

**DRAFT PORT TARIFF METHODOLOGY FOR UKRAINE**

**Second Draft**

*March 2017*



Contents

[METHODOLOGY FOR SETTING PORT AUTHORITY TARIFFS 3](#_Toc477510821)

[Preamble 3](#_Toc477510822)

[Legal and regulatory changes necessary for the tariff revisions 3](#_Toc477510823)

[1 INTRODUCTION 4](#_Toc477510824)

[Guiding principles for the revision of tariffs 4](#_Toc477510825)

[Approach to the tariffs 4](#_Toc477510826)

[Avoidance of Cross Subsidy 5](#_Toc477510827)

[Validation of the Cost Information to be used as a basis of the tariffs 5](#_Toc477510828)

[The problem of inflation 5](#_Toc477510829)

[Clawback 5](#_Toc477510830)

[Tax 6](#_Toc477510831)

[2 ADJUSTMENTS TO THE FOUNDATIONS OF THE TARIFFS 6](#_Toc477510832)

[Switch to Gross Tonnage 6](#_Toc477510833)

[Reduction in the number of dues 7](#_Toc477510834)

[Simplification and removal of duplication of tariffs. 7](#_Toc477510835)

[3 PERIOD TO BE COVERED 8](#_Toc477510836)

[4 PORT TRAFFIC IN THE BASE YEAR 8](#_Toc477510837)

[5 PORT TRAFFIC FORECASTS 8](#_Toc477510838)

[6 CURRENT REVENUES 9](#_Toc477510839)

[7 REVISION OF REVENUE CENTRES 10](#_Toc477510840)

[8 ESTABLISHING THE BASIC COSTS 10](#_Toc477510841)

[Other Costs 13](#_Toc477510842)

[9 SCOPE FOR EASY COST REDUCTIONS 13](#_Toc477510843)

[10 FORECAST OF COSTS 14](#_Toc477510844)

[11 FORECAST OF THE FUNDS REQUIRED FOR INVESTEMENT 14](#_Toc477510845)

[12 REQUIRED REVENUES AND CALCULATION OF THE COST BASED TARIFFS 15](#_Toc477510846)

[13 REFINEMENTS TO THE COST-BASED TARIFFS 17](#_Toc477510847)

[14 CLAWBACK 18](#_Toc477510848)

[15 TAX 19](#_Toc477510849)

[16 RESERVE 19](#_Toc477510850)

[ANNEX A 20](#_Toc477510851)

[LEGAL AND REGULATORY CHANGES NECESSARY FOR THE TARIFF REVISIONS 20](#_Toc477510852)

# METHODOLOGY FOR SETTING PORT AUTHORITY TARIFFS

### Preamble

This document is the third in a series of three, the objective of which is to develop a new methodology for calculating port tariffs in Ukraine. The first two analyzed the current state of the port tariffs, compared them with best practice elsewhere and discussed the options for reforms. They concluded that:

* There was a need for a large reduction in tariffs, which in 2015 generated revenues for USPA that were 3.5 times as high as total costs.
* The transfer of port profits to central government should be discontinued.
* In setting tariffs the economic interests of Ukraine should take precedence over the financial interests of the Ukrainian Sea Port Authority.
* The ports should be operated on a ‘not for profit’ basis. That is to say, all profits should be reinvested in the ports.
* Tariffs should be based fundamentally on costs, with some refinements based on commercial considerations.
* The ports should not have to fund investment wholly from accumulated profits. They should have access to external finance.
* The tariffs should be simplified and their number should be reduced.
* The ports should pay no corporation tax

This document now sets out the methodology for calculating the tariffs.

### Legal and regulatory changes necessary for the tariff revisions

To be effective the new port tariff methodology will have to be coupled with several legal and regulatory reforms. They are listed in Annex A.

## 1 INTRODUCTION

### Guiding principles for the revision of tariffs

The main objectives of this methodology***[[1]](#footnote-1)*** are to set tariffs at levels that will:

* minimise transport costs for the Ukrainian economy and in particular importers and exporters;
* recover port costs;
* enable Ukrainian ports to compete with ports elsewhere; and
* generate or remove bottlenecks to economic activity in Ukraine where possible.

This will require the economic interests of Ukraine to take precedence over the financial interests of the Ukrainian Sea Port Authority. USPA should operate as a “not for profit” organization[[2]](#footnote-2) in the sense that profits should be limited to those needed for port investment. There should be no additional profits and no transfer of profits to central government funds.

