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GENERAL NOTICE

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DEPARTMENT OF MINERALS AND ENERGY

**ELECTRICITY BASIC
SERVICES SUPPORT TARIFF
(FREE BASIC ELECTRICITY)
POLICY**

FOR

THE REPUBLIC OF SOUTH AFRICA

1 April 2003

The objective of this policy document is to facilitate the implementation of Free Basic Electricity (FBE) Services by Municipalities as Service Authorities.

The document also provides the FBE Services to be provided by Service Providers on behalf of Service Authorities.

The effective date of implementation of this policy is 01 July 2003. For further information please contact:

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Ministerial Foreword

In addressing the energy imbalance in the domestic sector, we have embarked on an aggressive Integrated National Electrification Programme (electrification programme), which seeks to address the electrification backlog by 2012. While the electrification programme is progressing well, we soon realised that there is a need to address affordability issues in electrified households.

In 2000, Government announced policy intent to provide free basic services to poor households. In this regard, water, sanitation and energy were identified as basic services to be supported by Government's programmes in respect of poor households.

This policy document concerns itself with energy support matters to poor households in general and electricity (grid and non-grid) in particular.

Effective from April 2001, Cabinet approved the removal of Value Added Tax (VAT) on paraffin to enable poor households to afford readily available fuel for all energy requirements in a typical un-electrified poor household (space heating, cooking, lighting, etc.).

In respect of Liquefied Petroleum Gas (LPG), Cabinet regarded the fuel as being predominantly an industrial fuel, thus no poverty relief is proposed at this stage. However, the demand pattern for LPG will be continuously monitored to enable possible policy interventions, as and when domestic consumption conditions warrant.

As indicated above, significant progress has been made in providing capital subsidies for electrifying poor households. Low electricity consumption patterns indicate that poor households do not benefit from the efficiency and environmental benefits afforded by electrification due to the severity of poverty.

This policy seeks to address ways and means through which government interventions can bring about relief to poor electrified households and ensure optimal socio-economic benefits from the National Electrification Programme.

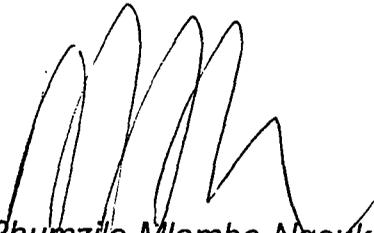
This policy proposes a systematic way through which poor households can be identified.

Recognizing that conventionally, the average poor household does not consume more than 50 kWh of electricity per month, the allocation of free basic electricity is set at 50 kWh, based on the utility that poor

households could derive from that amount of energy. We also recognise that this benefit can be increased through the efficient utilization of energy and savings interventions for the same amount of energy.

The administration of this policy poses challenges of constitutionality, funding, ownership, governance and oversight among different spheres of government. While these administrative challenges are being resolved, National Treasury has allocated funds to DPLG for Local Authority to commence with the implementation in the 2003/2004 financial year.

I trust that the combination of the above programmes (electrification and free basic electricity) under the auspices of the Department of Minerals and Energy will go a long way in improving the quality of life of ordinary South Africans.



Phumzile Mlambo-Ngcuka
Minister of Minerals and Energy

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ELECTRICITY BASIC SERVICES SUPPORT TARIFF (EBSST) (FREE BASIC ELECTRICITY) POLICY FRAMEWORK

1. DEFINITIONS

“Basic Fixed Charges” means charges necessary for the establishment, maintenance and operation of the electricity distribution networks.

“Current Limiting” means limiting the electricity demand to a particular maximum level. The limit proposed in this policy document is a maximum of 10Amperes;

“Free electricity” means electricity supply at no cost at all;

“Free Basic Electricity”/ “Electricity Basic Service Support Tariff (EBSST)” means limited free amount of electricity supply deemed necessary to support basic energy services of a typical poor household as determined by Government from time to time. Free basic electricity and EBSST will be used interchangeably;

“Funding Authority” means an organ of Government responsible for funding the Free Basic Electricity;

“Energy White Paper” means the White Paper on Energy Policy for South Africa of December 1998;

“Household” means residential premise with an official point of supply.

