South African Association of Ship Operators and Agents

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Att: Mr. Mahesh Fakir
Cc: Mr Chris LÖtter

Dear Sir

Submission to the Ports Regulator on Tariff Strategy for the South African Port System

In 2012, the National Port Authority (NPA) submitted a pricing strategy to the Ports Regulator. The view of the NPA was that the pricing system in the past had been inefficient and unbalanced. Their belief was that the existing pricing system lacked transparency. It also contained highly differentiated tariffs without any link to the cost of providing these services and the extent of cross subsidization, if any, in the pricing system.

The Ports Regulator, aware of the need to ensure that the prices charged enable South African ports to remain internationally competitive, responded with their document to elicit responses from the public before engaging in public hearings.

The purpose of this report is to respond to the Port Regulator on the pricing of services offered to users of the ports in South Africa. It points to certain problems when regulating the prices charged by a public utility such as the National Ports Authority. It also suggests a way forward in the pricing of port services to ensure greater transparency and consistency in the pricing strategy.

As a first step, the Ports Regulator engaged in a study of the pricing of ports services globally. This benchmarking exercise showed a substantial lack of competitiveness by South African ports in cargo handling. The premium on automotives was 743 per cent in 2012/2013, albeit declining to 541 per cent in 2014/15. In containers, the premium declined from 874 per cent in 2012/13 to 388 per cent in 2014/15. Coal and iron ore enjoyed a boost in competitiveness in comparison to their international competitors. This suggests that exporters were being subsidized by higher prices internationally on automotives and containers.

The global study showed that vessel costs in 2012 when compared with internationally prices were lower. In particular, by 2014/15 automotive vessel costs were lower than the global average by 47 per cent, coal by 36 per cent, containers by 26 per cent and iron ore by 71 per cent.

In April 2014, the Ports Regulator attempted to rebalance prices in line with their plans for the future. Cargo dues were increased by 5.9 per cent and dry bulk for coal, iron ore and manganese and marine services by 8.15 per cent. Container export tariffs were reduced by 43.2 per cent, container imports by 14.3 per cent and vehicle export tariffs by 21.1 per cent (Business Day 2014).

To improve transparency and unintended cross subsidization, the Ports Regulator intends to introduce a pricing regime that will lead to a radical change in the allocation of costs. The intention is to apply average cost pricing rather than marginal cost pricing. As is well known in the regulation literature, there are difficulties using marginal cost arising from identification and the presence of economies of scale. The Port Regulator is fully aware of these difficulties. The proposal, therefore, is to use average cost pricing but at the same time effect changes in the contributions to total costs from the reallocation of assets. This will affect the capital base allocated to each category of use, namely lessees, terminal operators, cargo owners and shipping lines. This reallocation will be phased in over a period of ten years resulting in the redistribution of costs as shown in Table 1.

Table 1: Cost Reallocation : Current and Long term (%)

User	Current	Long term
Tenants	22	29
Cargo owners	60	35
Shipping lines	18	36

The target set by the regulator entails substantial shifts in the share for cargo owners from 60 to 35 per cent and shipping lines' share from 18 to 36 per cent.
The intention is to phase in the reallocation over 10 years. This will minimize the shocks to the market but also put the market on notice of their intentions.

This reallocation of the asset base impacts detrimentally on shipping lines. A doubling of the share from 18 to 36 per cent leads to a 7.2 per cent annual price change in real terms. When expected inflation is included, the increase escalates providing a severe shock to the industry. On grounds of equitable treatment the industry is strongly opposed to increases of such magnitude.

We question this reallocation on two grounds. Firstly, despite a simple reallocation of the asset base, the Regulator escalates overall price by an average of 4.8 per cent annually. This suggests an escalation of profits above the competitive level for the NPA and an exercise of market power. Secondly, there is no justification given in the document for this arbitrary reallocation of assets. This arbitrary reallocation is suggestive of attempts at justification on the part of the Ports Regulator to rebalance on the basis of a Global Study of comparative ports pricing alone without cognizance of the conditions in the domestic market.

We suggest that the rebalancing could be achieved by basing the decision on data in the South African market. This could be achieved by a detailed price- cost study undertaken to ascertain the extent of excessive charges for certain services, such as cargo handling, in addition to ascertaining whether there is subsidization of other services charged to shipping lines and lessees.

The report asserts that these changes would be effected by cargo owners experiencing a real decrease in prices annually of -5.2 per cent, shipping lines a real increase annually of 7.2 per cent and lessees a real increase of 2.8 per cent annually.

If we assume that inflation annually is expected to measure in the mid range of the inflation target set by the Reserve Bank, say 4 per cent, the nominal changes annually would be as follows (Table 2):

Table 2: Annual Real and Nominal Changes in Prices (%)

	Real Price Change	Nominal Price Change
Cargo owners	-5.2	-9.2
Shipping lines	7.2	11.2
Lessees	2.8	6.8
Total	4.8	8.8

Over ten years it is expected by the Regulator that overall prices in nominal prices at the ports would rise by over 80 per cent and approximately 50 per cent in real terms. Cross subsidization, such as encouraging beneficiated exports and increasing protection to import substituting goods, is envisaged on an ongoing basis to give effect to government policy. Table 3 shows the base tariffs intended for the long term.