### Approach to the tariffs

Following worldwide best practice, the tariffs should be primarily cost-based[[3]](#footnote-3).

They should be designed to cover three sets of port authority costs, specifically:

* operating costs;
* depreciation of some, but not all (see section 8), assets; and
* a surplus to contribute an agreed share of future investment requirements (see section 11). This will require a decision by the Ukrainian government on the percentage of investment[[4]](#footnote-4) that should be funded by the port authority by profits from port tariffs. It should be decided in the light of initial calculations of the required port tariffs based on two sets of assumptions – (i) with the port authority financing all investments and (ii) the port authority financing only 50% of investments with the rest coming from external funds.

The primarily cost based tariffs, however, should be adjusted where necessary in the light of commercial considerations - in particular to meet competition (i.e. to avoid the loss of traffic to, or to attract traffic from, competing foreign ports); and to attract transit and transhipment traffic where possible.

The demand based adjustments, especially those for transit tariffs, will require consultation with the providers of the other transport modes used within Ukraine’s borders. The port users’ council should consulted before all changes to the cost-based tariffs.

The commercially motivated reductions or discounts to any tariffs, however, should be matched by compensating increases to other tariffs. That is to say, the dominant principle that the ports should cover their total costs should always be retained.

### Avoidance of Cross Subsidy

The ports authority should avoid cross subsidy between revenues centres except where is in the public interest.

### Validation of the Cost Information to be used as a basis of the tariffs

The main cost information to be used for calculating the tariffs will be that maintained by the USPA. They will need careful review, and an audit will be necessary to validate to the costs.

### The problem of inflation

The prediction of future costs and revenues will inevitably be complicated by the domestic inflation rate and the exchange rate between the hryvnia in which currency most of the costs are incurred and the US dollar in which currency the tariffs are denominated. The movements in recent years have been extreme.

### Clawback

To ensure that neither port users nor the port authority lose or gain as a result of gap between forecast and actual costs and revenues a clawback mechanism will be introduced and applied at the end of every year. Under this arrangement the Ministry of Infrastructure will make a ruling on the adjustment necessary in the next year’s tariffs to compensate port users as a whole for overcharging by the port authority, or to compensate the port authority for their having undercharged the port users. The adjustment of the tariffs annually is considered essential during the early years of the application of the new methodology, until many of the key variables to be taken into account (especially inflation and exchange rates) have settled. The annual adjustments will also protect port users from possible large step changes in the tariffs.

### Tax

(It is proposed that) a not-for-profit port authority should not pay corporation tax[[5]](#footnote-5).

## 2 ADJUSTMENTS TO THE FOUNDATIONS OF THE TARIFFS

Some basic changes are necessary to bring Ukraine’s tariffs into line with best practice worldwide. They are:

* A change in the basis for charging Tonnage Dues and other dues - from the ‘conventional volume’ used under the soviet pricing system to the standard basis used elsewhere in the world – i.e. the Gross Tonnage of the vessel.
* Reduction in the number of tariffs at Ukraine’s ports
* Simplification, removal of duplication, and increased clarity

### Switch to Gross Tonnage

The Ukrainian port dues which are still charged on the old soviet measure of the ‘conventional volume of a vessel’[[6]](#footnote-6) should in future be charged on the basis of Gross Tonnage of the vessels, ships. The Gross Tonnage (GT) of a ship, which is available in the vessel’s documents, is calculated on the basis of "the moulded volume of all enclosed spaces of the ship", by measuring the total capacity in volumetric tons of 100 cubic feet, adding the underdeck tonnage and the internal volume of tween-decks and deck space used for cargo. The formula to be used is defined in Regulation 3 of Annex 1 of [*The International Convention on Tonnage Measurement of Ships, 1969*](http://www.admiraltylawguide.com/conven/tonnage1969.html)*,* and serves to determine the ship's manning obligations, safety requirements and registration cost as well as port dues.

This change in the basis for charging should be applied to:

* Tonnage dues
* Channel dues
* Light dues
* Administration dues
* Sanitary dues
* Anchorage dues

A refinement that might be considered when moving to GT would be to switch the charging unit to GT-Days, to give an incentive to minimize time at berth and thereby raise the capacity of the quays – i.e. to encourage better utilization of resources. (However, a fixed charge per stay is more common in ports worldwide.)

The dues per GT might vary by vessel type, as is common at ports elsewhere.

