

Coastal Council

Backgrounder on the Rational Tariff Policy

Version one 15th December 2002 Living Document

Updated summary of Tariff Recommendations of the Coastal Council

During 1999 and 2000 The Coastal Council debated the problem faced by the Corporation in attempting to develop a tariff model that would provide an "equitable" tariff throughout the fleet. Given that no method has been applied to create the existing tariff structure it was difficult to develop a concept which would create "tariff equity". As a result of this recognition, the Council (with assistance from BCFC staff) developed recommendations to tariff rationalization. BC Ferries and Government then implemented a similar policy based on these discussions.

This document provides a summary of our recommendations for a Rational Tariff Model together with some background information and updates since our submission. Please refer to our original submission for details (see "Report on Tariff Rationalization" document on our website). This is a living document and will be updated regularly in light of new information/developments, it will always be available online on our website core review page at

<http://coastalcouncil.org/core.htm>

History of Provincial support and tariffs to 2000

When BC Ferries was created in 1977 provincial funding was provided in the form of a Highway Equivalent subsidy. This formula committed the Province to fund the Corporation with a provincial subsidy per route-mile of ferry operation, based on the construction and maintenance of equivalent highway lengths and adjusted for inflation annually. In addition the Province provided capital funding for vessels and terminals. This decision was a recognition by government of the total dependancy of coastal communities on ferry service infrastructure for their economy and the lives of their residents—that these communities are "ferry dependant" just as others are "road dependant" or "bridge dependant". The coastal communities have built up over the years based on this highway-equivalent infrastructure—just as mainland communities have developed based on road infrastructure.

The provincial subsidy, together with the Federal contract contribution and fares, were the contributions that formed the financial framework under which BC Ferries was to operate.

Since the 1970's, the relative contributions have shifted dramatically as a result of policy changes by government, as the Charts below indicate. The Provincial Government's contribution declined substantially over that period, while fare box receipts accounted for a much higher percentage of total revenues received by the Corporation. In 1999 we made recommendation on a Sustainable Financial Framework for BC Ferries (see that report on our website). In 2000, with the Corporation facing bankruptcy, the Province committed to funding the corporation with a 1.25 c per litre contribution from the Motor Fuel Tax and removed the Corporations debt load (which had been imposed on the Corporation due to lack of adequate Provincial funding and the Fast Ferry project). Present contribution by the province is still below highway equivalency and also well below that obtaining in other public transportation infrastructures, such as BC highways, transit, Translink or even Washington State's ferry system.

