Comments on regulatory methodology - PRSA

24 Oct 2016

Core component of the technical task of regulation

- Goal of economic regulation is to improve the functioning and efficiency of markets, where competition is insufficient to get prices right
- In order to get the price right, you need a lot of data!
- Process of collecting and analysing data is time intensive and costly – approach of requiring the regulated entity to produce a tariff proposal probably helps reduce such costs
- The more of the price determination that the regulated entity performs, however, the less control the regulator has of the price determination process
  - How consistently are data definitions being applied?
  - Any hidden cross-subsidisation?
  - Are investment levels excessive?
  - Are efficiency improvements possible?
- What should the growth path of regulatory rigour in ports pricing practices be?

Improving pricing rigour

How do you regulate a company that controls the information you need to regulate it?

Generate processes to stimulate and force the regulated entity to reveal detailed, structured, appropriate and periodic information

Possible data sources

Financial accounting or cost/management accounting

- Financial accounting is of limited use for regulators:
  - No possibility of separating costs according to regulated and non regulated activities
  - Historical approach, no forecast costs and revenues for future tariff setting
- Regulatory authorities need information similar to cost/managerial accounting used by management for planning, control and decision making, but they need it for different purposes
- Issues with using cost/managerial accounting:
  - System developed for managerial rather than regulatory needs: specific needs of the regulator will have to be defined
  - It is usually considered as internal “confidential” information and will never be revealed in its original version: Information exchange procedures and mechanisms will have to be put in place (with a legal regulatory background).

Regulatory accounting systems

- Information quality is best when the regulator uses a regulatory accounting system, accompanied by regulatory accounting guidelines (RAG)
- Objectives of regulatory accounting include:
  - Detecting anti-competitive behaviour, including cross-subsidisation and undue discrimination;
  - Clarity on internal subsidies in a regulated service;
  - Monitor performance against the assumptions underlying price controls ;
  - Monitoring financial health of the operator

- In practice, the regulatory accounting system is a cost/management accounting system with an allocation of revenues and costs that will enable the regulator to:
  - separate regulated and non regulated activities
  - separate regulated revenues and costs by sub-activities, regions and tariffs

Regulatory accounting provides clarity on cross subsidies

- Sustained allegations of a cross-subsidy between ports and rail, but little data available on it
  - How big is the cross-subsidy, and how big does it need to be?
  - What measurable policy objectives is the cross-subsidy designed to achieve, and is it achieving them?
  - Has it been designed to minimise undesirable market distortions (focus on inelastic prices, steer clear of policy priorities for volume increases)?
- Regulatory accounting system requires separation of revenues and costs by activity, and thus would provide substantial clarity on these issues
- Absence of data on this issue is a large gap in the rigour and consistency of current regulatory approach

Accounting separation

Accounting separation is an aspect of regulatory accounting systems

"*An accounting separation system is a comprehensive set of accounting policies, procedures and techniques that can be applied to the preparation of financial information that demonstrates compliance with non-discrimination obligations and the absence of anticompetitive cross-subsidies. The outputs from such a system must be capable of independent verification (auditable) and fairly present the financial position and relationship (transfer charge arrangements) between product and service markets. Using accounting separation, a National Regulatory Authority (NRA) imposes on the notified operator a set of rules on how accounting information should be collected and reported*".

Source: NATP-II Project Team, part of EU-funded project "New Approaches to Telecommunications Policy": http://www.natp2.org/ref_harm_reg/eng/Reference%20Guideline%20on%20Accounting%20Separation%20January%202007.pdf

Conclusion

- PRSA has a strategy of continuous improvement in the price regulation system
- Achievement of a system of regulatory accounting, including accounting separation between NPA and the rest of Transnet, would be an appropriate goal for this process
- Continued cross subsidisation with little transparency is an obvious hindrance to effectiveness of regulatory scheme

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