



Attention: Ms. Nonhlanhla Khumalo, Ports Regulator

By email: comments@portsregulator.org

SUBJECT: COMMENTS ON TRANSNET NATIONAL PORTS AUTHORITY (TNPA) TARIFF APPLICATION FOR 2022/23

1. Introduction

This submission serves as formal comment from the Western Cape Government on Transnet National Ports Authority's (TNPA) tariff application to the Ports Regulator of South Africa for the 2022/23 financial year.

The Port of Cape Town is a critical channel for exports and imports and is a major economic gateway for the province, with imports and exports flowing via the Port of Cape Town amounting to approximately R152 billion per annum. As such, effective, efficient, and internationally competitively priced cargo flows are essential for economic growth and job creation in the Western Cape.

However, inefficiencies and costs at the Port of Cape Town is an impediment to the cost and ease of doing business, which ultimately restricts economic growth, investment and job creation in the Western Cape.

Over the last year, port inefficiencies coupled with COVID-19 challenges have also exacerbated frustrations amongst port users and have been detrimental to the Western Cape economy. There has also been an increase in shipping lines omitting the Port of Cape Town, and vessels bypassing the Port of Cape Town.

Given the fact that South African port tariffs are not considered internationally competitive, whilst the performance of South African ports is also not competitive internationally, the request for an average tariff adjustment of 9.4% for the 2022/23 financial year cannot be supported by the Western Cape Government.

Comments on the application will be structured in the following four sections below:

- Tariff Application;
- Infrastructure and Capital Expenditure;
- Performance and Cost of Doing Business; and
- Governance.

2. Tariff Application

The weighted tariff adjustment application is for an increase of 9.4% across all commodity priority areas, which, as stated in the introduction cannot be supported. It is our view that the application should be considered in the light of the fact that South African ports remain amongst the most expensive in the world.

The Regulator's 2020/21 global price comparator study found that total National Port Authority costs to users in container ports in South Africa is still at a high premium of 146% above the global sample average. Furthermore, the report also found that *"port authority pricing, which is a combination of cargo dues and marine charges, is 69% above the global sample average thus positioning SA ports as amongst the most expensive against the global sample."* This situation is not consistent with the mandate of the Authority to lower the cost of doing business and enable economic growth, nor with their vision of becoming a world class port system.

The regulator tariff strategy for the evaluation of the tariff application based on a balanced distribution of charges to the different port user groups is supported. It is also encouraged to actively work towards rebalancing tariffs to different port user groups to be more competitive and comparable to international standards. It is also taken for granted that the tariff application will be evaluated within the context of the strategy which should incentivise performance on selected indicators but penalise on underperformance.

