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Port Concessions in Chile

Contract Design to Promote Competition and Investment

The objective of Chile's port reform is to encourage investment in better port equipment, in the hope that this will lead to more efficient service, in part by attracting larger, more modern ships. The first four major concessions, under which integrated terminals are run exclusively by private companies, started operations in January 2000. The integrated approach to port services replaces a system of free entry of multiple stevedoring companies. This Note reviews how the concessions were designed: the criteria for the winning bids, the rules to prevent concessionaires' abusing their monopoly power, the rules to encourage investment, and the provisions for redundant workers.

The old multioperator system and its limits

The new concessions replace a system established in 1981, when the government tried to introduce more efficient labor practices and competition in stevedoring. Private stevedore firms were gradually allowed to perform all transfer services in state-owned ports, a system known as the multioperator model. Until then, Emporchi, the state port company, had been the sole cargo handler on land, while stevedores performed cargo operations aboard ships and the number of workers was restricted by licensing. The changes increased throughput considerably, even with limited investments in infrastructure.

However, the division of cargo among several stevedore companies limited their incentive to invest in modern transfer equipment, and did

not permit an efficient use of limited backup space in Chilean ports. This problem was exacerbated by the considerable growth of trade in the 1980s and 1990s.

Emporchi tried to correct the shortage of investment by tendering a non-exclusive concession to install cranes in one of the main ports. The tender was won by a joint venture of the three largest stevedore companies, but this company was never profitable. The joint venture partners claimed that the multioperator system made it easy for small and informal stevedoring companies to undercut prices by breaking labor and safety regulations.

Dissatisfied with the performance of the non-exclusive concession, the government introduced the present reforms. An exclusive concession for

each of the main container terminals makes a single company or consortium responsible for operating and maintaining it, and for all investments in equipment and infrastructure—the mono-operator system. By the time this reform was introduced, the majority of the nearly 40 ports in Chile were owned by the private sector, but Emporchi still handled most of the container and general cargo traffic. The private ports handled almost all the dry and liquid bulk cargoes.

The intention of the new concession system is to promote investment in modern transfer equipment and in new berths when needed, and to bring the management of the terminals up to date. It is also intended to reduce port costs to clients and enhance service quality, particularly by reducing waiting and service times. More efficient ports should attract larger and more modern ships, transferring a reduction of freight charges to final clients in the medium term.

The process

The government faced a number of challenges. It had to obtain approval by the legislature, one of the conditions being that agreement must be reached with labor unions and interested stevedore companies. It had to form ten new state port companies as successors to Emporchi, rapidly but with no service disruptions. Finally, it sought to attract international interest to the bidding process.

The new state port companies, one for each main state-owned port, own the port infrastructure, run maritime and land access, and enforce the concession contracts. By law they are not allowed to handle cargo or berthing. They share revenues with the concessionaire—a minimum annual rental and some revenue sharing on the upside. It is not expected that the supervisory and revenue-sharing roles will be in serious conflict since the minimum rent from the concessionaire was such that a fair market return was assured to the port company.

The design of the reform was influenced by recent port reform experience in Latin America. Investors were particularly sensitive about terminals in Buenos Aires that found themselves competing with Exolgán, a port in a neighboring municipality governed by much more favorable rules. The Chilean government took several steps to reduce investors' fears: it

fixed minimum tariffs for five years at non-concessioned state-owned terminals; it stipulated that the bids for the main terminals must be simultaneous; and the bidding documents were made similar in all the concessions, rather than using a trial-and-error approach of starting with one concession and evaluating its results.

For the initial round of concessioning the government selected four terminals in the three main ports. They were a container terminal in Valparaíso that accounts for 75 percent of the movement in the port, a container terminal in San Antonio (60 percent), a break bulk terminal also in San Antonio (8 percent) and the whole of San Vicente port. These terminals accounted for half the cargo managed by Emporchi, and the concessions were awarded in August 1999. (Some smaller ports have also been tendered with mixed results and others will eventually benefit from some form of private involvement).

Bidding mechanism

Policymakers faced a number of trade-offs in the design of the bidding process. One was between lower tariffs and higher quality service. Another especially tricky one was the distribution of expected productivity gains. Should exporters, importers, shipping agents, and shipping companies be the main beneficiaries when tariffs fall and service standards improve? Should the government instead try to maximize its revenues from concessions? The outcome was a compromise. Bidders would be asked to offer the lowest maximum tariffs. If they bid at a certain pre-set floor value, they should include an offer for a tie-breaking payment to determine the winner. The main features of bidding were the following:

- Bidders should first offer tariffs as low as they judged profitable, but the authority set a floor in order to discourage overoptimistic bids from aggressive but probably inefficient participants gambling that the government would renegotiate charges after the concession was awarded. Those tariffs were defined as a single bidding number (adjustable by the U.S. producer price index), but it represented a weighted average of four key charges, thus giving concessionaires room to accommodate their own particular pricing practices. Rules stipulated that all tariffs be posted openly and

discrimination among port clients is forbidden, although premium services and discounts by volume are permitted. There was still some risk in this tariff regime that operators might cross-subsidize regulated tariffs with non-regulated charges, in which case the bidders might focus more on the rental payment in the bidding process. Regulators expected that competition in non-regulated markets would impede that outcome.