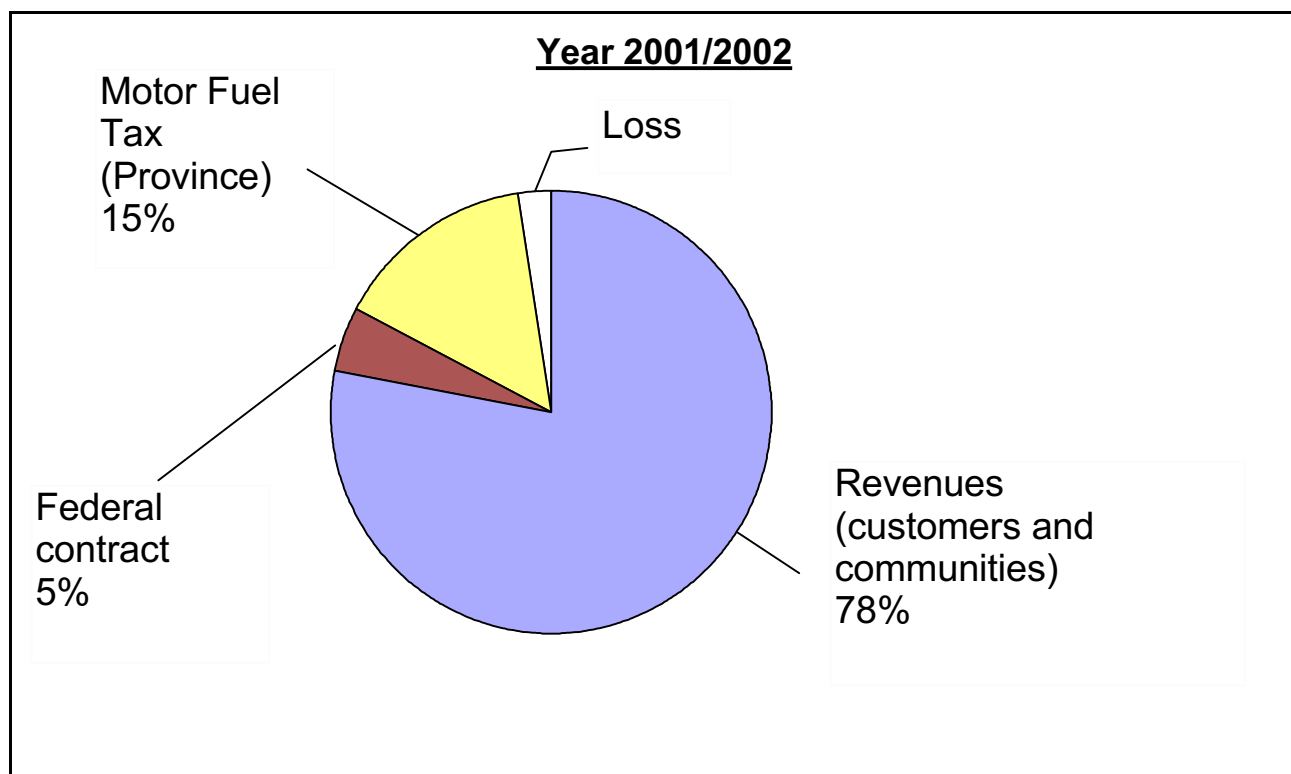
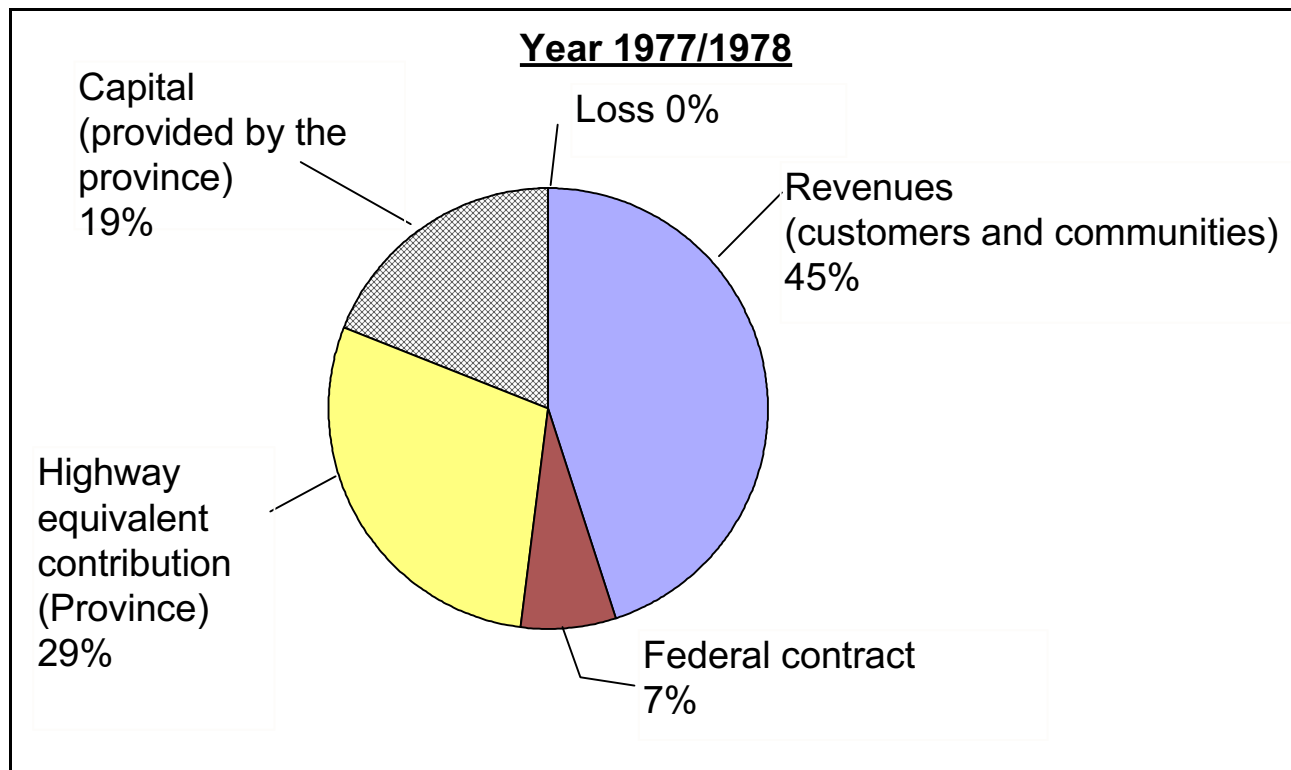
Many individual route tariffs were established based on historical fares, for example tariffs inherited from the Ministry of Transportation and Highways when BC Ferries took over those routes. Tariff was further complicated by arbitrary changes made over the years by government, including the large inflation of cash fares in 1997. These arbitrary changes took no account of demand elasticity (people buy less as the price increases) and thus often did not have the desired impact on revenue but rather just further impeded the ability of the Corporation to manage its finances. Increasing the tariff was frequently viewed as the simple solution to mounting losses, rather than reviewing the efficiencies of operation and administration of the Corporation. Tariff adjustments have been erratic and have exceeded the general rate of inflation (for example, averaging 4.5% per year during the past ten years).

