 2022/23, up from R6.4 billion in 2018/19. TFR's inability to generate sufficient revenues has resulted in Transnet's debt ballooning from R110 billion in 2015 to R130 billion in 2023. To help Transnet address its maturing debt and implement its turnaround plan, the government provided a R47 billion guarantee in December 2023. However, Transnet could only use a portion (R14 billion) until March 2024, specifically for debt repayment. This was to ensure that Transnet prioritised the immediate recovery efforts outlined in its turnaround plan and aligned this plan to the government's broader freight logistics strategy.

Transnet's turnaround plan seeks to return the company to profitability by the end of 2024/25. As part of this plan, TFR will be split into two new divisions : Transnet Freight Rail Operating Company (TFROC) and Transnet Rail Infrastructure Management (TRIM). In preparation for opening its network to third-party freight operators in the second half of 2024, TFR has established an interim Infrastructure Manager with a view to putting in place a permanent Infrastructure Manager by September 2024. According to Transnet, the interim Infrastructure Manager's objectives include maximising network utilisation, generating revenue through access fees that will fund network maintenance, and increasing the rail market, among others. On the other hand, TFROC will compete with private operators for slots on the network.

On the passenger rail front, Metrorail's number of paying passengers transported (trips) fell by 97 per cent between 2014/15 and 2022/23, from 516 million trips to 15.7 million. PRASA's fare revenue plummeted from R1.3 billion (in 2008/09) to R380.2 million (in 2022/23), a decline of over 70 per cent. This coincided with a troubling rise in operating expenses, which ballooned from R5.1 billion to R11.7 billion over the same period. As a result, PRASA has become increasingly reliant on government subsidies (in the form of an operational and capital subsidy) to stay afloat. This places a strain on the national fiscus.

South African passenger rail transport is expected to undergo a notable change with the DoT working to develop a National Devolution Strategy to guide the devolution of the passenger rail function from national to local government. This strategy document is expected to be completed by the end of 2024. Devolution is intended to address funding constraints, enhance competitiveness and bring about efficiencies in passenger rail services. A rail feasibility study, commissioned by the local government of the City of Cape Town, investigated the potential impacts of assuming control of the passenger rail service from PRASA. The study concluded that a fully restored and operational passenger rail system could generate cost savings totalling R81.1 billion for the city and its residents over a 20-year period. The primary areas of cost reduction would be in vehicle operating costs, encompassing fuel and maintenance expenses, and congestion time cost savings. These findings highlight the potential economic benefits of devolving passenger rail services to capable local authorities.

Evolution of the electricity supply network

1970s-1980s: A constrained operating environment

Escom was established by several industrialists and the South African government in 1923. The name was an acronym for the Electricity Supply Commission. By the 1970s and early 1980s, the utility was undergoing economic reforms. This was largely due to the growing isolation the country was facing due to the imposed sanctions against the apartheid government. During this period, the country saw an increase in anti-apartheid movements and a growth in neoliberalism. This led to decreased investment and government funding.

Prior to this, Escom had built a fleet of coal-fired power stations, and the forecasted demand for electricity was overstated, with the utility having excess capacity. However, during this period, the utility encountered financial constraints and struggled to raise financing internationally due to the imposed sanctions. Escom was forced to borrow locally at higher interest rates, resulting in significant electricity price increases. In the early 1980s, the power utility borrowed a significant amount of money due to the high gold prices. When the price of gold fell, Escom was left with substantial debt, which led to the crisis of 1985. The De Villiers Commission was established in 1983. It recommended a two-tier governance structure, i.e. an electricity council and a management board. The Commission also recommended scrapping the public interest clause, as it would allow the parastatal to operate commercially. The recommendation led to the Electricity Act of 1987, which repealed the public interest clause and led to the rebranding of the utility from Escom to Eskom, a combination of Escom and the Afrikaans name of the utility (Evkom). These changes led to the commercialisation of Eskom and the utility taking responsibility for its profits and losses. To achieve the aim of commercialisation, the utility used market mechanisms to achieve cheaper electricity, while the utility reduced expenditure. This was achieved by ceasing investment in new power stations and reducing the staff complement from 66 000 employees in 1985 to 46 000 employees in 1991. The utility also closed its old power stations. With this commercialisation, the utility opted to be a corporation instead of privatisation. Eskom operated as a commercial company with its own strategic goals, and operated away from the government.

1990s: Electrifying a nation

In 1991, the power utility launched the Electricity for All campaign. By 1992, 260 projects were planned to expand township electricity access. The success of these campaigns can be quantified by the statistics for the period 1994–1999, in which 80 per cent of urban households and 46 per cent of rural households had access to electricity. During the late 1980s and early 1990s, the growth in new electricity demand was largely due to increased household consumption. The post-apartheid government aided the campaign through its 1994 and 2001 policies of the National Electrification Programme. Between 1991 and 2014, 4.3 million households were electrified, of which 2.8 million were electrified between 1991 and 2001.

In addition to the domestic growth in demand for electricity, the power utility expanded its operation in Africa to generate revenue. Eskom reintegrated the Cahora Bassa Project in Mozambique and developed capacity through the West African Corridor. The power utility exported electricity to Namibia and hydropower from the Congo River.

