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Skills to regulate administered prices are in short supply

SHOULD SA have an inflation cap on increases in administered prices? The Reserve Bank, MPs and others have fingered administered prices as an inflation culprit. Tariff increases implemented by public entities, in sectors such as telecommunications, electricity and transport, have run ahead of the inflation target range, putting upward pressure on prices and undermining efforts to bring inflation down to within the range.

But research presented at a conference last week suggests the debate may be misplaced. The actual level of administered prices (or, for that matter, of increases in these prices) is not the issue. Rather, the question is whether these prices are being effectively regulated. The answer is that they are not.

Many are not formally regulated at all though the relevant ministries have a say, it is essentially a case of public sector monopolies (such as the ports, railways or water authorities) setting their own prices. Others, such as Eskom and Telkom, are subject to more or less independent regulators. But there is no consistent approach, and little evidence that price regulation is scientific or likely to lead to efficient pricing or optimal outcomes in terms of service delivery.

The research, presented at the recent TIPS/Development Policy Research Unit conference, was commissioned by the national treasury in response to calls for an inflation cap on administered prices.

Economists estimate these make up nearly a quarter of the consumer inflation basket measured by the target measure, CPIX. The sectors involved account for about 15% of gross domestic product. And the infrastructure and services they provide are key to the functioning of the economy as well as to achieving government objectives of extending service delivery.

Economists make the case for governments to intervene to regulate these kinds of entities, where markets do not work on their own because of natural monopolies, for example or do not work in the way governments want them to. So regulating prices is viewed as legitimate, even essential. And this is so whether the entities are publicly owned or privatised.

But the objective is supposed to be to address the problems of "market failure" to ensure efficient pricing. Alternately, where these entities use pricing to pursue social or economic objectives, using cross-subsidies, for example, to make services affordable for the poor or rural dwellers or rail commuters, this should be transparent so that government and taxpayers know what costs are involved.

In economic theory, researchers David Storer and Ethel Teljeur note, efficient prices are defined as prices that approach marginal cost, which is the level achieved under perfectly competitive conditions. Pricing should reflect the costs of efficient production, at least in theory, though in practice this is a bit more complex.

But the researchers found that even where there were formal regulators in electricity, telecommunications and aviation the regulators were generally not properly equipped to assess whether pricing was efficient. Skills and tools were lacking and access to key data was poor.

In telecommunications, for example, where the Independent Communications Authority of SA (Icasa) regulates pricing, Telkom has tended to use legislative loopholes to avoid supplying key information. But there are other problems, such as the ministerial discretion over Icasa.

In electricity, the regulator is genuinely independent and has appropriate powers. But, the researchers found, the regulator does not have the human resources skills or infrastructure to do its own scientific assessment of costing and pricing. "At present it is unlikely that the regulatory framework is consistently and forcefully driving electricity prices towards efficient levels," say Storer and Teljeur.

This has not emerged as a problem since the regulator was set up in 1995, because of Eskom's self-imposed commitment to containing tariff increases, but could become an issue.

The shortcomings of the regulatory systems mean that the parastatals tend to keep much of the power to set their prices. Reliable and useful costing information is in short supply and there is little examination of what cost efficiencies could (or should) be realised. The researchers found little is done in the way of appropriate international benchmarking. Cross-subsidisation is seldom properly costed. And there is little monitoring of outcomes. As Storer describes it, there has been a general drift to negotiation of pricing between the public entities and the regulators, as opposed to scientific controls.

An inflation cap on pricing could be an option, but it would be a very blunt tool that would not necessarily cause pricing to be any more efficient. Realistically, it is no good planning grand new regulatory systems either, if the necessary skills do not exist. The researchers are left recommending a series of incremental improvements to existing systems.

But clearly government needs to watch this one carefully.

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