MINERALS COUNCIL
SOUTH AFRICA

15 April 2023

Via Email: daarends@parliament.gov.za

The Secretary

Standing Committee on Appropriations

National Assembly

Attention: Mr D Arends

MINERALS COUNCIL'S COMMENTS ON THE 2023 ESKOM DEBT RELIEF BILL (THE BILL)

Thank you for inviting stakeholders to comment on the above-captioned subject.

The Minerals Council South Africa represents more than 90% of South Africa's mining production by value and represents an industry that is both a significant supplier of primary energy for electricity generation (>90%) but is also a large consumer of electricity (15% of total, >30% if smelters and refineries are included).

The mining sector directly contributes 7.5% to gross domestic product (GDP), however, this more than doubles when the mining supplier industries, plus the downstream industries that use mining outputs are included. In 2022, the mining sector employed 459 982 people, which is 4,1% of private non-agricultural employment. It contributed R75.8 billion to fixed investment, making up 11.8% of private sector fixed investment. In recent years the high commodity price has ensured that mining's contribution to corporate tax ranges from R90 billion to R120 billion per fiscal year. Exports amounted to R914.5 billion, which represents 47% of South Africa's total merchandise export earnings.

We would welcome an opportunity to present our position to the Standing Committee on Appropriations scheduled for Wednesday, 26 April 2023.

MINERALS COUNCIL OF SOUTH AFRICA

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BACKGROUND

For more than 15 years, since 2007, the SA economy has been growing less than population growth meaning that the standard of living of a majority of South Africans has been declining chiefly on account of inadequate electricity and double-digit tariff escalations. Instead of getting better, the situation has gotten worse because of government's refusal to completely liberalise the energy supply industry (ESI). Eskom continues to operate as a virtual monopoly. This has resulted in SA not taking full advantage of the most recent commodity boom which was driven by pent-up demand resulting from the COVID pandemic.

INTRODUCTION

Four indicators relating to Eskom's balance sheet make it clear that the state utility's finances are in a precarious position. Three of these point to the extent to which Eskom relies on government support and debt while the other shows the state utility's inability to collect revenues. The table on the left, extracted from Eskom's Integrated Report (31 March 2022) shows the measures the electricity giant has committed to in order to increase revenue and bolster its balance sheets. The right-hand-side table is actual government support in billions of rands per year.

IMPROVE THE INCOME STATEMENT
Pursue cost-reflective tariffs
Achieve sustainable cost curtailment measures

STRENGTHEN THE BALANCE SHEET
Obtain Government support
Reduce reliance on debt
Manage arrear debt
Dispose of non-core assets

Government support	R billion
2023	21.9
2024	21.0
2025	22.0
2026	23.0
Total	**87.9**

FACTORS AFFECTING THE DECISION TO GRANT ESKOM DEBT RELIEF

According to the National Treasury's 2023 Budget Review on Eskom Debt Relief, four main factors are behind government's position to grant the R254 billion (incl. the R70 billion direct takeover) debt relief. These include:

1. tariffs,
2. operational efficiencies,
3. disposal of non-core assets,
4. capital investment and maintenance requirements.

We briefly analyse these four indicators/factors to show the urgency and need for long-term solutions to Eskom's precarious financial position.

Tariffs: Eskom's standard average tariffs have increased by over 900% since 2007. The revenue raised through tariffs and annual escalations – which have mostly been double-digit increases and greater than consumer price inflation – cannot cover Eskom's operational and debt-service costs. And this has been the case for years. While some, including Eskom, argue that in US dollar terms domestic electricity tariffs are globally competitive, the fact of the matter is that the annual escalations have been more than consumer price inflation (CPI) and have resulted in the loss of global competitiveness in the real sector, especially export sectors, such as mining and manufacturing. Businesses across sectors have a set cost structure that they cannot easily or quickly adjust to counteract the significant yearly increases in electricity tariffs and therefore, to be competitive, these sectors have had to cut costs by reducing the number of jobs.

Furthermore, a critical reason for inadequate revenue collection by Eskom relates to **debt owned by municipalities**. Municipalities owed Eskom more than R56.3 billion in 2022/23, a 40% increase compared to the previous year. According to Eskom "the top 20 delinquent municipalities accounted for 80% of total arrear municipal debt, with over 35% of the total owed by Free State municipalities. At year-end, there were 53 municipalities with total arrear debt of more than R100 million each (2021:47), as the problem continues to worsen". The top ten municipalities that are in arrears owe the state utility R29.8 billion (2021/22) as indicated in the table.

Municipality, R million	2022	2021
1. Maluti-a-Phofung Local Municipality, Free State	6 499	5 804
2. Emalahleni Local Municipality, Mpumalanga	5 978	4 668
3. Matjhabeng Local Municipality, Free State	4 398	3 719
4. Emfuleni Local Municipality, Gauteng	4 240	2 714
5. Govan Mbeki Local Municipality, Mpumalanga	2 898	2 318
6. Lekwa Local Municipality, Mpumalanga	1 536	1 292
7. Ngwathe Local Municipality, Free State	1 467	1 320
8. Thaba Chweu Local Municipality, Mpumalanga	1 047	840
9. City of Matlosana Local Municipality, North West	884	582
10. Ditsobotla Local Municipality, North West	815	677

What is clear is that there is no political will on the part of the government or Eskom to collect the debt owed by municipalities. Collecting these revenues would go a long way in aiding Eskom's liquidity challenges.

