PUBLIC INTEREST ADVOCACY CENTRE

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INDEPENDENT PRICING AND REGULATORY TRIBUNAL

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Our Ref:

Nicholas Hague
Independent Pricing and Regulatory Tribunal
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1/5/02

Dear Nicholas

Re : Review of private bus fares

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit legal centre based in Sydney. Established in 1982 it strives to foster a fair and just society by empowering disadvantaged citizens, consumers and communities through strategic legal and policy intervention in public interest issues.

PIAC wishes to take the opportunity provided by the Tribunal's review of private bus fares to comment on the cost index model used for determining the charges imposed on customers of the private operators.

The description by the Tribunal of the cost index model used for fares determinations raises several issues. Chief among the concerns of PIAC is that this model is overly generous insofar as it imposes very little discipline on the operators in terms of many of their cost inputs. In effect, the model appears to ensure that rises in fares will be granted almost automatically. This is a poor outcome in regulatory terms and is questionable in terms of the impact on social equity among the users of private bus services.

This impact seems well illustrated by the current proposal of the Bus and Coach Association (BCA) for an increase in fares of 4.18% with an additional increase awarded in the form of a GST-related adjustment of 1.85%. By comparison, State Transit has proposed an averaged increase of 1.91% for the users of Government-owned bus services. The BCA hs failed in its written submission to the Tribunal to explain clearly the reasons for this disparity.

The BCA argues the cost index is a 'low cost, low risk model' designed by the NSW Government and suppposedly in the public interest. However, it is difficult to understand how the public interest is served by steady rises in fares, particularly when these occur at a greater rate than for the comparable Government-owned operator. Those members of the community who rely on private bus services should not be expected to accept outcomes of this nature. In many cases they well may be unable to afford them.

A further argument advanced by the BCA is that private operators should be given certainty of cost recovery. Yet, according to data supplied to the Tribunal by the BCA, the rate of return on assets for operators under the cost index model ranges between **3.4%** and 10.75%. Similarly, the return on equity between varies between1.65% and 15.5%. Accordingly, PIAC challenges the assertion that the cost index model is providing certainty to private operators. On the contrary, it is clear that some operators are enjoying far better circumstances than others as a result of the continued use of the cost index approach to fares setting.

However, it appears that the current approach does give certainty to private operators in relation to the renewal of their service contracts with the Government. The understanding of PIAC, based on the Tribunal's *Issues Paper,* is that the process of contract renewals provides for an almost automatic grant of rights to private operators to continuing providing their existing services. This has not been challenged by the BCA in its written submission to the Tribunal. It is a concern to PIAC that the Performance Assessment Regime may not be being implemented by the Department of Transport. PIAC is unable to comment on what impact the PAR might have on the level of fares.

It should be understood clearly that, in most cases, the private operators are monopolies. The BCA has commented on the operation of service parameters in the contracts between bus providers and the Government. Yet, a situation where such obligations concerning standards and scope of service are imposed on providers is not exceptional among regulated industries, particularly those which are capital intensive in nature. What is more, PIAC is of the view that the majority of the customers of the private operators regard them as monopoly providers. The BCA has cited competition from alternative transport modes such as cars yet, in our view, this is an issue more of substitutability – something which is not a viable option for many of their customers.

This is not to say that the private bus operators should not face some of the pressures or disciplines commonly observed within competitive markets. Indeed, such disciplines seem very much called for in an environment where prices for bus users appear able to rise each and every year and to do so at a rate greater than inflation.

It is notable that there are no obvious efficiency incentives in the current cost index model. PIAC accepts that the nature of the bus industry militates against the introduction of the kind of incentives introduced in other regulated industries. Shorter asset lives and the overall size of many participants in the bus transport industry do not support, for example, CPI-X regulation. Nevertheless, downward pressure on costs on the part of the bus operators would be expected to produce, in turn, presure on the prices charged by the various suppliers of equipment and services to the bus industry.

The data provided by the BCA suggests that, on a per passenger basis, the proportion of to revenue is actually very similar to that achieved by State Transit. This raises the question as to whether lower costs on the part of the private operators would result in lower fares. Given that the private operators rely largely on low levels of staffing and rising fares to achieve their current profitability, PIAC believes there is merit in an exploration of the possibility for further cost savings in other areas of these businesses.

In addition, PIAC believes that an examination is required also of some of the underlying costs for these businesses such as with regard to capital expenditure. In our view, the contract based approach to determining rights to operate bus services for the Government has taken the place of more transparent planning. In other words, the process of renewal of contracts with their obligations for business viability and service levels has been substituted for consideration of longer term issues such as fleet sizes and roadworthiness. The apparently automatic nature of contract renewals suggests that companies need only satisfy the Government about their asset base at the point of the initial contract signing. The suspicion, then, is that continual increases in fares have been permitted in order that the businesses can build up money in the bank to buy new bus fleets in future years. Such an approach would not only lack transparency in relation to the effect on fares but reduce further the pressures brought to bear on the cost base of the private bus industry.

Importantly, as the Tribunal has noted, the issue of costs need to be balanced against movements in revenue experienced by the private operators. Changes in demand, in the number of people actually paying for a service, can have critical effects on the cost base of a business such as bus transport. Where there is a greater number of people utilising a service each input cost can be spread more thinly and prices for individual customers can be lowered.

PIAC is supportive of revenue-based approaches to regulation employed by the Tribunal in the case of other industries. We note, furthermore, that even in those cases where regulators are called upon to determine final prices which a service provider may be permitted to charge an important factor in such a determination is the level of revenue needed by a business to remain viable. The public interest would not be served by having prices set so low that operators of private bus services were forced to relinquish their contracts. Neither does the community benefit from operators being permitted to charge far in excess of their costs.

Forecasting future demand has proven a difficult exercise in public transport as much as other industries. The current approach whereby private bus fares are determined in advance for each succeeding twelve month period suggests that errors from forecasting need not be excessive. Alternatively, a form of 'backdating' has been discussed in the electricity retail industry regulated by the Tribunal, whereby growth in demand in a previous year is factored into the decision making for each regulatory period.

Whether or not such approaches are appropriate for the setting of maximum fares for private bus operators, it is clear from the BCA submission that patronage has been increasing significantly in recent years. PIAC believes that any decision on the maximum fares permitted to be charged by these operators needs to take into account the growth in revenue they have enjoyed and, likely, will continue to enjoy.

Yours sincerely
<u>Public Interest Advocacy Centre</u>

Jim Wellsmore
Policy Officer