



Public Hearings on the Electricity Distribution Industry: Portfolio Committee on Energy

25 July 2012

For an Equitable Sharing of National Revenue

OUTLINE OF THE PRESENTATION

1. Infrastructure and economic growth
2. Status quo and future plans within the electricity sector
3. Cross-subsidisation by municipalities
4. Electricity distribution: challenges and implications of current situation
5. Lessons from previous restructuring attempt
6. Recommendations for the way forward

1. INTRODUCTION

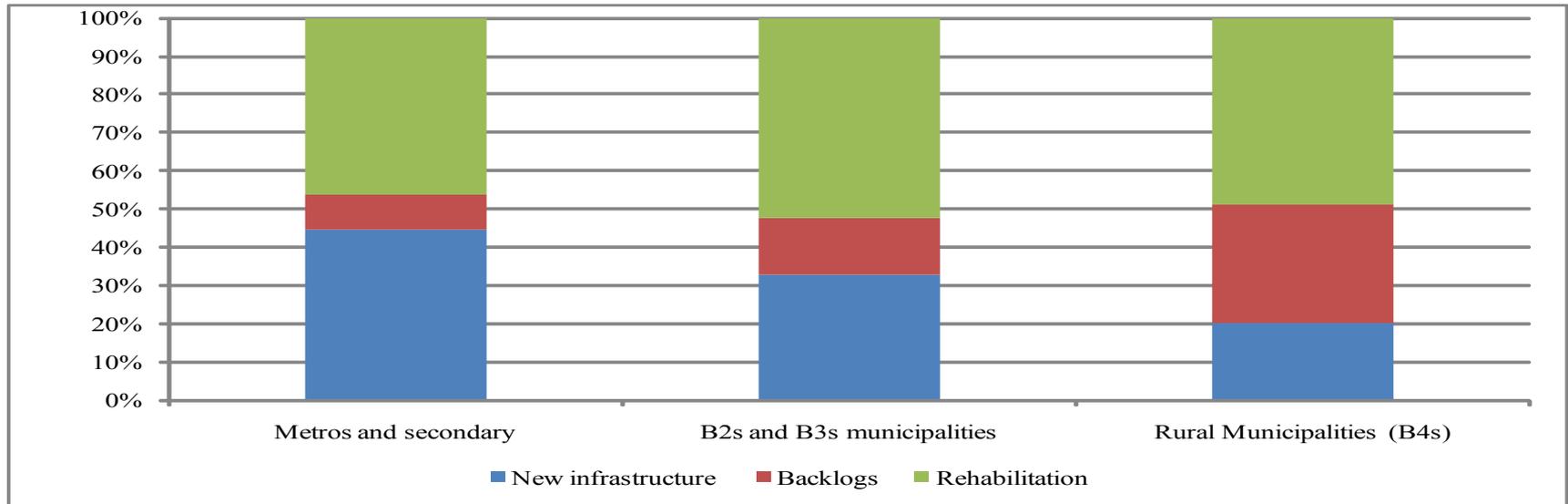
- Infrastructure and potential for growth
 - FFC recommendations for 2009 division of revenue
 - Equally important is maintaining and rehabilitating existing/new infrastructure to ensure sustainable service delivery
 - Critical given commitments on infrastructure made in the 2012 State of the Nation Address
- Challenges of spending on infrastructure in South Africa are driven by among other things
 - Significant backlogs
 - Inadequate funding of and underspending on capital budgets
 - Low spending on repairs and maintenance
 - Generally low technical capacity (e.g. engineers) to guide implementation of infrastructure projects

1. INTRODUCTION (CONT.)

•A 2009 World Bank study on municipal infrastructure finance, estimates that for the local government sphere to adequately meet its infrastructure investment needs it will require R500 billion over the next 10 years

- R180 billion for new infrastructure
- R80 billion for backlogs
- R240 billion for rehabilitation

Municipal Infrastructure Investment Requirement Over the Next 10 Year (as at 2009)