The White Paper on Energy was published in 1998. It highlighted several issues the government would encounter. Emanating from the White Paper was a new proposed structure for the utility, which included the unbundling of Eskom, the privatisation

of the utility and the agreement with and generation capacity of independent power producers (IPPs). The report envisaged a multi-market model electricity market framework with Eskom producing 70 per cent of existing generation and 10 per cent of the utility being black owned. The recommendation of privatisation was met with opposition from the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP). In 2001, the African National Congress (ANC) government opted to avoid the recommendation of privatisation, but instead opted for the utility to become a state-owned entity and compete in the free market. Many of the recommendations made in the White Paper were set aside. For instance, the government decided to delay investment in generation capacity until the separation of entities had been completed. Thus, despite the warnings and recommendations made in the 1998 White Paper on Energy, no immediate action was taken to increase capacity.

2000s: Conversion to a state-owned entity and declining financial sustainability

After the Eskom Conversion Act of 2001, Eskom became a state-owned entity (SOE). The Act weakened the utility by stripping away its autonomy and ability to provide cheap electricity. The newly formed SOE retained its coal-fired power stations, but reduced the number of engineers at the utility. At this time, the nature of the board changed. The utility no longer conformed to the two-tier governance structure. This rendered the electricity council obsolete. Despite these changes, in 2001, the utility received the Global Power Company of the Year Award. In 2003, the power utility was still generating substantial amounts of energy, with the country's demand for energy consumption per capita being almost double the global average.

This was the start of the utility's woes. Researchers and analysts have cited several reasons for the issues that were experienced, such as corruption, financial mismanagement and poor-quality coal. Eskom was profitable before the electricity crisis (between 1995 and 2006). During this period, the utility achieved a net profit margin of 12.2 per cent. This was significantly higher than the 7.8 per cent average of non-financial corporations. In 2007/08, the electricity reserve margin fell to below 6 per cent. This led to the utility implementing rolling blackouts to manage the electricity demand. After 2007, the utility saw a decrease in its net profit margin, averaging 4 per cent, compared to non-financial corporations' 9 per cent average for the same period. The utility also experienced losses between 2007 and 2009.

Due to Eskom's supply constraints, various measures have been put in place over several years to reduce energy demand, including higher tariffs during peak hours, the introduction of light-emitting diode (LED) lighting, and encouraging the use of energy-efficient appliances, geyser management initiatives and timers, to mitigate demand during times of supply constraints. Since 2000, Eskom's generation capacity has declined, reaching below 80 per cent in 2014. Annually, the utility has been forced to implement demand management initiatives to reduce demand for effective sales.

When energy shortages started to hit crisis levels, Eskom commissioned the building of Medupi and Kusile, two coal-fired power plants with a gross capacity of around 4 800 MW. The combined output would constitute 25 per cent of the country's total power generation capacity. The original intention was for Eskom to fund 53 per cent of Medupi through equity funding. The government also provided a government guarantee of R176 billion to enable Eskom to raise debt. By 2010, R117 billion had already been committed. The delays brought about by Medupi and Kusile have not only cost the government in terms of the escalation of costs, but also in the loss of potential sales and broader economic benefits from the potential loss of investment and losses in manufacturing and production capacity, among others, as the energy crisis persists.

In 2010, Eskom had a credit rating of BBB+, indicating that the company had adequate capacity to meet its financial commitments, but was more subject to adverse economic conditions. In 2015, the Standard & Poor (S&P) rating agency downgraded Eskom's long-term credit rating to BB+. The new grading falls within a non-investment grade, a speculative-grade category. BB+ grading is seen as obligor-rated. BB is less vulnerable in the near term than other lower-rated obligors. However, it faces major uncertainties and exposure to adverse business, financial or economic conditions, which could lead to the obligor's inadequate capacity to meet its financial commitments. In 2018, the rating agencies further downgraded Eskom to CCC+ grade. The reason provided was due to the negative outlook and the fact that the utility had raised R30 billion in short-term funding. In 2023, S&P Global announced upgrading Eskom's rating from CCC+ to B due to the government's support package.

Conclusion

This policy brief highlights the historical evolution of South Africa's rail transport and electricity industries, particularly the conditions that led to the current operating and financial environment of Transnet, PRASA and Eskom. These entities are riddled with issues of weak fiscal governance, dependence on the national fiscus and an inability to operate sustainably. While the SOE model aimed for improved efficiency and service delivery, the complexities of governance and other external factors have led to a decline in the performance of the SOEs

Previous research by the Commission[1] supported the establishment of a centralised holding company that was capable of exercising strict control over debt and capital expenditure plans. There have been substantial changes to the SOEs' governance structures, which led to the issues they currently face. The Commission has recommended that significant reforms are needed for these SOEs to operate efficiently and effectively.

These include interventions to minimise institutional corruption, mismanagement and governance failures. To this end, the Commission welcomes several reforms that have been implemented to address the challenges faced by the three SOEs, most notably the development of the National State Enterprises Bill, which aims to establish a state-owned holding company (SOHC) with the overall objective of promoting the long-term commercial sustainability of the holding company and its subsidiaries.

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[1] See Chapter 2 of the FFC's Annual Submission for the 2024/25 Division of Revenue.