Berth dues, however, should continue to be based on the tonnage of the cargo loaded and discharged, as in major ports elsewhere.

### Reduction in the number of dues

The number of port dues should be reduced to bring Ukraine’s port tariff schedule into line with those of major ports elsewhere[[7]](#footnote-7). The largest North West European ports of Rotterdam and Antwerp charge only two significant tariffs (tonnage dues and berth dues) plus a minor (sanitary dues). Ukraine, however, might retain another major charge, that of channel dues, reflecting the fact that expenditure on dredging in Ukraine is high.

It is noted that the merging of tariffs may require a change in the Port Law.

### Simplification and removal of duplication of tariffs.

The need to simplify the tariffs and remove duplication and lack of transparency should be borne in mind during the consolidation the tariff schedule into a smaller number of dues.

## 3 PERIOD TO BE COVERED

The tariffs should be set for a period of 3 years[[8]](#footnote-8).

## 4 PORT TRAFFIC IN THE BASE YEAR [[9]](#footnote-9)

Ukraine’s port traffic should be established for the base year (2016). The statistics should be presented in a format that enables the traffic that generates revenues from each tariff to be forecast. The main tariffs are, and will continue be, based on the capacities of the ships, although on Gross Tonnage rather that ‘conventional volume’ used until now; while berth dues should be based on cargo tonnage.

The basic information required is:

*Current (2016) Cargo Traffic (in tonnes or teu for containers):*

Total traffic in Ukrainian ports

Broken down:

By port

By cargo

*Current (2016) Shipping traffic:*

 Number of ship calls by port

Gross tonnage of ships calling by port

Average Gross Tonnage

## 5 PORT TRAFFIC FORECASTS

The demand for port facilities and services over the period for which the tariffs are to be set should be forecast *for each cargo and each port separately*, from the following building blocks:

* The growth rates for each cargo at each port, and the associated ship calls in terms of GT, over the last five years. This data should be available from USPA’s historical statistics.
* Recent GDP growth and the ratio of growth in GDP to that of cargo traffic and the Gross Tonnage of shipping.
* Analysis of the growth prospects for the main cargoes, especially bulks such as cereals,
* iron ore and coal.
* Analysis of the impact of political developments, particularly on the prospects for transit cargoes from Russia and other countries.

The forecasts should be based primarily on statistical trends but supplemented by interviews with port users. They should be undertaken by staff at the individual ports that have local knowledge of their own markets and can consult their local users, and then consolidated at the national level. The USPA staff may need some guidance from outside consultants who specialise in ports and are knowledgeable about global forces for the first set of forecasts, but should then be able to take on this task themselves.

The forecasts should be calculated initially in tonnes (and teu for containers) and then in number of ship calls and Gross Tonnage.

## 6 CURRENT REVENUES

Port authority income for last three years should be established by tariff item. The main incomes have been from the following charges:

* Tonnage dues;
* Berth dues;
* Channel does;
* Anchorage dues;
* Administration dues; and
* Sanitary dues

In addition the USPA’s consolidated financial statement shows ‘financial’ as well as ‘operating’ incomes that should be included in total revenues. All current assets including cash that have been included in the USPA’s consolidated financial statements should be clarified along with their benefits.

Available statistics will require a detailed examination before drawing up a valid set of revenue accounts.

It is also noted that:

* ‘berth dues’, which would normally account for a significant share of port authorities’ incomes, are low (see footnote 7). The reasons for this should be examined; and
* rentals, concession, and other fees which are not shown in some of the USPA’s revenue statistics, will need identifying and clarifying.

## 7 REVISION OF REVENUE CENTRES

The number of revenue centres should be reduced to four (to be agreed). The final list will require discussion but may be:

* Tonnage dues;
* Berth dues;
* Channel dues; and
* Sanitary dues

Most of the existing minor tariffs such as VTMS, Harbour Master’s fees and administration dues (see footnote 7 for full list) should be consolidated under Tonnage Dues.

## 8 ESTABLISHING THE BASIC COSTS

The port authority’s operating costs for each revenue centre should be established. This will require careful examination of the several sets of statistics that are available.