2. STATUS QUO WITHIN ELECTRICITY SECTOR



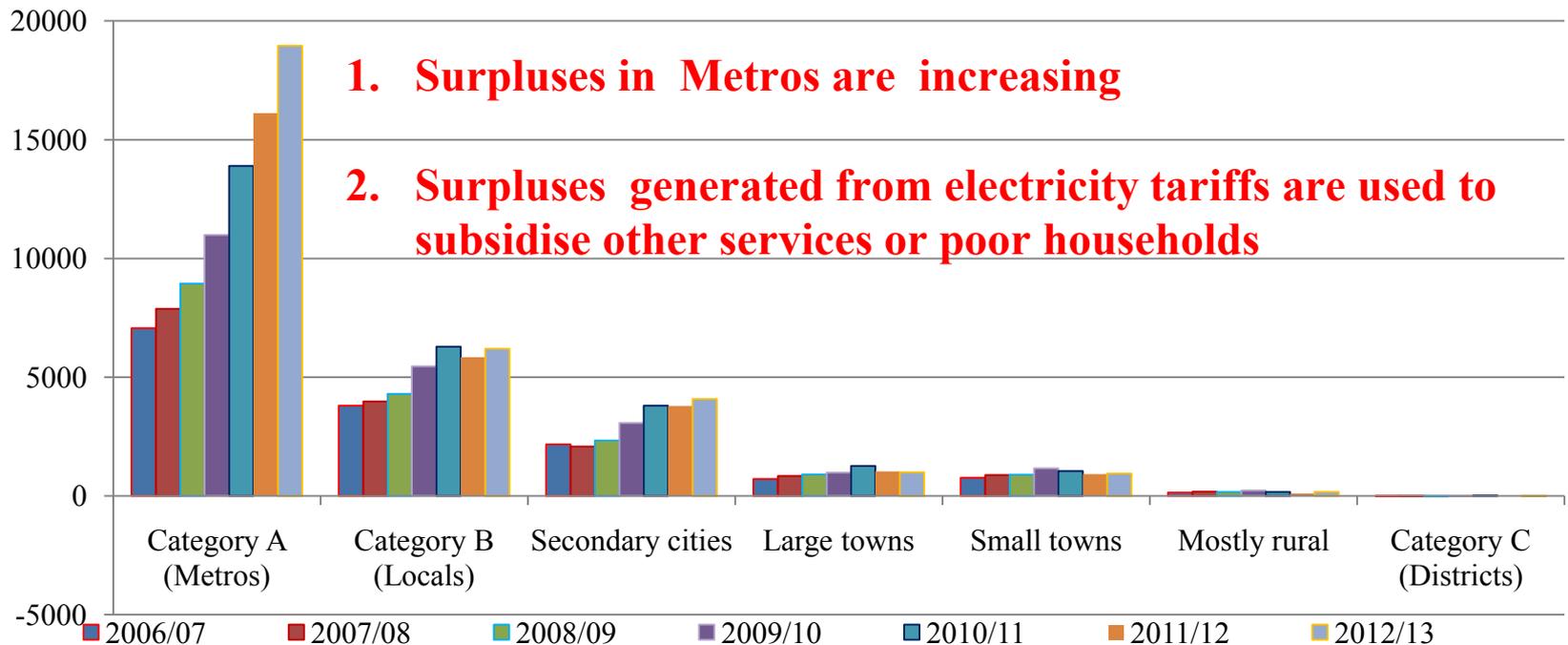
- Generation: Satisfactory condition, can reasonably meet current demand although major capital investment in new infrastructure is needed to ensure demand can be met over next five years. Risks include ageing infrastructure, new project completion and coal supply
- Transmission: Satisfactory condition, can meet current demand, major capital investment required to meet needs over next five years
- Distribution: Inadequate operations and maintenance capacity, shortage of skilled personnel, infrastructure is ageing and/or overloaded. Lack of capacity to meet demand. Big risk is impact on the national economy if significant investment are not made

2. FUTURE PLANS WITHIN ELECTRICITY SECTOR

- Plans as per Government's Integrated Resource Plan (IRP) :
 - Averting the risk of power shortages while increasing energy supply and efficiency to support the needs of a growing economy in the longer term;
 - Ensuring affordable energy to support inclusive development;
 - Addressing local environmental threats related to energy use, notably those related to air pollution and human health
- With respect to infrastructure plans over the long term, the IRP notes the intention to :
 - Deploy new nuclear capacity, renewable energy capacity, expand regional agreements to expand hydroelectric power and increase substitution of unconventional and imported natural gas for coal
- Positive development - shift from sole focus on access to electricity to access to energy (alternative green power sources) as well

