# POLICY BRIEF 2025

FINANCIAL AND FISCAL COMMISSION

For an Equitable Sharing of National Revenue

# Electricity tariff process

## Executive Summary

Eskom is a public utility and the primary electricity supplier. It is wholly owned by the South African government. The power utility also operates several notable power stations and Africa's only nuclear power plant. Eskom is divided into generation, transmission and distribution divisions. Together, these divisions generate approximately 90 per cent of the electricity used in South Africa and 40 per cent of that used in Africa. Eskom currently generates, transmits and distributes a large percentage of electricity. Local authorities carry out the balance of the distribution operation.

The policy brief provides an overview of the electricity industry in South Africa and the tariff application process for Eskom and local authorities. Tariffs are predetermined rates used to determine how much money one owes for a service. For example, the money one owes on one's municipal bill is calculated using predetermined tariffs and principles. The ultimate aim of setting an appropriate tariff is for the revenue that is generated to fully cover the cost of the service, while ensuring that services remain affordable for consumers. The energy industry in South Africa is regulated by the National Energy Regulator of South Africa (NERSA), which is responsible for setting the tariffs for Eskom and for municipalities. Therefore, it is important to understand the process that Eskom and the municipalities need to follow annually to have their tariffs approved for the upcoming financial year.

## Overview of the electricity industry

The South African electricity supply industry can be characterised as a vertically integrated utility. It is defined as an organisation that engages in multiple activities along a single supply chain, resulting in a monopoly. Given the dominance of coal-fired power generation in the country, Eskom is a vertical monopoly. Since South African electricity production is still predominantly from coal, Eskom profoundly impacts market behaviour.

## 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.

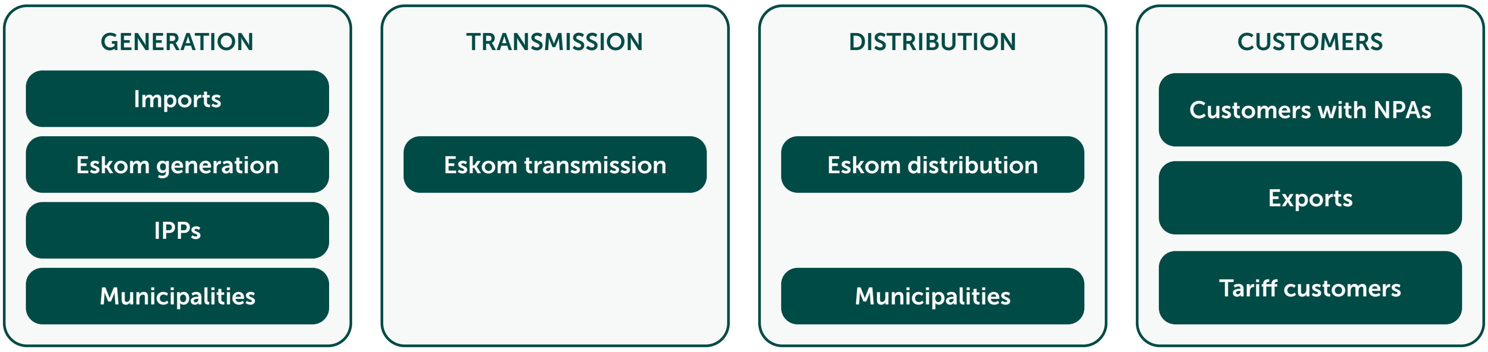
The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between national, provincial and local spheres of government. This relates to the equitable division of government revenue among three spheres of government and to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

Eskom is an electricity giant globally, producing approximately 40 per cent of the electricity on the African continent.[1] Figure 1 illustrates the electricity supply industry in South Africa, It shows that Eskom is responsible for all three phases of the electricity cycle. Eskom directly supplies several categories of consumers, and sells electricity to municipalities for distribution to customers. Aside from self-generation, Eskom buys electricity from independent power producers (IPPs) under various power purchasing agreements and imports from various generating facilities outside the country.