For example, the most comprehensive figures available show, for each of 21 ports and for each of seven revenue centres (tonnage, berth, channel, light, anchorage, administration, and sanitary dues) the following costs for 2014:

USPA Port Costs (one of several sets), 2014

|  |  |  |
| --- | --- | --- |
| Payroll and social |  162,800  | 6% |
| Fuel |  |  17,826  | 1% |
| Energy |  |  6,894  | 0% |
| Other materials |  61,716  | 2% |
| Administrative and other expenses  |  545,417  | 21% |
| Repair of fixed assets  |  40,408  | 2% |
| Costs of investments  |  856,472  | 33% |
| Expected value of income tax |  880,578  | 34% |
| TOTAL | 2,572,110 | 100% |

Source: USPA

Several features of these costs, however suggest a need for adjustment. In particular,

* Tax is not an operating cost
* The costs of investments are not normally included under operating costs.
* Payroll cost is very low. In fact, other statistics from USPA suggest that staff costs are around half of total - a figure that is in line with ports elsewhere in the world. It is assumed that a large part of staff costs are included under the heading of administrative and other expenses.
* The figures are dominated by a large figure for administrative costs which is in need of disaggregation.
* Repair of fixed assets appears very low.

An audit will also be necessary to validate the assumptions and figures selected as the true costs of operation.

The validated costs should then be:

* broken down by port;
* broken down by main category of cost – for example, into staff, depreciation, materials, fuel and electricity, administration and other costs; and
* assigned to revenue centres. Comprehensive statistics are already available on costs by revenue centre over the last five years, although there are some inconsistences with other USPA statistics.

Some costs, however, will not be immediately assignable to revenue centres. They include finance and accounting, HR, administration, security, Head Office and workshops. Options for allocating these cost to revenue centres (for example, in proportion with revenues earned via each tariff), should be evaluated.

Several of the recorded costs will require careful examination, including the top two costs, those of staff and depreciation:

***Staff***

The largest cost is that of staff, which accounts for about half of total costs according to one set of USPA’s statistics. It is also the area in which it may be able to make simple economies in the short term. (It should also be possible to cut staff to levels more in line with international benchmarks in the longer term, but no such programmes are likely to be practical in the three year period covered by the initial tariff).

Prior to review by auditors, the following details of employment costs should be presented:

 Number of approved posts

 Actual staff numbers

Wages and salaries

Breakdown of wages and salaries between basic wages, overtime, bonus

Pension costs

Contracted and casual labor

After consolidating these costs site visits should be arranged at the ports, terminals and vessels, and interviews conducted with key staff to identify staff requirements for each of the operations.

***Depreciation***

Depreciation costs for the base year should be established. The port authority’s statistics show differing figures for this item and they should be reviewed before drawing up justifiable figures.

The analysis should also consider several questions about the depreciation calculations.

First, the objective of depreciation is to create a pool of funds to be used to replace port assets when they reach the ends of their working lives. In practice, however, some of the port authority’s main assets in ports such as breakwaters and in particular port channels and canals are unlikely to be replaced. This applies most of all to port channels and canals. They are maintained but not ‘reconstructed’, and they have accounted for over 40% of USPA investment over the last five years. Accordingly, no allowance for channels or breakwaters should be included in the depreciation calculation. Berths, however, may need rehabilitating and strengthening after, say fifty years. The decision of which assets need a replacement fund require detailed analysis of the ports’ assets.

Secondly, even when major assets are replaced it is common practice internationally to fund some of the expenditure from loans as well as internal surpluses. Consequently, the funds accumulated to cover depreciation are often surplus to requirements.

Thirdly, the asset lives assumed for calculating depreciation are presumed to have been set in soviet times and may need bringing into line with those used at international ports elsewhere. For example, the Port Designers Handbook by Carl Thorensen, 2003, shows the following asset lives:

 Years

Breakwater 100

Berths 50

Container cranes, gantry 20

Container cranes, mobile 10

Straddle carriers 5-10

Rubber fenders 10

Aprons and roads, concrete 20

Asphalt surfacing 10

Forklifts and reach stackers 10

Road tractors 10

Warehouses and sheds 40

Fourthly, the asset values need updating. They are stated in Ukrainian currency and examination of the USPA’s statistics over the last three years suggests that they have not been revalued to take account of the increased cost of replacement in terms local currency.

Revaluations of assets should be carried out on a routine basis every three years, and more frequently in periods of high domestic inflation and/or changes on the hryvnia-dollar exchange rate.

### Other Costs

Other costs, including fuel and electricity, materials, contracted services, insurance and maintenance and repair are likely to more straightforward to forecast, on the basis of statistical trends in recent years.

## 9 SCOPE FOR EASY COST REDUCTIONS

It is a common problem with cost-based tariffs applied by state monopolies that the agency is aware that whatever costs are incurred, they will be able to recover them. This can lead to the employment of excess staff, and Ukraine’s port staff levels is a good example, being well above international benchmarks.

