Watts happening in the GNU? Tensions over access to affordable electricity tariff's goal of the 1998 White Paper on Energy

Hon. NQ Mvana

19 September 2024

The dominant market position of Eskom and the constant regulatory intervention by the National Energy Regulator of South Africa (NERSA) to control electricity prices has always caused political tension between parties that are trying to defend the electricity market from politically motivated interference by the state and those that wish to retain state regulation and control over the electricity market.

Parties that support a 'free electricity market' raise an unjustifiable concern that the escalating electricity tariffs, in addition to the proposed 36.15 per cent tariff increase for the 2025/26 financial year, reflect the existence of very high levels of inefficiencies in the electricity market, implying that both Eskom and NERSA are at best imprecise and at worst spectacular failures of state intervention.

Contrary to what is commonly believed amongst parties that support a 'free electricity market', the current revenue-based methodology, commonly known as the Multi-Year Price Determination (MYPD) methodology and its embedded Regulatory Clearing Account (RCA), was in fact a good methodology to determine Eskom's revenue allowance when it was introduced, given the stage of development in which Eskom and the electricity market were at the time.

More crucially, the MYPD methodology is framed by the postures informing the Electricity Regulation Act and the Electricity Pricing Policy. Or, better, put, the Electricity Regulation Act and the Electricity Pricing Policy provide the rationale for the MYPD methodology and in turn, Eskom and NERSA use this methodology as the main source of their legitimacy. The implication here is that policymaking rather than Eskom and NERSA accounts for the escalating electricity tariffs, thereby necessitating the need to amend and review the Electricity Regulation Act and the Electricity Pricing Policy.

In short, despite the many distortions, NERSA has the technical competence and analytical capacity to regulate electricity tariffs that are economically desirable and, alas, economically desirable electricity tariffs at lower levels are politically impossible to deliver due to the policy misalignments that require extensive and requisite reforms.

Certainly, NERSA can rectify the escalating electricity tariffs, but it is unable to do so for several reasons.

The first reason is that the MYPD methodology falsely presumes that NERSA has control over the two components of revenue, namely price and costs and, hence, NERSA can effectively guarantee Eskom revenue allowance based on setting the average electricity tariff by dividing allowed revenues, largely determined by Eskom's declared costs, with the forecasted sales. Whilst NERSA uses a Return on Asset (ROA) formula to determine what Eskom can claim for costs to run coal-fired power stations and Open Cycle Gas Turbines (OCGTs) into the future, for example, NERSA has no control over Eskom's sales.

A neat illustration of this is Eskom's sales volumes that have been inconstant, declining from 218 120Gigawatt-Hour (GWh) in 2006/07 financial year to 191 852GWh in 2020/21 period. Unfortunately, when volumes sales decline and therefore are not achieved at the guaranteed price, then Eskom's revenue allowance will also not be recovered.

Aside from declining volumes sales, Eskom's anticipated revenue allowance is unrealistically collectable due to the escalating municipal arrear debt which has reached uncomfortably high levels, resulting in a revenue shortfall to cover Eskom's planned expenditures and current operating challenges.

Henceforth, NERSA is compelled to fulfil its promised revenue allowance by allowing Eskom to recover R8 billion through its Regulatory Clearing Account for the 2021/22 financial year, thereby translating into a 4 per cent electricity tariff increase which can be recovered during the 2025/26 financial year or in the future. NERSA's failure to fulfil Eskom's promised revenue allowance often triggers the national utility to approach the courts for relief since the development of the MYPD methodology is not aligned with the status of the law or binding to courts.

The second reason is that the MYPD methodology lumps together utility costs across the generation, transmission, and distribution value chains to determine Eskom's revenue allowance which is then divided by the forecasted volumes sales to set an average electricity tariff. This averaging of costs inherent in the MYPD methodology is inconsistent with the actual costs incurred by Eskom and thereby limits the social benefits of electricity use and undermines the policy intention of affordable access to electricity since the MYPD methodology socialises all costs, resulting in average electricity tariffs that are too high for poor and working-class households. Not surprisingly, the MYPD methodology not only sends incorrect tariff signals to Eskom's end-users, but also falls short in providing stable electricity tariffs.

Whilst the failings of the MYPD methodology result in inefficiencies, it is prudent to acknowledge that NERSA plays a useful role in ensuring that Eskom's approved electricity tariffs reward performance rather than installed capacity.

Contrary to what is typically suggested, Eskom's current approved and proposed electricity tariffs for the 2025/26, 2026/27, and 2027/28 financial years disincentivize utility inefficiencies and therefore do not create a fiscal drain on poor and working-class households' income. Eskom inefficiencies are not passed down to poor and working-class households, but rather are frequently covered by the government to prevent the utility from becoming insolvent.

The Eskom Debt Relief Act, 2023, which provides relief of R254 billion towards Eskom's debt servicing costs is a case in point.

Energy studies analysing the escalating electricity tariffs confirm that the operation of the electricity distribution value chain undermines the government's goals of energy justice and affordable access to electricity. In short, the electricity distribution value chain is the final arbiter of who is included and excluded from electricity. The bottom line is that municipal tariffs are much higher relative to Eskom tariffs, meaning that end-users serviced by municipalities pay more compared to those serviced directly by Eskom. In short, municipal tariffs reproduce rather than redress energy poverty since distribution at the municipal level rests on several fundamentally flawed propositions.

For example, whilst Eskom increases its electricity tariffs from 1st April, it can only increase tariffs to municipalities from 1st July due to the requirements of the Municipal Finance Management Act (MFMA). In turn, this time lag leads to an under-recovery by Eskom from sales to municipalities, which requires a higher bulk tariff increase to municipalities since the outstanding revenue must be recovered within a 9- instead of a 12-month period.

Consequently, the cycle of rising municipal tariffs ensues, thereby creating incentives for customers to default on their payments. The costs of default are not shared equally throughout the society. For example, the variance between Eskom's actual and forecasted revenue allowance has led to several instances where the paying customers subsidize non-paying customers by paying higher than usual electricity tariffs.

In sum, whilst the ANC sympathizes with popular resentments against electricity tariff increases and is committed to finding useful solutions to this crisis, the party does not advocate for political interference and, hence, will not exert any pressure on NERSA as an independent and competent Regulator. Moreover, parties in Parliament like the DA must refrain from indirectly lobbying NERSA as this may be particularly risky as we do not want the electricity industry which is being reformed to be too weak and too prone to be captured by vested interests.

Thank you.