“National Electrification Programme” means the Integrated National Electrification Programme under the auspices of the Department of Minerals and Energy intended to address the backlogs in the household electrification in South Africa.

“Self Targeting” means a system whereby a household approaches the Service Provider, indicating the intention to be considered for benefiting from the Free Basic Electricity programme.

“Service Authority ” means the authority of a municipality to regulate the provision of municipal service(s) by a service provider.

“Service Provider” means an agent (person or institution or any combination of persons and institutions), which provides municipal service(s) on behalf of the Service Authority.

2. BACKGROUND

Government announced a statement of intent in respect of the provision of free basic services in 2000. The main areas of focus were free basic water and free basic energy.

In respect of the provision of basic energy, the Department of Minerals and Energy (DME) considered liquid fuels and electricity.

In terms of liquid fuels, Cabinet approved the zero rating of Value Added Tax (VAT) on paraffin. This policy was implemented in April 2001.

In respect of Liquefied Petroleum Gas (LPG), Cabinet considered the fuel to be mainly a commercial fuel, and thus no consideration for cost reduction to the poor was made at the time. The usage of LPG will however be monitored and necessary policy changes will be made if and when the consumption of the domestic sector warrants.

Cabinet considered the operational issues and restructuring challenges facing the Electricity Supply Industry (ESI) and its ability to facilitate the provision of EBSST. Recognizing that the provision of free basic services is primarily, a social welfare function, which is the responsibility of Government, Cabinet accepted the proposals of the DME, regarding the process to develop a national EBSST policy. The following preliminary recommendations were made at the time (in January 2001):

- 2.1. Provision of free 50kWh of grid electricity per month to all households with concomitant blocked or stepped tariffs for electricity consumption beyond 50kWh to mitigate the cost implication of the free basic electricity provided.
- 2.2. Provision of free non-grid electricity to all non-grid electrified households (connected through the National Electrification Programme) funded from the energy component of the Equitable Share to the maximum of R48-00 per household. Any difference between the future actual maintenance and operation costs, and the subsidy will be borne by the consumer.

2.3. Pilot projects were to be commissioned to determine the cost implications of the EBSST and to minimise the impact on the Electricity Supply Industry (ESI).

2.4. Based on the outcomes of the pilot studies, the DME presented an EBSST Policy Framework to Cabinet for approval in 2002/2003 that will culminate in the phased implementation of the EBSST policy on a national basis.

This document outlines policy positions considered by Cabinet in respect of provision of free basic electricity.

3 EBSST RESEARCH PROJECT

Based on the Cabinet decision of January 2001, the DME, through a multi stakeholder Task Team, commissioned pilot studies in October 2001 in order to gain understanding of the main issues involved in formulating the EBSST policy framework. Eleven (11) pilot projects were established in Eskom's licensed areas throughout South Africa. These pilot projects culminated into a draft research report, "Options for a Basic Electricity Support Tariff". The research project was extended to pursue socio-economic implications of the recommended options and the load implication of such options on the electricity infrastructure during a typical winter season.

While noting that not all the research findings and recommendations of the report were in line with the policy intent, the contents of the report were useful in arriving at certain policy recommendations.

Note: Policy statements are written in bold italics to facilitate easy reading

4. MAIN RESEARCH FINDINGS

The main issues influencing the implementation of free basic electricity allocation to poor households are the following:

- i) level of the free basic electricity allocation;
- ii) identification of recipients of the allocation;
- iii) costs implications of such an allocation; and
- iv) sustainable sources of funding for such allocations.

These are discussed in detail in the following sections.

4.1 Level of the free electricity allocation

- i) The national Government announced, during the last quarter of 2000, its intention to introduce 'free basic services' in order to 'alleviate the negative impacts of poverty on communities'.
- ii) Based on the research, the basic utility of free basic electricity was established, together with the associated cost. It was suggested that an allocation of 50kWh per month be provided to all poor households connected to the national electricity grid.
- iii) The provision of 50kWh to targeted households should be made subject to *restrictions and principles* detailed in Section 5 being met, as an integral part of this policy document, in order to enhance the financial well being of the ESI. The said principles will be amended from time to time as conditions warrant.