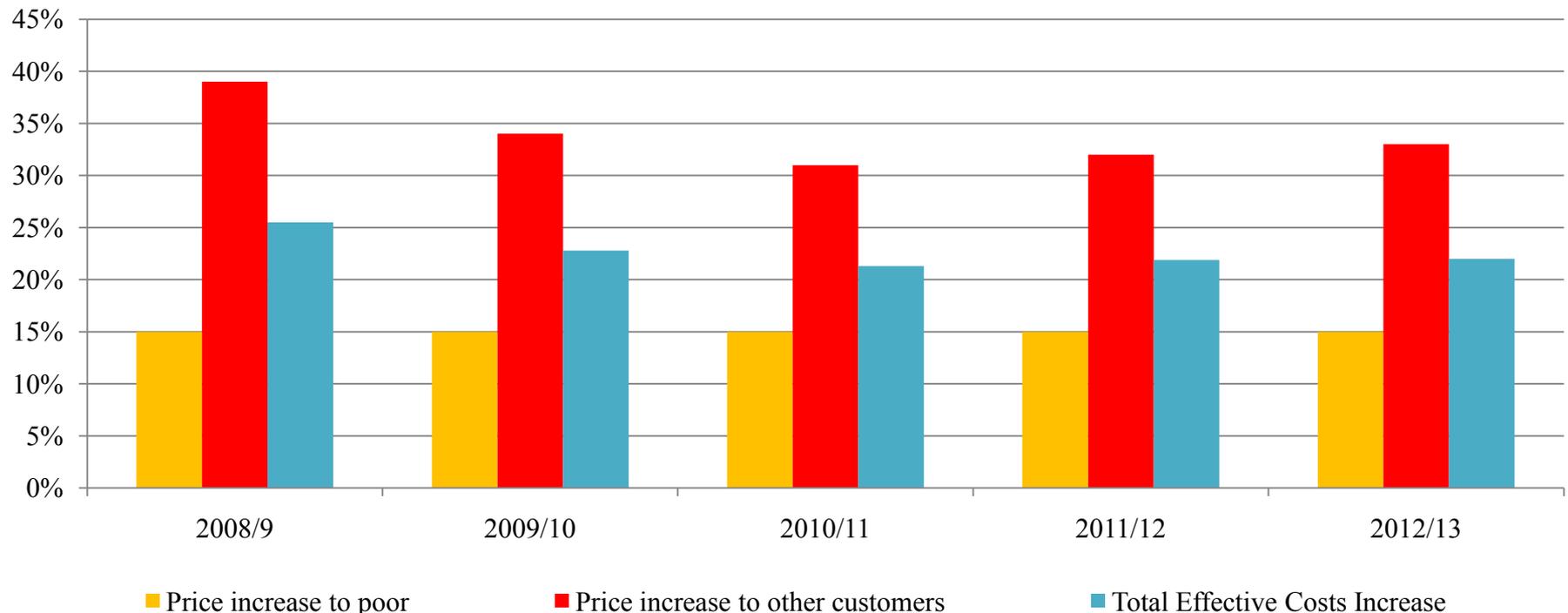
3. SURPLUSES AND CROSS-SUBSIDISATION

- Many municipalities make surpluses from electricity
 - Surpluses used to cross subsidise other services (Inter service cross subsidisation)
 - Within electricity poor consumers are subsidised by well to do ones