Table 3: Intended base tariffs in the Long term (R)

DRY BULK	Import (tons)	6.53
	Export (tons)	6.53
BREAK BULK	Import (tons)	31.03
	Export (tons)	31.03
LIQUID BULK	Import (tons)	15.21
	Export (tons)	15.21
RoRo	Import (tons)	51.30

	Export (tons)	25.65
CONTAINER (FULL)	Import (TEU)	651.53
	Export (TEU)	325.77

Source: Ports Regulator, Draft Tariff Strategy for South African Port System, 2015.

Table 3 shows that exports and imports receive different treatment. Once the goods become more finished, imports are charged at a higher price than exports. This accords with government policy to encourage exports and protect import substituting activities. However, Table 3 is not helpful in terms of the intended cross subsidization sought by government to encourage beneficiation.

Benchmarked global prices of vessel costs are shown by the 2012 global survey commissioned by the Regulator to be higher than South African port costs. On the other hand, cargo handling costs in South Africa were found to be substantially higher than global prices. Given the absence of detailed costs for cargo handling and vessels, it is difficult to assess whether the cost of vessel services reflect efficiency. In addition, cargo handling costs appear to be either woefully inefficient and/or the NPA has been exercising market power with respect to cargo handling.

In order to determine this, price cost ratios would have to be computed. If the Ports Regulator is correct in interpreting these statistics as a form of cross subsidization, present cargo handling prices would exceed costs excessively, while vessel costs would exceed vessel prices. However, in the absence of such data it is difficult to conclude definitively on whether or not there is cross subsidization from cargos to vessels.

Types of Regulation

There are two types of regulation of public utilities whether they are privatized or not. Price cap regulation and rate of return regulation are used depending on the incentive structure that the regulator wants to achieve.

If the regulator wants to incentivize the port operator to invest in equipment and infrastructure, then rate of return type regulation leads to investment in capital assets given an appropriate rate. The World Bank (1996) has found that with rate of return regulation, firms have had to pay for their cost of capital in the range of 15 to 20 per cent on the capital base. Price cap regulation on the other hand provides incentives for the operator to keep costs under control and improve efficiencies. Price caps are typically indexed to inflation in the economy.

In terms of the mandate provided by the National Ports Act of 2005, the National Ports Authority (NPA) sets the tariffs for the both the services and facilities with the approval of the Ports Regulator. When the Act was amended in 2010, the Regulator's mandate when approving these tariffs required the Regulator to ensure that these proposed tariffs allow the NPA to perform the following:

(1) Recover its investment in owning, managing, controlling and administering ports and its investment in port services and facilities;
(2) Recover its costs in maintaining, operating, managing, controlling and administering port services and facilities; and
(3) Make a profit commensurate with the risk of owning, managing, controlling and administering ports and providing port services and facilities.

Given these aims, the revenue from the NPAs services must be used as follows:

(1) Maintain basic port infrastructure;
(2) Provide current and future port infrastructure;
(3) Maintain and provide the current and future marine fleet;
(4) Maintain and provide current and future ship repair facilities.

Source: Ports Regulator, Draft Tariff Strategy for South African Port System, 2015.

Closer examination of these objectives requires not only that costs should be covered but that the asset base should be maintained and enlarged in addition to making a profit to compensate for the assumption of risk on the part of the port authority. No mention is made of how risk will be assessed. It must be remembered that the NPA is not a private company but a government entity enjoying a monopoly position with the opportunity to charge excessive prices to users.

The type of regulation envisaged by the National Ports Act of 2005 is of the rate of return genre. There is no guidance given in the Act as to the appropriate rate of return that would achieve all the above objectives. Interestingly, the notion of linking profit with risk is risible given the lack of competition between ports and sole ownership by the State. Hence the assumed rate of return should be made transparent to users of the services of the ports and debated in open forum.

Provision of an efficient and lowest cost service to users is mentioned in the report. Our observation is that the incentive structure here does not encourage cost minimization. As ports are considered an essential facility the regulator has also to be sensitive to the exercise of market power on the part of the NPA in the absence of good regulation.

Recommendations

These recommendations follow on from the preceding analysis of the Port Regulator document. They are:

(1) There needs to be greater clarity on the type of regulation that the Ports Authority intends to apply.

(2) There needs to be transparency of the rate of return allowed on the capital base.

(3) The method of valuation of the capital base and assessment of capital costs in the average cost calculation needs to be published.

(4) Government encouragement of beneficiated goods must be made transparent.

(5) Price cost ratios should be calculated by the Ports Authority to determine the levels of cross subsidization and excessive or subsidized prices and the results should be published.

(6) As the average annual real price change of 4.8 per cent for all services is in excess of the rate of inflation, with shipping lines due to experience an annual 7.2 per cent real increase (Table 2), users of the services will need to be assured that cost containment and transparency is ensured. These increases will be, and should be, hotly contested and debated in open forum hearings to assure users that there is no exercise of market power on the part of the NPA.

(7) Justification for the reallocation of the asset base must be documented and argued in public forum.

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Regards,

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