This proposed level of basic electricity is motivated on the following basis:

- 56% of households in South Africa connected to the national grid (in Eskom's licensed areas) consume on average less than 50kWh of electricity per month (*Source: Eskom*). This is more than the last two quintiles of the population that can be classified as poor;

- 50kWh per month is considered adequate electrical energy to meet the needs for lighting, media access and limited water heating and basic ironing (or basic cooking) for a poor household;
- The level of 50kWh has been spoken of generally at national level and has been accepted as a norm in respect of free basic electricity. This quantity has achieved widespread political and community acceptance and expectation.
- The utility of this 50kWh can be increased by using energy efficiency lighting interventions and other energy saving initiatives.

▪ *Free basic electricity provision will be phased in with preference being given to the poor at all times.*

▪ *Grid connected households will be provided with 50kWh of free basic electricity funded mainly through relevant inter-governmental transfers, subject to the contractual obligations between the Service Provider and the consumer being met. Any consumption in excess of the set limit (50kWh) will be payable by the consumer.*

- iv) While the pilot study suggests that 35 to 60kWh of electrical energy per month would be adequate to meet the needs for lighting, media access and limited cooking, it makes no specific recommendation for a proposed level of allocation. This is mainly a result for a combination of possible options available including energy efficiency lighting, which could reduce the demand of electricity substantially.

▪ *In respect of grid-based electricity consumers, free basic electricity provision is intended to facilitate the provision of lighting, media access, limited ironing and water heating as basic electricity services.*

- v) It was also noted that free allocation of electricity has been introduced in a number of municipal areas since July 2001 and that the level of these allocations varied between 20kWh and 100kWh per month. The funding for these allocations was made from internal sources of municipalities, the Equitable Share (inter governmental transfer allocation) and cross-subsidisation from other consumer categories. The cross-subsidisation has been limited to the customers of distributing municipalities.
- vi) Consumers serviced by Eskom have been excluded from the preliminary and voluntary provision of free basic electricity by pioneering municipalities,

▪ *Where funding is received from the fiscus, through inter-governmental transfers, the provisions of basic electricity may be made to all qualifying households on self-targeting basis by relevant Service Authorities in their respective Municipal Areas.*

- vii) The DME is conscious of the fact that approximately 30% of the existing households in South Africa currently do not have access to grid electricity supplies. Although a National Electrification Programme is rolling-out electrification connections, it will take at least ten years before electrification of existing backlog approaches 100 percent. The envisaged programme will also take longer if the current growth rate of households is taken into account.

▪ *The provision of free basic electricity services shall be limited to existing qualifying consumers, legally connected to both grid and non-grid electricity systems, and those electrified through the National Electrification Programme.*

viii) DME has commenced with the implementation of **non-grid electrification** in remote rural areas, using Solar Home Systems (SHS). The capital for these systems is funded through the National Electrification Fund (NEF).

ix) Non-grid electricity connections will be provided in rural, poorer communities where grid electrification will not be a viable option for some time. Households will be required to pay a monthly service fee, currently about R58 per month. To this end, the level of free basic electricity subsidy recommended is R48.00 per SHS connection for the financial year 2003/2004. This figure will be revised from time to time as the conditions for non-grid systems warrants.

▪ *Consumers connected to non-grid systems, installed through the National Electrification Programme will receive a subsidy of up to 80% (or R48-00 per month per connection in 2002 Rands) of the monthly service fee to provide access to non-grid systems, subject to the contractual obligations between the Service Provider and the consumer being met. This amount will be revised from time to time.*

▪ *In respect of non-grid electricity, free basic electricity provision is intended to facilitate the provision of basic lighting and basic media access.*

- *Where consumers are converted from non-grid to grid systems, conditions pertaining to the provision of free basic electricity in respect of grid systems shall apply. The service provider will be responsible for the transitional processes (technical, financial and administrative).*

4.2 Recipients of the EBSST allocation

In line with the policy intent, the difficulties of identifying 'the poor' have been acknowledged. A broad-based approach, where **all households** with a legal electricity connection receive the intended benefit, will result in a large degree of leakage of the benefits to households for whom poverty alleviation is not intended.