- A bidder offering the floor tariff should also offer an upfront tie-breaking payment. This would act as a compensation mechanism if annual rental payments were underestimated by the authorities.
- Annual rental payments were fixed in advance, to prevent implicit subsidies to concessionaires affecting the competitive position of private ports. The rent must equal or exceed a minimum rate equivalent to those of Central Bank bonds of equivalent maturity, applied to the accounting value of assets in the concession, but concession contracts established an increasing rent to the state port company as tonnage rises. This means the state port company is to some extent a partner of the concessionaire, sharing part of its commercial risk and being rewarded for that. Contracts established annual rents proportional to actual tons transferred in the previous year, with a floor in the downside and with revenue sharing by the authority in the upside.

As it turned out, most tariff bids stuck to the pre-determined floor value, so the tie-breaking mechanism was triggered. The upfront payments (in six annual installments) to the first three state port companies in this process were nearly US\$300 million, three times higher than expected by the government. The tie-breaking device also boosted average returns to the state port companies on concessioned assets. For example, for the San Antonio container terminal, returns on concessioned assets for the state port company were 49.6 percent, well above the 11.5 percent obtained when no tie-breaking was expected. This is a high return given risk-free rates of about 6 percent and the fact that downside risk for gross income for the state port company was limited by the pre-established floor of

fixed annual rental payment. It indicates that tariffs could have been lower or that port assets were undervalued.

Competition

The outcome of the bidding would approximate a duopoly for the two main concessionaires. The Antitrust Commission therefore restricted horizontal integration between concessionaires or between private port owners and concessionaires in the same region. In particular, a firm or its related companies cannot hold more than 15 percent of a concessionaire if they hold more than 15 percent in another terminal or in a private port in the same region.

There are also limits on vertical integration. No more than 40 percent of a concessionaire may be owned by a “relevant” port player, defined as a shipping company, exporter, or importer operating more than 25 percent of transfers at the concessioned terminal or more than 15 percent of transfers at the ports in the region in the previous year. This is to prevent discrimination in favor of the related company, which would displace competitors and monopolize the related markets. This vertical integration restriction is reinforced with several anti-discrimination rules, and with tariff ceilings and service quality standards described below. The restrictions are temporary and can be lifted by the Antitrust Commission if the competitive situation changes.

The local shipping and stevedore companies argued in court that the bidding process discriminated against them in favor of foreign shipping companies which, because they had no history in the country, were not affected by the rules against integration. They also argued that the market had no potential for monopolistic behavior. The state port companies and the Antitrust Commission replied that there are high entry barriers in the port industry in Chile because of the scarcity of naturally protected bays and sheltered waters, and therefore potential exists for collusion between operators of ports in the same region and of monopolization of activities downstream. The Supreme Court ruled that the Antitrust Commission and the state port companies had used their powers properly, but the court case delayed the concessioning process by six months.

Incentives to invest

Instead of stipulating how much the concessionaire must invest, the concessions encourage investment simply by imposing penalties for slow service. Transfer velocities and ships' waiting times are specified in the contract. The intention is that the concessionaire will invest in the facilities it judges necessary to avoid penalties. There are also rules for progressive improvement in these service standards during the life of the contract.

The concessions are also designed to avoid any disincentives on the part of the concessionaire to invest as the end of the contract approaches, since a departing concessionaire would be able to take only its more liquid and mobile assets. The concessionaire will be compensated for the part of fixed assets not depreciated. To increase investors' confidence that they will get fair market values, any disputes are to be referred to an independent arbiter. Also, the initial concession period of 15 or 20 years (depending on the port) may be extended to the maximum permitted by the law of 30 years, if some investments in infrastructure (specified in the concession contract) are operative some years before the initial period ends.

Although basic maximum charges on vessels and cargo transfer are fixed in the concession contract, the concessionaire is also allowed to charge special tariffs provided they are for additional value added (for example, extra charges for prompt dispatch). Allowing premium services encourages the concessionaire to invest according to the evolution of both the technical progress in port operations and the demands of customers of different levels of sophistication. The contract stresses that premium services must never preclude the supply of some basic services by the concessionaire; otherwise tariff ceilings would be effectively eluded.

Labor unrest

There were several stoppages arising from labor unrest but with no additional delays to the concessions. The 5,000 employees of the stevedoring companies, some permanent, others temporary, demanded a return to the pre-1981 labor licensing system, and compensation for any workers laid off by the concessionaires. The government rejected both demands, arguing

that private companies, not state companies, employed these workers. After several labor stoppages the government agreed to set up a safety net for workers who might be laid off after the concessions. Voluntary early retirement was provided for older workers, and 700 have already availed of it. The safety net, if fully used, will cost US\$30 million, about 10 percent of the upfront payments by winning bidders.

The lesson is that there is no such thing as a private conflict when a national interest—in this case, the country's foreign trade—is involved. The dynamics of conflict resolution and decision-making make it difficult to avoid political costs, which could be mitigated by making provision for safety-nets in the early stages of conflict.

Conclusion

While it is too soon to assess Chile's port reforms, there are some positive signs in terms of lower tariffs and more efficient service. A crucial factor in getting both lower tariffs and a reasonable return to the treasury was the deliberate effort to keep a high level of competitive tension among prospective bidders. Five of the major world operators participated in the bidding consortia (Hutchison, P&O, Stevedoring Services of America, HHLA and ICTSI, among others). Competition was enhanced through simultaneous bidding, hiring an internationally respected investment bank whose fee was partly tied to the number of qualified bidders, and using sealed bids to avoid collusion among bidders.

Other reforms are needed to complete the modernization of the ports. The issuing of maritime permits to build a new port should be transferred from the administrative sphere to another format that can guarantee stability to investors in new private ports. Tariffs for navigation aid systems are too high and over-finance this service. Pilotage is monopolistic (reserved to former navy officers) and charges are also too high.

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viewpoint

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