To base the new tariffs on existing costs that have not been subjected to discipline - market or otherwise - will inevitably involve an element of sub-optimisation. But the aim for the initial recalculation of the tariffs should not be radical surgery to the costs. It should be limited to improvements to operations that are easy to achieve

It should also be borne in mind that although future staff rationalisation may reduce the numbers employed, their salaries and wages, which appear low at present, may increase.

## 10 FORECAST OF COSTS

Forecasts of the costs should be based primarily on

* The base costs identified in section 8
* Recent trends in each of the main costs
* Forecasts of domestic inflation, local wage rates and changes in the hryvnia-dollar exchange rate.

This task will require both an understanding of cost center budgeting and financial modeling, and may require the assistance of outside consultants who specialize in the ports industry in the initial stages.

## 11 FORECAST OF THE FUNDS REQUIRED FOR INVESTEMENT

The funds required for investment should be forecast based on actual investments and their trends over the last five years[[10]](#footnote-10)

The percentage of future investments that should be funded by the port authority should be decided, taking into account the fact that it is common practice worldwide for ports not to fund ***all*** the costs of their investments entirely from accumulated port surpluses, but to borrow/attract some of their funds from banks, governments, international agencies, bond issues, etc[[11]](#footnote-11).

As stated in the introduction, the percentage of investment costs that should be funded by the port authority should be decided in the light of initial calculations of the port tariffs based on two sets of assumptions – (i) with the port authority financing all investments and (ii) the port authority financing only 50% of investments with the rest coming from external funds.

In deciding the arrangements for funding investments, however, precautions should be taken to avoid the potential criticism that if USPA opts to impose one set of tariffs across the ports (see second last paragraph on section 12) and allows major investments at only a limited number of ports this would entail cross subsidization or cross financing of some port investments at the expenses of other ports costs.

The relatively assured nature of the ports’ revenues and the introduction of a clawback mechanism to recover any annual losses should ensure that the ports should be regarded as low risk by lenders.

The cost based tariff should cover interest payments on loans.

## 12 REQUIRED REVENUES AND CALCULATION OF THE COST BASED TARIFFS

The results of the preceding analysis should be drawn together to consolidate the ***total costs in each revenue centre***. They should consist of:

* Operating costs
* Depreciation of those facilities that will require replacement
* A surplus to fund a percentage (to be decided) of investment requirements over the next three years.

The total costs are summarized as follows:

Total costs = (O +D +Ir+Int+C)

Where:

O Operating costs (S+R+F+E+In+M+O)

*Including:*

*S Staff costs including benefits and pension*

*R Repairs*

*F Fuel*

*E Energy*

*In Insurance*

*M Materials*

*O Other operating costs, including contracts and outsourced services; and administration but avoiding double counting of staff costs*

D Depreciation

Ir Port authority investment requirements

Int Interest on loans, if any

C Clawback (+/-)

The final steps should be to:

* divide the total costs in each revenue centre by their forecast shipping and cargo traffic volumes to derive required revenues and therefore cost based tariffs per GT or per tonne of cargo; and
* convert the required tariffs from Hryvna to US dollars.

The resulting tariffs could be calculated separately for each port or, following existing practice, for Ukraine as a whole, with similar tariffs at almost all of the main ports, with limited exceptions.

Particular attention will be paid to the assumptions on the value of the dollar against the hryvnia. There should be no change in the current set-up wherein most of the costs are incurred in Ukrainian currency.

## 13 REFINEMENTS TO THE COST-BASED TARIFFS

The cost based tariffs calculated as described in the previous section should be adjusted in the light of commercial considerations where necessary - in particular to enable the Ukrainian ports to compete with other ports (i.e. to avoid the loss of traffic to, or to attract traffic from, competing foreign ports); and to attract transit and transhipment traffic where possible. Ukraine’s ports have lost large volumes of transit traffic to foreign competitors in the last decade.