3. Infrastructure and Capital Expenditure

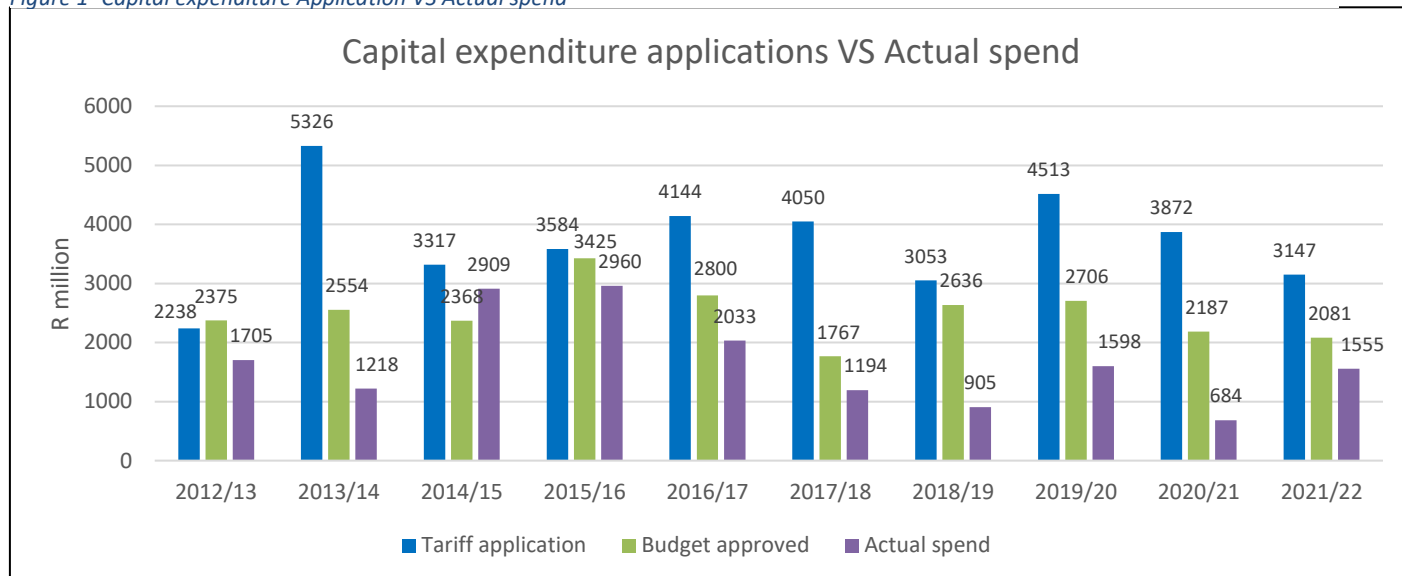
TNPA argues correctly in their tariff application, that to fulfil their mandate, significant capital expenditure will be required in the short to medium term. This is supported, but the evidence points towards a lack of capacity in this regard, resulting in perennial under-expenditure of capital. The Port Sector Review of the Regulator indicates persistent under-expenditure of capital budgets, as well as a declining trend in capex from 2011 to 2021.

The fact of chronic capital under-expenditure is also confirmed in TNPA's Tariff Application Roadshow Presentations, as depicted in figure 1, a trend of big discrepancies between what TNPA applies for, what is approved and compared to what is actually spent.

TNPA spent R20.4 billion less on capital expenditure than they applied for in their tariff applications between 2012/13 and 2021/22. Moreover, TNPA also spent approximately R8 billion less than what they budgeted for between 2012/13 and 2021/22. The fact is that TNPA has not been able to spend more than R2 billion per year on capital since 2016/17 and over the same period, 2016/17 to 2021/22, the average under expenditure on capital amounted to 43% per annum. Overall capital expenditure is expected to be 8.8% lower in 2021/22 than it was in 2012/13 in nominal terms, which means the decline is even greater if inflation is accounted for.

During this period TNPA's profits, before tax, has been increasing consistently from R2.9 billion in 2016/17 to R4 billion in 2017/18, R7.4 billion in 2018/19, and R5.1 billion in 2019/20. The decline in capital expenditure, whilst recording significant profits would seem to be at odds with TNPA's mandate.

Figure 1- Capital expenditure Application VS Actual spend



Source: NPA Tariff Application Roadshow Presentation 2019 and NPA Tariff Application Roadshow Presentation 2021

Capital expenditure in the Port of Cape Town in particular, has dropped from almost R200 million in 2015/16, to approximately R20 million in 2018/19. Subsequent capital expenditure was higher, but still below R100 million per annum. It is our view that TNPA should indicate how it has effectively improved its capital project management capacity before any tariff increases can be allowed. Penalties for persistent under-expenditure of capital budgets are recommended.

It is also our view that private sector participation should be considered as an option rather than to view all capital expenditure as necessarily having to come from own funds as a default position. The capital expenditure items that are planned for Port of Cape Town, such as the hydraulic shore tensioners to mitigate against ranging, returning the larger tugs (70 ton bullard power) to Cape Town or procuring new ones, as well as improvements to the ship repair facilities, are all top priorities for the Western Cape.

4. Performance and Cost of Doing Business

Poor port performance is directly linked to increasing cost of doing business and weakens international competitiveness of industry in South Africa. In general, South African ports rank poorly on the international stage when it comes to performance, as indicated in the World Bank Container Port Performance Index, where the Port of Cape Town ranked 347 out of 351, Port of Durban ranked at 349, and Port of Ngqura ranked very last at 351. It would seem counter intuitive to have very expensive ports with possible increased costs, while performance is not competitive.