A rationalization of tariff had thus become a necessity to provide a basis for sound business planning and customer confidence, and, with the new secure funding in place, had become a possibility. Council had been concerned that, once a sustainable funding framework was in place, proportional contribution from tariffs did not increase further and that tariff changes were kept to CPI (Consumer Price Index—measure of inflation).

1977/78 vs 2001/2002

Contribution Levels

Note that "loss" for 2001 includes Fast Cat write down.



Examination of tariff models

The Council, with the technical assistance of B.C.F.C. staff, examined various metrics (factor representations) and how they related to the existing tariff. Through this research it was determined that the existing tariff is somewhat correlated with the distance metric. The results of the stakeholder survey also indicated that distance was the most widely accepted metric for tariff.

The Council carefully examined models based upon other metrics (factor representations), particularly route utilization and operating cost—but found no satisfactory rationale. This was due, in part, to the many arbitrary factors that influence operating cost and utilization. It was decided that the only rational choice was to view the system as a whole—as is normally the case with transit systems—and develop a rational tariff for the system based primarily on distance travelled.

A model was developed to examine the application of this distance metric to tariff, based on certain assumptions:

- revenue neutrality
- minimizing rate shock's
- weighted average distances for multiport routes and for routes 1,2 and 30
- the use of the same per mile and lift off charges system wide
- that traffic patterns would follow current trends.

This model was used to develop a recommended rationalized tariff .

Rationalized tariff model

In the model recommended by the Council the rationalized tariff is comprised of two components; one representing distance travelled, and one representing a lift off charge (the "taxi" model).

We recommended, based on data provided by B.C.F.C. staff, that the lift off charge be \$4.00 and the per mile charge be \$.14 (rounded) for Passengers and the lift off charge be \$10.50 and the per mile charge be \$.47 (rounded) for underheight passenger vehicles.

The Council also made recommendation on rationalization of discount tariffs, as addressing the fact that many coastal communities' must use the ferry service to access basic essential services (e.g. schools, hospitals/medical services, banks, government services,) and employment. The stakeholder survey indicated that such "isolation" was the second most widely accepted metric for tariff.

Council recommended that the Corporation continue its recent efforts to assist local communities, where welcomed, to develop local economies and create new revenues through co-operative initiatives.

