Administered prices and the cost of living

From 16 to 8 percent: A sigh of relief?

On 28 February 2013, the National Electricity Regulator of South Africa (NERSA) granted ESKOM an 8 percent average increase per annum over the next five years. Since ESKOM was demanding a 16 percent increase, the 8 percent increase brought a sigh of relief to many. However, the 8 percent annual increase is likely to be above inflation. Over the past two years, inflation has been hovering around 5.6 percent.[1]Already in his 2013 budget speech, presented to parliament a day before NERSA's announcement, Minister PravinGordhanprojected an inflation lower than 8 percent. Gordhan said that "inflation remained moderate, with consumer prices rising by 5.7 per cent in 2012 and projected to increase by an average of 5.5 per cent a year over the period ahead." The sigh of relief is therefore a case of "half a bread is better than nothing."

While we cannot ignore the contribution of the price of electricity to inflation, the problem is far greater than ESKOM. South Africa has a general problem of high administered prices that impact negatively on the cost of living, and to wage demands in the labour market.

What happens in Kuwait can affect the price of petrol in your village

In South Africa, the prices of electricity, fuel levies, port tariffs, municipal charges, and water, fall under the category of administered prices. Administered price is a technical economics term defined as "the price of a good or service as dictated by a governmental or other governing agency."[2]The advantage with the administered prices is that the price control systems can specify a price ceiling and a price floor for specific goods categorized under administered prices. But that does not completely eliminate abuse or uncompetitive behavior by cartels.

In theory, these prices are said not to be determined by regular market forces of supply and demand. However, in practice they are. It is highly unlikely that when South African fuel regulators sit around the table to determine the price of petrol and diesel they do not consider supply and demand factors in the sector. The PSA believes they do.

When the international price of a barrel of oil goes up due to a huge demand and limited supply, fuel in South Africa must also go up. This is how international demand and supply affect us here at home. Fluctuations in the value of the Rand also have an impact on the price of oil, since international trade is conducted through the medium of the US dollar. When the Rand is weak, fuel becomes more expensive for our country. The fuel levies imposed by our government also affect the price of fuel; they are an additional burden to ordinary users of transport.

In a global economy we live in today, what happens in a village in Kuwait can affect life in rural South Africa. As the African Development Bank also observed in 2006, “the high price of oil impacts directly on firms, consumers and the government. …. [It] increases the domestic price of petroleum products, raises the cost of many intermediate inputs, and as a result leads to higher production costs.”[3] It is for this reason that the PSA believes that, in practice, the administered prices are not immune to the influence of market forces. Their contribution to rising inflation and the cost of living cannot be understated. The PSA is therefore urging the employer to consider the impact of these factors on the cost of living when deciding on wage increases.

A well known problem

The problem of administered prices is well known and has been troubling the minds of South African Reserve Bank Governors for years. From former Reserve Bank Governor Tito Mboweni to the current Governor, Gill Marcus, they all have expressed concerns over administered prices during their term of office.

In 2004, Mboweni decried the negative impact of administered prices on inflation targeting.He said that administered prices carried about 25 % weight in the CPIX basket at the time. Mboweni urged government to assist the Reserve Bank to keep inflation under control: “If government wants to assist us in ensuring that we remain within the three to six per cent target range, then it has to ensure that these prices stay within the target. If government could ensure that administered price came in at the mid-point of the inflation target that would be wonderful.”[4]

As recent as January 2013, Gill Marcus raised her concerns about administered prices:

- Administered prices increased by 8,8 per cent, and by 7,6 per cent excluding petrol… Administered prices remain on average well in excess of the upper end of the target range, and there is as yet no clarity about the new Eskom tariffs to be implemented later this year.[5]

The PSA is concerned that this years’ State of the Nation Address did not make any reference to the challenge of high inflation, of which administered prices are a significant part. We believe that President Zumashould have given feedback on the task he had given to ESKOM “to seek options on how the price increase requirement may be reduced over the next few years, in support of economic growth and job creation.”[6]

Monopoly capital

South Africans are already burdened by unscrupulous business people who collude to overcharge the state on infrastructure development programmes. The recent scandal in the build industry wherein cartels have allegedly collaborated to fix prices in order to elbow out small players in the development of 2010 FIFA World Cup infrastructure is one such example. This is a problem of monopoly capital, in which cartels resort to uncompetitive behavior to throttle small business. Indeed, the dynamics of this phenomenon have long been understood:

- Cartels come to an agreement on the conditions of sale, terms of payment, etc. They divide the markets among themselves. They fix the quantity of goods to be produced. They fix the prices. They divide the profits among the various enterprises.[7]

In South Africa, we do not only have private monopoly capital. We have state owned monopoly such as the one enjoyed by ESKOM on electricity distribution. The people have no choice but to succumb to ESKOM's exorbitant fees. This monopoly also boosts ESKOMs confidence to demand price increases that are way above inflation.

The PSA supports the idea to address administered prices by introducing and nurturing a competitive environment in the energy sector and break up ESKOM's monopoly. We believe that if the playing field waslevel, the price of electricity would come down. This could be done without shedding jobs.

Income is eroded by high inflation

Given South Africa's declining manufacturing and agriculture, the country is becoming heavily dependent on importedproducts and food.In 2010, "South Africa imported processed agricultural food products than it exported."[8] This has serious implications for food prices. Last year Gareth Ackerman, Chairman of Pick n' Pay, made a compelling argument about the impact of food prices on household incomes. He pointed out that household incomes of the poor were eroded by rising food prices.[9]In June 2010, for example,a loaf of brown bread was R6.97. In February 2013, it has risen to R10.00. The rising cost of bread is not only as a result of the scarcity of wheat, it is also as a result of input costs such as the rising cost of fuel and electricity.

Statistics SA has shown that food and non-alcoholic beverages inflation stood at 8.7%, according to the April2012 consumer price index and was projected to rise to 18%.[10] While an average household spent 14.5% of its total annual income on food and non-alcoholic beveragesin 2005, this had increased to 19.3 percent in 2008. Recent data shows that the poor spend more on food than the rich, averaging 36.4 % and 2.9 % respectively in the last year. The burden that rising food prices impose on the poor is indeed disproportionate.

Conclusion

The PSA welcomes the decision by NERSA not to grant ESKOM the 16 % increase they had requested. We are still concerned, though, that the increase given to ESKOM is still way above projected inflation. Combined with the ever increasing price of fuel, food and other essential needs, it will be difficult for workers to cope with salary increases that are only inflation adjusted. Our concern is that the annual increase given to ESKOM will adversely affect the cost of living.

The PSA will continuously monitor these increases in Administered Prices and persuade the Government to insist that the National Energy Regulator grant only inflation-linked increases so as to reduce the cost-of-living for the majority of the South African citizens.

References

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