The DME recommends a '**Self-Targeted Approach**' for the implementation of the first phase of the EBSST roll out. This approach will more accurately target the poor and would be less costly to implement and fund. .

a) **Broad-Based Approach**

This approach refers to the implementation of an agreed allocation of free basic electricity to **all** legal household connections. It has been established that this approach is possible but at a significant cost which will be examined in section 4.3.1 below:

b) **Self-Targeted Approach**

Two possible methods of implementing this approach have emerged from deliberations. These approaches will require either that the '**poor households**' **apply for a current-limited electricity supply** and then become eligible for the free basic electricity allocation or that the responsible electricity **Service Provider identifies households consuming, on average, less than a pre-determined amount of electricity per month and then automatically apply the free basic**

electricity allocation to such households. These two methods of application are discussed below:

i) Self-Targeting with Current-Limiting

Households that are 'poor' generally have a low demand for electricity. Their needs could adequately be met by restricting the current drawn from their supply to about 10 Amperes (A). These households would consume the free basic allocation of electricity at no cost and pay the approved electricity tariff for each unit of electricity consumed above the free allocation. Households should apply to the Service Authority to be put onto this tariff.

Once approved, it will be the duty of the Service Authority or funding authority to transfer to the Service Provider, the relevant amount to cover the cost of providing free basic electricity.

The advantage of this method is that it is expected that mainly low consumption, poorer households will apply for the current limited supply (hence self-targeting). This will accurately target the poor and cost substantially less for provision of free basic electricity supplied.

It is also expected to reduce the incidence of overloads on rural electricity power lines. The pilot study estimates that the cost of reinforcing such lines (if a broad-based approach is to be implemented) to be R770 million.

The disadvantages are:

- the electricity Service Provider will incur higher administrative costs;
- the cost of altering the current capacity of service connections, particularly in the case of households served by credit (conventional) meters. Current-limiting devices will need to be installed on the service connection where these do not exist.

- Prepayment meters that do not have current limiting software will need to be changed and those with the facility will need to be re-programmed.

In choosing any option, the cost of such modifications needs to be capitalised.

ii) Self-Targeting without Current Limiting

This alternative method of self-targeting involves households using on average, less than a pre-determined amount of electricity (up to 150 kWh) per month applying for the free basic electricity allocation. To reduce administrative costs, the electricity Service Provider could automatically select those households that comply with these requirements and move them to the free basic electricity tariff. The agreement of the Service Authority must be obtained to ensure payment of the Service Provider in respect of free basic electricity provided.

This method is probably more suitable for implementation by municipal electricity distributors since it can easily be applied to credit or pre-payment meter services. There is also no need to visit the prepayment meters in order to re-programme the current limiting facility. In this regard, the administrative burden of ensuring replacement of meters or that meters are correctly programmed could be avoided.

In addition, the electricity demand of many poor households in cities and towns exceeds the 10A limit of the current-limited option due to households living with extended families. If these households were restricted to the current-limited method they would experience frequent supply trips. This 'nuisance' tripping of the electricity supply would not be a problem with conventional metered consumers.

▪ *The recipients of free basic electricity allocation shall be those households that either apply to their Service Providers for a current-limited electricity supply of 10A, or who apply to be charged a special non-current-limiting tariff that provides the free basic electricity allocation. The choice of method used for self-targeting is left to the Service Authorities and the respective Service Providers.*

4.3 Cost of the free electricity allocation

The costs for the programme can be separated into the cost of the 'free' basic energy, the technical and administration costs of implementing the programme.