***Figure 1. Structure of the South African electricity industry***

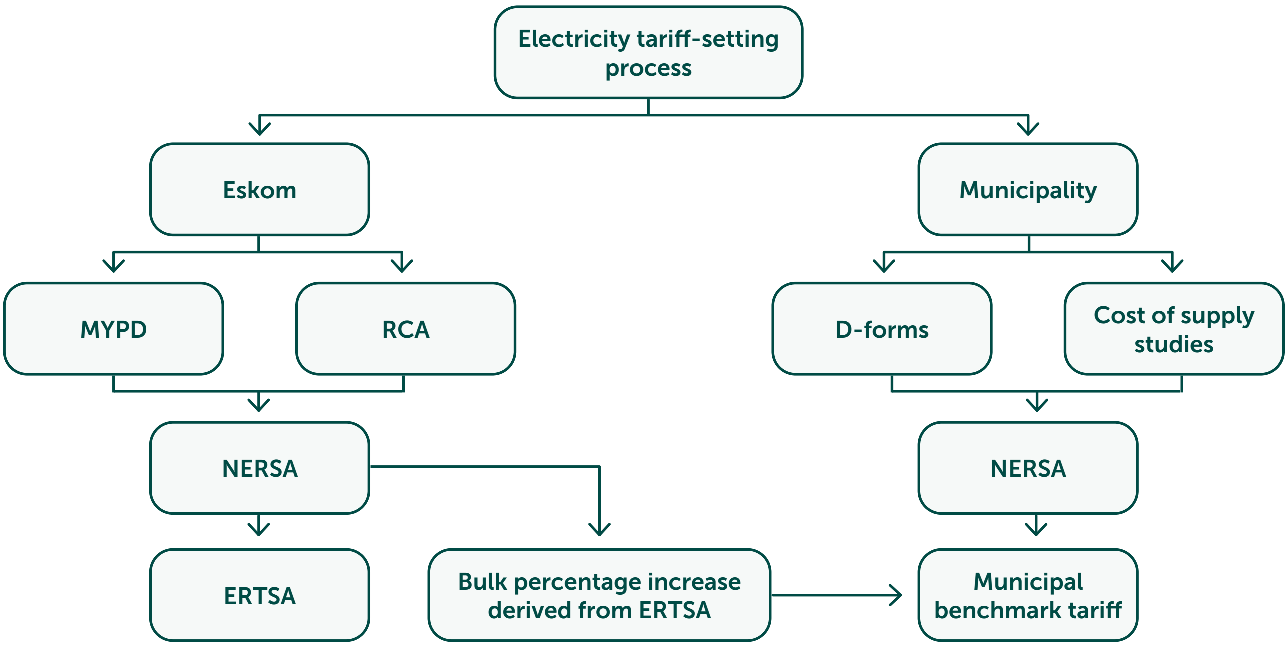



*Source: Department of Public Enterprises, 2019*

## Electricity tariff-setting process

NERSA regulates the South African electricity industry and is responsible for the tariff process of Eskom and the municipalities. The NERSA-approved municipal tariff-setting process is known as the municipal benchmark, and the tariff increase for municipal customers is implemented at the start of the municipal year, i.e. 1 July. The Eskom annual tariff increase is known as the Eskom Retail Tariff Structural Adjustment (ERTSA). The price increases apply to all Eskom customers, effective from 1 April. Figure 2 explains Eskom's tariff-setting process and the dependency of the municipal benchmark tariff process on the ERTSA.

***Figure 2. Electricity tariff-setting process***




*Source: Author's own compilation*

1 https://www.thegwpf.org/content/uploads/2020/06/Decline-Fall-Eskom.pdf

The left-hand side of Figure 2 explains Eskom's tariff-setting process. Eskom's tariff application submitted for consideration by NERSA is a two-pronged process: the proposed tariff increase for the Medium-term Revenue and Expenditure Framework (MTREF), which is the Multi-year Price Determination (MYPD), and the clawback of lost revenue, which is the Regulatory Clearing Account (RCA). The first part of the process involves calculating the MYPD. This is the revenue and cost prediction for the upcoming year. Eskom has three business activities: generation, transmission and distribution.

The calculation of the MYPD is based on the application of section 15(1) of the Electricity Regulations Act of 2006, which states that the tariffs should recover the full-service cost, including a reasonable return margin. To ensure that this section's aim is achieved, NERSA developed a methodology based on the rate of return and incentives for efficient performance. The tariff methodology developed by the Regulator ensures that each of the three business activities generates sufficient revenue to cover its expenditure requirements.

The second part of the tariff process involves calculating the RCA. This is a mechanism to monitor and track certain uncontrollable costs and revenue assumptions made in the MYPD calculations, compared to Eskom's actual costs and revenues. The RCA is a process that applies at the end of each financial year. It is a means to reconcile the variances retrospectively. The RCA process is two-fold: Eskom must first identify and compile the RCA balances, which must be submitted to NERSA. Once NERSA receives the RCA application, the Regulator reviews, approves and adjusts the tariff accordingly. The addition or overestimation will be added to the MYPD to determine the ERTSA for the upcoming financial year.

As is the case with Eskom, the Energy Regulator also sets the municipal tariffs. Municipalities must submit their financial information annually. They must either submit their revenue requirements via the municipal d-forms or complete a cost-of-supply (CoS) study. The Electricity Pricing Policy (EPP) requires municipalities to submit a CoS study once every five years. However, since 2021, NERSA has promoted the annual submission of CoS studies. The information is used to determine the total expenses used in the weighted average cost of capital (WACC) formula that is used to determine the municipal benchmark tariff. Each factor of the WACC contribution is calculated by the annual contribution as a percentage of total expenditure. The weighted increase depends on the Consumer Price Index (CPI), the bulk increase and the municipal wage agreement. The percentage bulk increase depends on the ERTSA. However, it is not the total increase applicable to Eskom customers. Given the three-month difference between the financial year of Eskom and the municipalities, the ERTSA is adjusted annually to accommodate the lag. The adjusted bulk increase is the percentage increase for bulk purchases. This is the largest input factor of the guideline determination process.

## Conclusion

This policy brief provides a brief overview of the electricity industry and the electricity tariff-setting process of Eskom and the municipalities. The Electricity Act of 1987 repealed the public interest clause, leading to Eskom's commercialisation. This resulted in Eskom taking responsibility for generating its own profit and losses. The RCA methodology allows the power utility to claw back lost revenue from consumers in the future, which contradicts the view of Eskom's commercialisation. It provides the power utility with a safeguard that, should it not generate sufficient revenue, it does not bear the burden of its failure.

## References

Department of Public Enterprise (DPE). 2019. Roadmap for Eskom in a reformed electricity supply industry.

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