Council recommended that CPI increases only be applied if required by BCFC budget and that if CPI is low, rational adjustments be made perhaps every three years.

Council recommended that the effects of any "tariff model" be reviewed annually to determine the true impacts on the Corporations revenues relative to the projected impacts.

Recommendations on phased implementation of rationalized tariff

As the proposed tariff model was designed to "rationalize tariffs" and as the existing tariff structure did not reflect any form of a linear relationship the application of a linear model would result in numerous tariff adjustments.

As the Council was extremely cognizant of the negative impacts of rate shocks on the economies of coastal communities we recommended that compliance with the model for existing routes would initially be achieved when any particular tariff fell within +/- 10% of the tariff predicted by the model.

We also recommended that no route tariff should be adjusted by any amount larger than +/- 10% in any given year (with allowance for minor variations due to rounding fares to the nearest \$.25) regardless of whether tariff adjustments are implemented annually i.e. adjustments are not cumulative if not adjusted on an annual basis.

Once a tariff falls within the +/-10% band the remaining adjustments towards the predicted tariff would be accomplished through the specific application or non-application of CPI increases year by year and by the application of rounding fares (up or down) to the nearest \$.25.

Council recommended these measures be applied over time. The tariff model, as proposed, would constantly move actual tariffs to their "rational" values through the application or non-application of CPI increases and rounding.

This process clearly demonstrated that tariff can be rationalized to provide system wide parity with little negative impact.

Resulting implementation in 2000 to 2002.

Based upon Council recommendations BCFC put forward, and Government implemented, a rational tariff policy in 2000. This was the above "taxi" model, with a more slowly phased implementation. BCFC termed the tariff goals "equity" tariffs. The application and use of CPI increases within the model was to be as outlined above.

Due to understanding of the importance of rationalized tariff and the need for rational CPI increases to cover rising inflationary costs, stakeholder acceptance of the changes was positive.

Following the implementation of the funding package and the rational tariff model, BC Ferry Corporation realised operating surpluses (before write-down of high-speed ferries) of \$10.714 million (2000) and \$17.378 million (2001).

In the year 2002 budget the first post-rationalization CPI increase was put forward, and , again, stakeholder acceptance of the changes was positive.

The Wright Report (2001)

The Wright Report was commissioned by the Provincial Government to examine BC Ferries, for details of our response please see the "Wright Report Response" document on our website.

In the area of its examination of tariff the Wright Report was seriously flawed: firstly, in its analysis of the impact of tariff increases (it ignores elasticity effects), secondly, that it did not consider the place of the routes as part of the highway system of the Province—where costs would be borne by government in the same way that they are for roads (Tariffs on ferries are very high in relation to costs in comparison to the few local examples of toll charges on roads and in relation to licence fee costs for vehicles), and, thirdly, that there is no consideration of the fact that routes make up one whole and contribute to one whole integrated transportation infrastructure and thus should not be considered in isolation. We have expressed and argued clearly in our previous reports that financial sustainability for BCFC must be approached on a system wide basis. System wide choices of operating systems, labour practices, crewing levels, ship allocation and others have large affects on the cost base of individual routes and to set these routes to competing with each other is a pointless exercise.

The implication in the report that there are routes that break even (when considered in isolation) does not stand up to the test of proper analysis—if the cost of capital is considered (and the report suggested even higher capital costs should be planned for) then even the mainland services routes do not break even. This is relevant to the tariff in the area of "cross-subsidy" and considering the system as a whole.

We already have real world sensitivity results for large tariff changes, courtesy of the NDP government's ill conceived tariff hikes (including the two in 1997). Using Mr. Wright's figures; from 1976 to 1992, traffic grew 86%, or 3.95% per year, while population grew 35%, or 1.91% per year. Since that time traffic on BCFC has been fairly constant, growing 6%, or 0.67% per year, while population grew 22%, or 2.21% per year. This is not, as Mr. Wright supposed, due to declining real income, but, rather, to ill considered tariff manipulation.