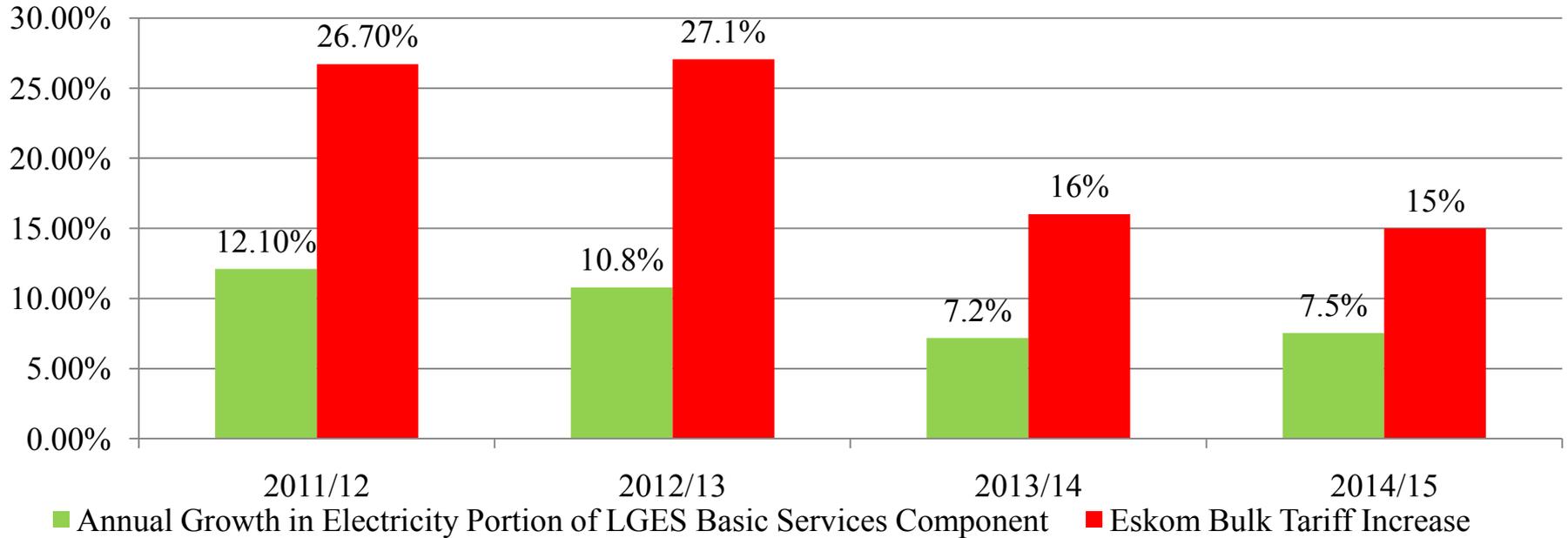
3. INTER AND INTRA CROSS-SUBSIDISATION (CONT.)

- Price increases are another indicator of cross subsidisation across household groups
- Price increase for high income people are high and for poor increases are stable year on year at a maximum of 15%



Source: FFC calculations based on National Treasury data

3. EFFECT OF ADMINISTERED PRICES



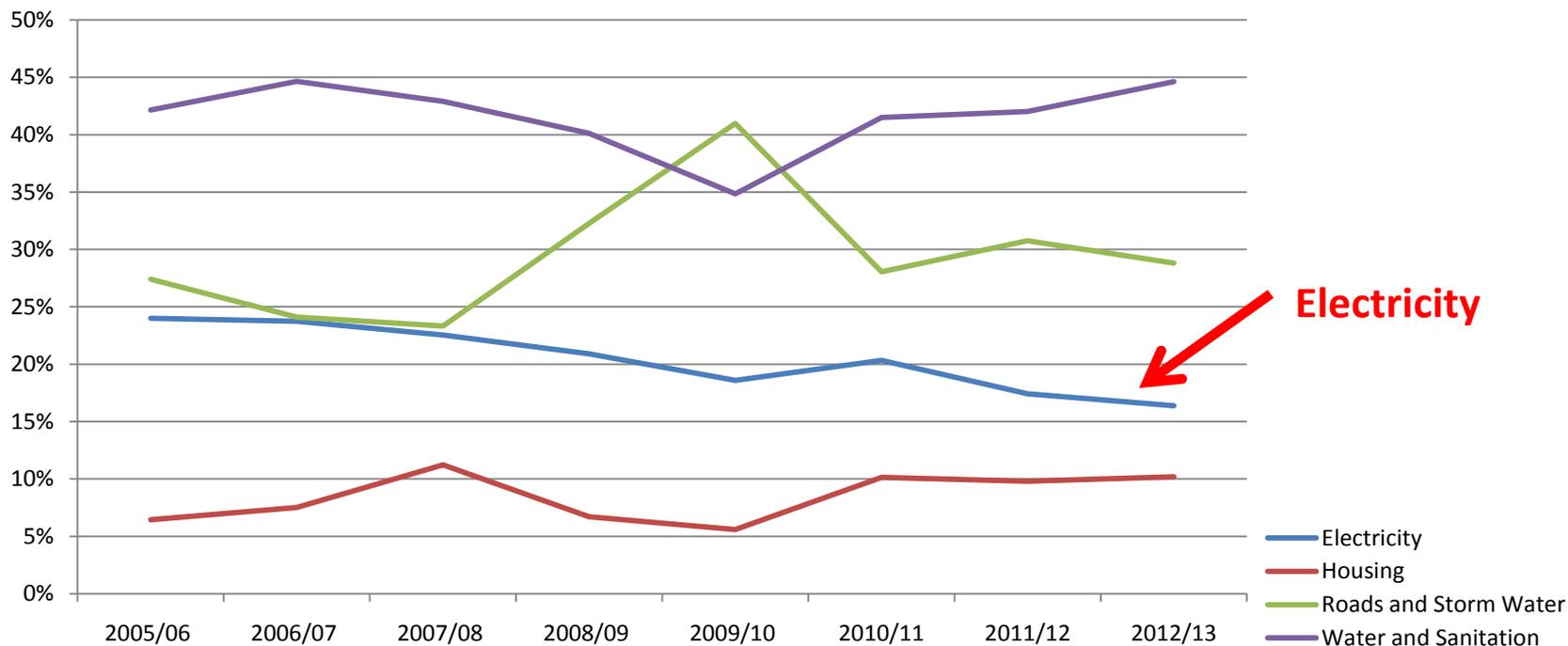
Source: FFC calculations based on National Treasury data