▪ *The capital cost pertaining to the provision of free basic electricity consists of vending, meter replacement, administrative systems, etc shall be capitalised.*

▪ *A limited capital support/grant may be made available to service providers pertaining to the free basic electricity provision infrastructure upon request and approval by the funding authority, subject to availability of capital grants for this purpose.*

4.3.1 Broad-based method of allocation

There were 6.8 million domestic customers connected to the national grid in 2000. If 50kWh of free basic electricity was proposed for all grid connected households, the estimated cost to the Electricity Supply Industry (ESI) to supply a zero rated supply of 50 kWh per household

per month (calculated at an average of 40 c/kWh based on 6.8 million grid-electrified households), would be R1.64 billion per annum, for the year 2001. This amount excludes infrastructure, vending systems and upgrading costs. These costs should be capitalised and be recovered from other non-targeted customers.

It needs to be noted that these costs will also increase with the increase in the level of electrification through the National Electrification Programme, which is estimated at additional 330 000 connections (mainly in poor rural areas) per annum over the next 10 years, resulting in additional costs of R80-90 million per annum (2002).

4.3.2 Self-targeted method of allocation

Considering the bottom two quintiles of electricity consumers, the estimated cost for providing free basic electricity to the poor households is estimated to be in the order of R600 million (in 2002 Rand, based on 2001 electrification figures).

4.3.3 Technical/Administration Costs

It has been recognised that the provision of the free basic electricity could involve substantial costs in:

- upgrading of billing and pre-payment vending systems;
- replacement of pre-payment meters not compatible with vending of the free allocation and the cost of current limiting electricity devices;
- upgrading of rural (and possibly urban) electrical networks to cope with a possible increase in demand for electricity;
- providing administrative capacity at municipal and Service Provider level for the implementation and monitoring of the free basic electricity allocations to households.

Initial estimates put this capital cost nationally at R600 million. The self-targeted approach will reduce these costs to about R200 million.

4.4 Funding of the free basic electricity allocation

Several funding options are possible but only two of these are practical for EBSST funding, namely:

- Paying for the EBSST from nationally collected revenue, (fiscus), through transfers to local Government, or
- Paying for the EBSST by means of a cross-subsidy from high electricity consumers.

4.4.1 National funding

The report examines a number of ways that the EBSST can be paid for from the national budget or nationally collected revenues. The following advantages of funding the EBSST through the national budget are noted as follows:

It is recognised that the EBSST is a national policy and thus places the final responsibility for funding and implementation on the national government.

The national funding:

- *enables the national government to implement a uniform approach to the EBSST countrywide.*
- *enables the national government to evaluate the EBSST against other national priorities, particularly other national re-distributive programmes.*
- *enables the national government to manage the costs of the programme (particularly decisions on increases of allocations) in the light of macroeconomic conditions and national fiscal considerations.*
- *enables the government to manage directly any fiscal risk associated with the policy.*
- *enables the government to match the allocation of funds directly to the cost of implementation – there would be minimal risk of under- or over-funding – a real risk of the earmarked taxes.*

- *in this regard it is recommended that the Department of Provincial and Local Government be responsible for the EBSST funding through the Equitable Share allocation or any such fiscus grants to Service Authorities for all targeted consumers in their supply areas.*
- *This option can equally be used in the current and restructured states of the Electricity Distribution Industry.*

▪ *The Department of Provincial and Local Government shall be responsible for the first phase of EBSST funding through a separate window of the Equitable Share or any such fiscus grants to Service Authorities for all targeted consumers within their respective municipal boundaries. Such funds shall be disbursed on a pro-rata basis in case of multiple Service Providers operating in the same municipal boundary.*

4.4.2 Application of Cross-Subsidies

▪ *Municipalities with adequate resources, especially Category A Municipalities, will be in a position to cross-subsidise free basic electricity consumers within their customer bases and across other services and customer categories. This is portrayed by the ability of some metros to provide free basic services without any national Government support.*

The need to move towards cost-reflectivity in the electricity sector negates the above approach. Weaker municipalities cannot provide basic services through cross-subsidization. In this regard, external funding contemplated in 4.4.1. above will be required.