For this purpose it will be necessary to:

* Examine competition from other ports, comparing tariffs, handling speeds and water depths to assess the scope for attracting traffic, or avoiding loss of traffic. The competition will come not only from neighbouring ports but from distant ports with which Ukrainian exporters have to compete in world markets – for example, Brazilian ports for iron ore, South African ports for coal and Australia ports for cereals.
* Consult with port users, railways, trucking companies, port handling and storage companies on the discounts that would be necessary. For this purpose the port users council needs to be strengthened and its role in the discussions on tariffs should be formalized.
* Review the need for exceptions to cost-based tariffs. Either USPA or Port Councils are to initiate the adjustments to port tariffs.
* Set discounts

It is noted that a letter from the Antimonopoly Committee of Ukraine dated 05.05.2014 (№ 136-29 / 06-3996) requires approval from the Ministry of the methodology for determining discounts to port tariff rates. However, two considerations - the complexity of the factors determining an ideal discount, and the fact that the dominant agencies in the transport chain are not the port authorities - rule out the possibility of any fixed methodology for tariff setting based on commercial considerations and their related discounts. The discounts should be set on a case-by-case basis after examining the competition. They should not, however, be set below the *combined* short run marginal costs (SRMC) of Ukrainian transport providers (including Ukrainian rail, road, port terminal, storage and other national transport facilities) for the transit movement within the Ukrainian borders. There is often great scope for such cuts in transit tariffs because the short run marginal costs are often very low. The reason is that the costs of staff and equipment are more or less fixed in the short term, and setting prices just above them can attract traffic that would not be attracted by tariffs covering full operating and depreciation costs.

The SRMCs, however, will remain low only as long as there is surplus capacity at the berths. When full capacity is reached and a new investment is required the SRMCs - i.e. the cost of handling additional tonnes - rise to a high level. At this stage an economic cost-benefit analysis would be necessary to establish whether new facilities are justifiable. With SRMCs fluctuating from year to year, the discounts should therefore be reviewed on a regular basis.

It is emphasised that the port authority’s charges will usually be the smallest in the transit transport chain, well below those of port handling, storage and rail costs; and the routeing decisions will be based on total supply chain costs not port costs. Close cooperation will therefore be essential between (i) the ports and the other operators on the transit route and (ii), most importantly, the exporters and importers in order to develop an effective joint approach to the cargoes they are hoping to attract. It will also be important to maintain up to date information on the costs of optional routes – especially via the Baltics and Russia, where governments are active in influencing cargo routings.

A further complication with demand-based pricing is that the port’s competitors will often react with their own tariff changes. The objects of the strategy therefore become moving targets.

Against this complex background, which will differ on a case-by-case basis, there can be no formula for optimal pricing.

The discounts for transit should be expressed as percentages of the normal tariff. They should be implemented in a transparent open manner and should be available to anyone who meets the criteria

## 14 CLAWBACK

The tariffs should be fixed by the MoI every three years on the basis of the traffic, cost and revenue forecasts submitted by the USPA. However, during each three year period clawback adjustments will probably be necessary every year.

The reasons are that there will almost inevitably be some differences between the forecast traffic, cost and revenue figures and the actual figures. Two major examples of unforeseen developments in recent years have been the loss of transit traffic due to political tensions, and the windfall to the ports when the devaluation of the hryvnia in 2014 and 2015 resulted in tariffs quoted in dollars trebling in terms of hryvnia. Ukraine’s ports are more exposed to such fluctuations than most ports worldwide

To deal with this problem a clawback mechanism should be introduced to ensure that neither the ports nor their users gain or lose out from discrepancies between traffic, cost and revenue forecasts made at the time of the tariff application and actual realised figures. The basic principle will be simple: where there is over-recovery of , say, 5%, in the previous year’s accounts, the Ministry will reduce the next year’s tariff by that amount; and vice versa where there is under-recovery in the previous year.

For the clawback to work effectively the ports will need uniform financial and budgeting procedures and audited financial statements available without significant delays.

## 15 TAX

As a ‘not-for-profit’ port authority the USPA should not pay corporation tax[[12]](#footnote-12).

Some progress has already been made on the subject of whether or not the USPA should pay tax. In a letter from the Ministry of Finance of 21 nov.2016 № 31-24020-10-5 / 32891 to the Ministry of Infrastructure it was stated that the revenues from port charges should not be regarded as USPA revenues, but should have the status of targeted financing

The arguments for and against paying local taxes, however, should be examined[[13]](#footnote-13).to and For The caseShould ports have to pay some form of PILOT (payments in lieu of taxes) to local or regional governments for external services provided? eg. fire, police etc.

 There is a case for this. Just over half of European ports pay local taxes according to a recent survey

## 16 RESERVE

The proposed cost-based tariffs - with revenues limited only to those necessary to cover operations, depreciation and investment - will reduce costs to importers and exporters.