- Government to work with the National Energy Regulator (NERSA), and other critical stakeholders to develop an effective financing framework

4. THE CHALLENGE WITH ELECTRICITY DISTRIBUTION INDUSTRY

- Estimated that backlogs grow by R1.6 billion per annum (2011 Infrastructure Report Card, SAICE)
 - Municipalities not increasing portion of budgets dedicated to repairs and maintenance and refurbishment
 - Monitoring of maintenance and refurbishment expenditure on electricity challenging due to lack of disaggregation in budget formats etc
 - Is current approach to funding repairs and maintenance appropriate?
 - Presently municipalities fund repairs and maintenance from their operating budgets
 - Limited resources in the face of significant non-payment
 - Historically tariffs not cost-reflective (NT, 2011) - move by NERSA to encourage more accurate costing of tariffs in line with Section 74 of Municipal Systems Act
 - Policy uncertainty as a result of unresolved restructuring process

4. ACTUAL CAPITAL EXPENDITURE BY SECTOR, 2003/04-2012/13 (REAL)



Source: FFC calculations based on National Treasury data

- Figure highlights declining investment in electricity relative to other sectors

4. IMPLICATIONS OF THE CURRENT SITUATION

- Compromised service delivery
- Higher subsequent repair costs places strain on public finances
- Distorted linkages in the economy: impacts on productivity and profitability of companies
- Contributes to increased backlogs
- Stalled EDI restructuring process creates policy uncertainty, thus affecting investment in the sector
- Impact of generation issues on distribution side
- Demand management including use of alternative green sources

5. PREVIOUS ATTEMPT TO RESTRUCTURE EDI

- Restructuring process initiated during the late nineties
- Aimed to establish six wall to wall regional electricity distributors (REDs) that would take over assets and functions from Eskom and municipal distributors
- Significant financial and human capital resources dedicated to this – EDI Holdings set up in 2003, 17th Constitutional Amendment proposed in 2009
 - Cabinet decision to discontinue the reform process in December 2010
 - No indication of an alternative
 - Restructuring remains an outstanding issue

5. LESSONS FROM PREVIOUS EDI REFORM ATTEMPT

- Reform should not be piecemeal but should address the entire electricity value chain (generation, transmission and distribution)
 - White Paper on Energy envisaged a two-pronged, all-encompassing reform process of the electricity sector focussed on EDI and the electricity supply industry
- Address root causes of the challenge
 - Poor performance may be as a result of ill defined mandates, poor regulation (is NERSA adequately fulfilling its role?), lack of funding (especially repairs and maintenance), poor managerial skills and leadership capacity (lack of capacity a well documented challenge especially with respect to municipal distributors)
- Differentiated reform approach that recognises variances in performance of individual electricity distributors to be considered