Operational (*in*)efficiencies: In 2021/22 Eskom's non-technical losses amounted to R2 291 million compared to R2 319 million the previous year. While these are predominantly out of Eskom's control, measures to limit illegal connections should be speedily implemented and these include the installation of pre-paid meters, starting with the most problematic municipalities.

Disposal of non-core assets: The disposal of Eskom Finance Company (EFC) has resumed since year-end, after having been put on hold on the instruction of the shareholder due to "unfavourable market conditions". The selling of immovable, non-core assets can aid Eskom in raising capital to pay off its debt – which is an unsustainably high debt burden at this stage. Eskom also has a significant real estate portfolio that does not form part of its core functions.

Capital investment and maintenance requirements: National distribution infrastructure requires heavy investment to restore it and expand capacity to enable more electrons from new renewable power sources to come online. **Capital investment:** Eskom requires R178 billion to invest in the **transmission grid** over the next nine years to 2031. This will also enable, among others, new generation capacity, network reliability investments, load growth, and refurbishment of existing infrastructure. The **distribution grid** requires a capital investment of R42.6 billion over the next four years to support around 250 major customers that will be added to the grid by 2026.

According to Eskom "funding remains a significant risk as essential projects in this space are deferred as we are forced to reallocate constrained capital to completing the new build programme and stabilising the generation fleet". The debt relief will assist greatly to ensure the availability of funding for the abovementioned transmission and distribution investment requirements.

Maintenance requirements: Eskom has not been able to carry out proper maintenance because of a lack of generation capacity. The utility urgently requires 4 000 – 6 000 MW in order to carry out the required maintenance. Eskom has also acknowledged that it does not have the internal capacity to provide these electrons. In the 2021/22 FY, Eskom spent R19.1 billion on repairs and maintenance.

MAINTENANCE SPEND	
Generating plant R14.7 billion (2021: R13.4 billion)	▲ 9.6%
Transmission network R0.8 billion (2021: R0.7 billion)	▲ 16.5%
Distribution network R3.6 billion (2021: R3.4 billion)	▲ 7.7%

The debt relief that has been made available by government will ensure that Eskom is able to pay for parts ahead of time and that when they open their equipment for maintenance, they have all parts and contractors ready. These amounts will also ensure that Eskom is able to do the long duration maintenance on Koeberg, Kusile and Medupi amounting to over 4 000MW that is critical to avoid loadshedding and curtailment.

MINERALS COUNCIL SOUTH AFRICA

RECOMMENDATIONS

The Minerals Council makes the following recommendations:

Recommendation #1: The 'old' coal power plants must be sold or concessioned to the private sector. The private sector will be in a position to recapitalise them and raise each plant's energy availability factor. Government, as the sole shareholder, and with various competing economic and social objectives, would better use the billions of rands wasted on Eskom to invest in education, health and the safety of its citizens. It can also use such resources to invest in sectors of the economy where there are actual market failures.

In short, because of competing economic and social objectives, governments eventually run out of money to recapitalise enterprises in which it is the sole shareholder.

Recommendation #2: In the event that government is not in a position to sell the coal power station to private companies we recommend that a public-private partnership (PPP) model is pursued. We strongly believe that this approach will relieve the fiscus of resources government needs to invest elsewhere in the economy.

- Government is mulling the extension of life for the Hendrina and Arnot coal power stations through PPP (public-private partnerships). We unequivocally support this move.

Recommendation #3: While we have not addressed it above, the unbundling of Eskom into three entities, namely, generation, transmission and some parts of distribution will not solve the country's electricity woes because they will still be wholly owned by government. As for generation, as stated above, the coal-fired power plants must be sold or concessioned to the private sector at reasonable terms allowing them to recapitalise the plants without the use of public funds. Similarly, the transmission side of the business must also be concessioned to independent private players for a period of at least 15 to 20 years.

Recommendation #4: The Just Energy Transition from coal to clean energy sources must be well managed. Anecdotal evidence suggests that a major reason some of the coal-powered power plants are not performing – with abysmal EAFs – is because of worryingly low staff morale. This is because employees have been told that the plants they work in will be decommissioned. The national and social/labour narrative surrounding the Just Energy Transition needs to be well managed to ensure worker productivity and optimism about the future.

Recommendation #5: According to the National Treasury's Municipal Debt Relief MFMA Circular No. 124 published on March 31, 2023 "*the Minister of Finance's conditions for the* *conversion of portion(s) of the Eskom loan into government equity includes that Eskom completely write-off the principal debt and interest and penalties of municipalities that owe Eskom as of 31 March 2023 (excluding the current Eskom March 2023 accounts) over a three-year period*". The potential writing-off of municipal debts owed to Eskom presents a moral hazard which will most likely escalate the problem in future. When economic agents (municipalities) know that they can take a risk and another party (government) will bear the consequences/costs, they are likely to take an even greater risk in future. Mitigating or even punitive measures for non-payment should be firmly established to ensure that municipalities service their debt with Eskom. A free pass will, without a doubt, create a bad precedent.

CONCLUSION

The recommendations presented above are aimed at the advancement of SA Inc, igniting economic growth, improving the living standard of citizens by creating more jobs, and the protection of the country's fiscal position.

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