They will, however, leave the ports no longer cash rich. As such, they will be vulnerable to events and shocks that have not been forecast. Such events might include damage due to weather, collapse of infrastructure, strikes, war, and loss of traffic as a result of political events.

There will therefore be a need for a reserve to allow the ports to be independently self-sustaining, and tide them over such shocks.

Such a reserve could be funded from the current excess profits, which amounted to $200 million for the year 2015 alone, according to USPA’s Consolidated Income Statement.

## ANNEX A

## LEGAL AND REGULATORY CHANGES NECESSARY FOR THE TARIFF REVISIONS

Ukraine is burdened with and unusually large number of laws and regulations affecting tariffs[[14]](#footnote-14). Consequently variuoslegal and regulatory changes will be necessary to implemente the methodology - including the ‘not for profit’ institutional arrangements whereby all profits are reinvested in the ports. In particular, changes will be necessary to the following laws or orders:

* the Commercial Code of Ukraine (in particular, art. 19, 74.75, 142),
* the Tax Code of Ukraine,
* the Law of Ukraine "On sea ports of Ukraine",
* the Order of Cabinet of Ministers Ukraine from 23.02.2011 # 138,
* the Order of Cabinet of Ministers of Ukraine as of 11.07.2013 #548-p "on approval of the Strategy of development of sea ports of Ukraine till 2038"
* and so on.

Some specific changes will also be required in order to:

* Rationalize the role of the lighthouse dues. They are supposed to be the source of funding for maritime safety and rescue (as required by the Order of the Minister of Infrastructure of 27.05.2013 number 316 "On Port Fees", registered with the Ministry of Justice 06.12.2013 for № 930/23462) and are paid not to the USPA but to another agency, "Derzhhidrographia." But following the Order of the Cabinet of Ministers of Ukraine of 24.02.2016 number 158 "On restoration of a unified system of search and rescue at sea", the USPA now has to provide funding for search and rescue by transferring ten percent of tonnage dues to the public enterprise "Marine search and rescue service" (CE "MPRS"). Endorsement of these proposals will require changes in the sources of funding of KP "MPRS" and control of the functions of "Derzhhidrographia." This will require amendments to current legislation.
* Incorporate the VTMS into the tonnage dues. This proposal would require amendments to the Law of Ukraine "On Prices and Pricing", p. 21, and to the Law of Ukraine "On sea ports of Ukraine" p.22, and to the Resolution of the Cabinet of Ministers of Ukraine of 03.06.2013 number 405 "On approval of the list of specialized services provided in seaports natural monopolies, which are subject to state regulation" (as amended) as well as other legal acts;
* Incorporate the Administrative due into the tonnage due. This would require amendments to paragraph. 37 ch. 2, Art. 29 of the Budget Code of Ukraine, which states that the administrative fee should be a revenue source of the State Budget of Ukraine, an amendment to the Budget Code, and art. 22 of the Law of Ukraine "On sea ports of Ukraine."

It was also observed that some of the port tariffs shown in USPA cost and revenue statistics are charged not by USPA, but by:

"Derzhhidrographia" (the lighthouse fee),

LLC "TIS" (tonnage, berthing),

LLC "SMEs" Nika-Tera ",

LLC "NIBULON" (tonnage, channel, berthing).

It is recommended that these organizations should be subject to the same methodology as for the main USPA port tariffs.

1. The reasons for a new approach to the tariffs include the facts that the methodology of the existing tariffs has not been changed since soviet times; there has been an increasing disconnect under the current system between cost and revenues which has been aggravated by high inflation rates and changes in the exchange rate for the hryvnia; the emergence of tariffs that are well above those of competing ports; and port authority revenues in 2015 that were 2.8 times as high as costs. [↑](#footnote-ref-1)
2. A good example of the ‘not for profit’ arrangement are the UK Port Trusts. [↑](#footnote-ref-2)
3. The setting of tariffs to cover costs is the dominant approach worldwide. It advantages include:.