The Port Sector Review of the Regulator (2020/21) indicates a drop in containers handled since 2015/16. The Western Cape Government is of the view that cargo volumes, especially fruit and wine for export have been increasing after the drought of 2017 and has significant growth potential. The drop in number of containers handled is seen as an equipment constraint, rather than as an indication of growth potential.

Cape Town Container Terminal information indicates that vessels often wait for three days or more to berth, compared to the global norm of one day. Although there are many factors that impact on waiting time for vessels to berth, the operational availability of equipment, such as rubber tyred gantries (RTGs), is one of them. The Container Terminal requires at least 21 RTGs to operate efficiently, both on the water and the land side. The Terminal only has 15 gantries available on a daily basis, and they often break down. Every delay that is caused by equipment constraints, means that a vessel stays longer at berth and the next vessel waits longer before it can berth.

The Regulator has repeatedly found that port tariffs in South Africa are above the global norm, such as container cargo dues that are still 166% above the sample average according to the 2020/21 Global Pricing Comparator Study. The improvement from 233% in 2019 is noted, however the cost of delays, whether waiting to berth or at berth, in addition to direct port charges, impacts directly on decisions by shipping lines to omit Cape Town.

In line with global indicator monitoring for marine cargo, such as used in the World Bank for the Container Terminal Performance Index, it is recommended that waiting time for vessels to berth could be included in the key performance indicators to be measured by the Regulator.

The decline in ship turnaround time by 17.4% for Cape Town up to Q3 2020/21 and documented by the Regulator, is noted with concern. It is also argued that the weighting of the Weighted Efficiency Gains from Operations (WEGO), which is capped at 5% requires regular reconsideration, because it mitigates the effect of penalties on persistent under-performance on tariff applications.

5. Governance

The corporatisation of the TNPA National Ports Authority is fully supported. However, there is some concern about the time it is taking to implement since the matter was raised by the Ports Regulator. Going forward it is anticipated that an arm's length relationship will be created between the boards of the National Ports Authority and that of the Transnet operating divisions. It is also anticipated that an independent verification of the asset base of NPA will be concluded as part of the corporatisation process, because this value is central to tariff expectations and calculations.

Port users like South African Association of Ship Operators and Agents (SAASOA), and academic articles such as Chasomeris (2015) and Gumede and Chasomeris (2017) have consistently argued for an asset beta

lower than 0.5. This resonates with the Ports Regulator of South Africa's (PRSA) proposal to apply an asset beta of 0.35 over the period 2021/22-2023/24. However, there is a view, which is shared by the Western Cape Government, that the asset beta could be even lower. The recommendation is that consideration be given to the systematic reduction in asset beta over time.

The attention of the Regulator is also drawn to the tax implications of corporatisation that are included in the tariff application. Chasomeris and Gumede (2020), for example, have calculated that the TNPA annual profit before tax increased by 155% from just over R2.9 billion in 2017 to more than R7.4 billion in 2019. This matter of profitability objectives in a public corporation requires clarification before expected tax obligations can be included in the tariff.

A critical point to raise is that currently TNPA's tariff application already uses a 28% corporate tax rate in its application, as opposed to the equitable (proportional) tax rate normally used which is around 15.5%. During the Western Cape region's virtual public hearing on the tariff application TNPA indicated that the difference between using the 28% as opposed to the 15.5% amounts to approximately R600 million. Using the 28% significantly increases the required tariff levels. It is argued that the application of the 28% is premature given that the process of corporatization of TNPA has not been completed yet, and until TNPA is made a proper subsidiary, the equitable tax rate should be used.

It is also anticipated that governance improvements in the Ports Authority will exceed the pace of tariff increase applications.

In conclusion, the Western Cape Government is unable to support Transnet National Ports Authority's application for an average tariff increase of 9.4% for 2022/23 on the basis that:

- Port costs are still considerably higher than that of global competitors;
- Port, as well as container terminal performance is considerably lower than the performance of competitors;
- Capital budgets are persistently underspent; and
- Governance issues, such as the objective valuation of assets and the tax implications of profits on future tariffs, are yet to be clarified.

Yours Sincerely,

MR DAVID MAYNIER

PROVINCIAL MINISTER OF FINANCE AND ECONOMIC OPPORTUNITIES

DATE: 15 OCTOBER 2021