▪ *Existing Municipal initiatives already underway will be integrated with the national EBSST implementation programme to the extent that they target the same self-targeting poor households.*

▪ *The DPLG shall request a free basic electricity recurrent budget through the MTEF process from the National Treasury to fund the free basic electricity allocation, pending a resolution to fund free basic services otherwise.*

▪ *The DPLG shall develop administrative systems and procedures to disburse on an equitable basis, the free basic electricity budget in line with prevailing legislation.*

5 PRINCIPLES AND RESTRICTIONS OF PROVIDING FREE BASIC ELECTRICITY

The DME recognises that the provision of free basic electricity will be implemented by a number of different Service Providers. In proposing a national policy it is deemed prudent to suggest that clear guidance on principles and restrictions relating to the implementation of the allocation of free basic electricity be established.

The following principles are an integral part of the national EBSST policy:

- 5.1 The free basic allocation of electricity units is to be made available to **all qualifying households** that meet the requirements of self-targeting. Where more than one dwelling is bulk metered, the Service Providers will need to take this into account in allocating the free basic service.
- 5.2 Normal municipal connection fees levied by the distributor will be applied to all new electricity services;
- 5.3 Basic charges/fixed charges, if applicable, will only become effective when monthly consumption exceeds the free allocation.
- 5.4 No carry over of the free basic electricity allocation or any portion thereof from one month to the next is to be permitted for credit metered customers. This will particularly address cases of unoccupied households claiming cumulative EBSST.
- 5.5 Free EBSST allocations not claimed by prepaid metered customers in any calendar month will be forfeited, subject to proper billing by the Service Provider to the Service Authority in respect of the claim arising from such provision of free basic electricity to all qualifying households.
- 5.6 In respect of the credit-metered households, the free allocation should be applied to the account if electricity is consumed in any billing period. If the consumption is less than the free quota, only the amount of the consumption is issued free, subject to the proper billing of the

Service Provider to the Service Authority in respect of the claim for providing free basic electricity to all qualifying households.

- 5.7 The distribution/allocation of the free basic electricity allocation must be as simple as possible to obviate the need for high levels of capital/upgrading and administration expenditure.
- 5.8 Consumer discipline must be upheld. No free basic electricity allocation is to be made available following disconnection from the electricity supply for reasons normally applicable in the distributor's environment such as meter/system tampering or non-payment, until the consumer has met all the distributor's/authority's requirements to have the supply restored.
- 5.9 No cash/voucher/service will be payable in lieu of the free basic electricity allocation or non-grid operational subsidy for household connected to the non-grid systems.
- 5.10 The free basic electricity allocation/subsidy will only be effected when a qualifying consumer has been officially connected to the electricity supply system of a Service Provider;

▪ *In order to facilitate the provision of free basic electricity and to enhance the functioning of the Service Authorities, the above principles for implementation of free basic electricity will form an integral part of this policy.*

6. IMPLEMENTATION OF FREE BASIC ELECTRICITY

Free basic electricity will be implemented through existing service delivery channels.

- *The DME in consultation with the Department of Provincial and Local Government and the National Treasury will determine the extent of provision of free basic electricity, which can be funded through inter-governmental transfers on an annual basis.*

The administering authorities need to allocate the funds as per mutually agreed business plans between the Funding Authority and the Service Provider.

The funding allocation will be determined by the extent of poor electrified households registered with the service provider. This self-targeting mechanism will eliminate un-electrified or affluent households from benefiting from the free basic electricity programme.

- *The cost of providing free basic electricity shall be included in the MTEF budget allocation of the Department of Provincial and Local Government.*

Where Service Authorities have been allocated with inter-governmental grants to provide for operating costs in respect of basic services, such municipalities shall pass on the benefits of such grants to targeted households in respect of providing free basic electricity allocations as contemplated in this policy document, for the corresponding financial year.

Consumers whose electricity demand exceeds or whose consumption exceeds the limits for free basic electricity set out in this policy would suggest an ability to afford full electricity services. These consumers should then be converted to normal domestic tariff.

- *Notwithstanding other provisions contained in this document, nothing in this policy prevents Service Providers from creating and offering lower tariffs for special customers categories within the broader NER approved tariff structures.*
-