– Not all municipal distributors perform poorly

– Further research needed on capacity of municipalities, costs involved etc

5. LESSONS FROM PREVIOUS EDI REFORM ATTEMPT (CONT.)

- Take municipalities on board from the start
 - Electricity distribution is listed as a municipal function in the Constitution, however Municipal Systems Act (Sections 82 and 87) allows for responsibility for service delivery to be delegated to another party
 - Ensure that revenue of municipalities is not compromised as it is used to cross-subsidise delivery of other municipal services
 - If approach is to delegate distribution to a third party, careful consideration should be given to ability/capacity of municipalities to conduct adequate oversight over activities.
- This is critical in ensuring that social objectives are

maintained

5. VIABILITY OF AGENTISATION

- Does a good business case exist for outsourcing to an agency?
 - Proper lines of accountability should be defined at the start of the process
 - How will it work in practice - how will agency interact with municipality and sector department?
- Weigh potential benefits and risks
 - Perhaps outsourcing brings better skills/management, but one of the risks relates to the increase in transaction costs for the consumer – i.e. Presently municipalities provide a one stop shop with respect to basic services for residents, investors, developers
 - If electricity distribution is taken away from municipalities, we risk ability to ensure integrated service delivery – consumers will have to deal with different service providers for different services

6. RECOMMENDATIONS

FFC Recommendations on EDI and Electricity Demand Management

(Submission for DoR 2011/12 and 2012/13)

- Government should
 - Revisit the Blue Print assumptions initially made to restructure the EDI, specifically regarding whether it is necessary to change ownership and structure in order to ensure efficiency, economies of scale, robust regulations and to deal with management challenges in the sector
 - Conduct an up-to-date re-evaluation and analysis of the costs and benefits of restructuring the EDI
 - Finalise legislation and practical guidelines around restructuring prior to moving towards more advanced stages of restructuring
 - Universal access to electricity should not be lost in EDI restructuring process – to be coupled with strong emphasis on demand side management and greener technologies
 - Any restructuring embarked upon should take a differentiated approach
- Metro's and high capacity municipalities relative to those municipalities that are not able to effectively deliver - consider establishment of multi-jurisdictional service utilities

6. RECOMMENDATIONS

FFC Recommendations on EDI and Electricity Demand Management (Submission for DoR 2011/12 and 2012/13)

- Balance maximising potential benefits associated with outsourcing with minimising attendant risks
 - If outsourcing/use of an agency is the preferred route, it is critical to link this to the capability and capacity of parent municipality and NERSA, as the regulator, to effectively conduct oversight
- Government should consider a performance-based conditional grant which rewards or incentivises actions that are energy efficient
 - Specific focus areas for this grant should include:
 - Efficient energy management practices, including minimisation of electricity losses (unaccounted for electricity), elimination of illegal connections and energy savings by households and industry
 - Grant to support new technologies and other innovations that will ensure efficient energy utilization
 - Grant to support implementation of green procurement principles

6. RECOMMENDATIONS (CONT.)

- Municipalities should prioritise development of maintenance plans, maintenance management system and production of maintenance reports. Municipalities are not doing so, FFC analysis shows that spending on this item is less than 5% of operational expenditure (FFC, 2011/12)
 - More focus should be directed towards preventative maintenance
- Development of asset registers as required in terms of Section 63 of MFMA should be enforced
- Government should develop norms on minimum acceptable maintenance levels
 - Mechanisms should be put in place to monitor cost of, and municipal spending on, maintenance by sector

6. RECOMMENDATIONS

- Government should consider an alternative/innovative approach to funding repairs and maintenance
 - Rehabilitation fund (once off)? Ring fenced funding (can not be a permanent solution)?
 - Development and implementation of models for life-cycle costing of infrastructure (operational and rehabilitation) to be emphasised
 - FFC is conducting research on this matter in its current research cycle
- Government should work with NERSA to put in place a financing framework that deals effectively with electricity pricing
 - There is a need to ensure sustainable price increases that do not lead to high levels of non-payment

6. GOING FORWARD

- Commission would welcome opportunity to be part of the process going forward and commenting on restructuring option selected
- In the Commission's view, a comprehensive plan to restructure the EDI will incorporate the following aspects:
 - Clear understanding of what exactly is status quo within municipalities – do municipalities want the distribution function, costs involved in restructuring, lessons learned from previous reform attempt
 - Clarity regarding accountability of service authority versus service provider
 - Revenue distribution (where will funding flow from/to)
 - Implementation (how will transfer of assets/liabilities be dealt with)
 - Incentives for demand management and for diversifying access to alternative green sources of energy



THANK YOU.

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