These results indicate that BCFC's tariff elasticity figures are overly optimistic and apply only to small changes in tariff. Mr. Wright, in his analysis of BCFC sensitivity factors did not consider elasticity adequately, and in his statements about tariff he made no reference to this key issue.

Considering that the rational tariff model had already started its implementation phase, the Wright report took a large retrograde step in suggesting higher tariff for lower volume routes (a very impractical suggestion when elasticity and relative revenue base is taken into account).

In our response to the Wright report we made the following recommendations on tariff:

"We urge the government to allow BCFC to continue with the planned rationalization of tariff, and not to impose arbitrary tariffs. Together with proper, continuing, funding of BCFC this will address BCFC's financial needs".

"Coastal and Vancouver Island communities are "ferry dependent", just as other communities are "road dependent". To radically increase tariff or reduce service would be to destroy these communities, together with their economies and their contribution to the Province. "

Rational tariff and the new Ferry Authority

Core review and "a new course for BC Ferries"

The initial press releases surrounding the announcement of a new governance model for ferry service delivery suggested that the Government was proposing that the new Authority have the ability to manage and continue implementation of the rational tariff model. Until we learn otherwise we propose working on this assumption and offering our expertise to Government and the new Authority in this area, particularly in the development of service plans and the use of the rational tariff model.

We note the proposed caps to fare changes and assume these to be an operating envelope to allow the Authority to move tariffs within the model whilst preventing the use of tariff to subsidize inefficient operation, ill conceived capital projects etc., as has been the case in the past. The different rate caps for major and minor routes may, in the same light, be taken to be a recognition of the vastly larger impact on revenue of a small change on a larger route and thus the need to encourage the new Authority to restrain themselves and the operator from using those routes as a cash cow.

We hope to work with the Government and the new Authority to ensure continuing application of the rational tariff model, and to ensure that, with the model in place, that the same basic rate (distance plus lift off) applies to all routes and that rationalized tariff does not increase beyond inflation.

We are concerned about the potential impact of GST charges on tariff and revenue, with the new private corporation model.

We are of the opinion that tariff must not be used (even within the caps proposed) to cover costs of corporate inefficiency, off book financing, etc.

We are disappointed and concerned that the current CPI increase appears to be being applied in an arbitrary "across the board" fashion with no adjustments being made at this time to move tariffs closer to the rational (BCFC "equity") model. Some route tariffs should have increased above the 3.8% and others should have increased less. We will work to ensure that future CPI increases are used as opportunities to move tariff closer to the rational tariff line. Stakeholder support for the CPI increases was based on the use of the rational tariff model.

We continue to be of the opinion that the Federal Government should provide considerably greater support to the ferry system, as they do on the east coast, and will continue to advocate for this support. In our response to the Wright Report we made the following recommendation:

"We ask the Provincial Government to make strong representations to the Federal Government encouraging them to devote a large proportion of the Federal gasoline tax collected in BC to the development and maintenance of BC transportation infrastructure, including the marine highway (ferries)."

In this regard we also voiced our concern about the costs (both financial and to efficiency) of restrictions placed upon BCFC by Provincial and Federal policies (such as Transport Canada crewing and certification regulations and environmental regulations). We have stated in our reports that costs for public policy decisions should not be borne by users of the system (and welcome the Province's acceptance of the cost of social programs), but rather by the originating government. We note the high cost of Federal regulations and the fact that the Federal government does not use its' gas tax to support Provincial infrastructure in BC in any reasonable proportion to the amount it collects here. Federal gasoline tax revenues from the coast alone greatly exceed the amount spent by the Federal Government on the ferry system and other coastal transportation infrastructure.

Reference

This is a living document and will be updated regularly in light of new information/developments, it will always be available online on our website core review page at <http://coastalcouncil.org/core.htm> in both PDF and HTML (webpage) format.

For complete versions of our reports and recommendations on Tariff Rationalization, A Sustainable Financial Framework and our Response to the Wright Report, together with supporting documents please visit our website at: <http://www.coastalcouncil.org/>

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