	1. Enabling the port authority to finance its own operations independently of external assistance and at the same time minimise cost to port users
	2. The fairness of the principle of that “the users pays” the full amount for each service used.
	3. The accounting and business discipline it imposes on the port by highlighting whether each revenue centre is covering its costs.
	4. The economic efficiency resulting from the optimal allocation of resources. Tariffs that are not based on costs will in most cases undermine the role of pricing signals in the optimal allocation of resources. [↑](#footnote-ref-3)
4. The use of external funding sources is necessary to bring Ukraine into line with best practice elsewhere in the world’s ports, where a significant percentage of port investment costs are funded by bank loans, international

agencies, bonds and private companies. [↑](#footnote-ref-4)
5. A recent study of a large number of European ports by ESPO (European Sea Ports Association) showed that only 55% of ports paid income tax, while over 80% paid Value Added Tax. [↑](#footnote-ref-5)
6. Calculated in cubic metres from the sum of three values (vessel length, vessel beam and vessel freeboard) shown in the certificate of tonnage (principal dimensions) or in the document that substitutes for it. [↑](#footnote-ref-6)
7. This should not be difficult adjustment as 92% of the port authority’s dues come from two tariffs, i.e. tonnage and channel dues (in 2014). The third tariff that might have been expected to account for a higher share of total revenues is “berth dues”, which accounted for only 5% in 2014:

Port Revenues by Tariff Item 2014

Tonnage dues 54%

Channel Dues 37%

Berth Dues 5%

Sanitary Dues 3%

Anchorage Dues 0%

Total 100%

It will be noted that only a few of Ukraine’s minor port charges are itemised in the USPA’s statistics on revenues shown above. They do not show (there is a need to check that all of these tariffs are paid to the port authority):

• VTMS (Vessel Traffic Management System)

• Administration dues

• Boatmen dues

• Harbour Master fee

• Port information fee

• Watch keeping service

• Sealing of output valves [↑](#footnote-ref-7)
8. An annual review will also be necessary because currency rate changes, inflation and other various shocks will make it difficult to plan accurately for a longer term. The review should also establish the value of the clawback. [↑](#footnote-ref-8)
9. Some of the tariffs ( e.g. tonnage dues)are, and will be, based on Gross Tonnage of the vessel calling and others (e.g. berth dues) are based on cargo volumes [↑](#footnote-ref-9)
10. The expenditure on investment over the last five years for which statistics are available (2010-14) averaged 834 million hryvnia, equivalent to 12% of port authority revenues in 2015. [↑](#footnote-ref-10)
11. The ports of Ukraine are currently required to fund all their investment projects from their profits, a practice that dates back to soviet times. In fact there were similar arrangements worldwide up to the 1970s, when most ports were not only state owned but also state operated, and most of the port authority investment came from internal reserves – although assisted by government funds and international aid agencies such as the World Bank (the loans, however, were made to sovereign governments and on lent to the ports).

Today, with the withdrawal of most ports to a landlord role, a significant part of the burden of port investment has been lifted from the port authorities. The private sector now finances the construction of entire terminals, including quay walls as well as superstructure, and equipment – under leases and concession arrangement. Almost all this private port investment uses loans.

But it is not only the private investors that use external funding Port authorities are now generally expected to operate commercially and although much of the funding still comes from internal funds they also draw on loans, from a wide range of agencies.

The lenders to port authorities include:

***International development banks***. Some of those most relevant to Ukraine’s ports are:

the EBRD which has recently funded a grain terminal in Odessa and has made loans to several port authorities in the region, including Durres, Ploce and Dubrovnik;

the European Investment Bank (EIB) which in the last five years has provided more than EUR 5 billion for infrastructure in maritime transport and inland waterways and for a significant number of port projects – e.g. at Hamburg, Bremerhaven, Rotterdam, Helsinki and Marseille.

the World Bank, which has recently assisted the construction of port infrastructure in Tanzania, Myanmar and Pakistan.

***Loans from commercial banks.***

Examples of loans from commercial banks to port authorities for major projects include:

.

	* The Port of Rotterdam Authority’s loans for the recent construction of Maasvlakte 2.
	* In 2006 the Port of Singapore Authority went to a consortium of banks consisting of DBS Bank, Royal Bank of Scotland and Barclays to arrange relatively short term loans for their purchase of 20% of the shares of HPH.***Bonds.***

Bonds are used by many ports as sources of funding, especially in the USA. Figures from the US Department of Transportation Maritime Administration show that almost 40% of US port finance came from bonds. [↑](#footnote-ref-11)
12. A recent study of a large number of European ports by ESPO (European Sea Ports Association) showed that only 55% of ports paid income tax, while over 80% paid Value Added Tax. [↑](#footnote-ref-12)
13. Just over half of European ports pay local taxes according to a recent survey [↑](#footnote-ref-13)
14. The UK has no national laws or regulations affecting port tariffs. [↑](#footnote-ref-14)