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Commentary by Patrick Brown

The subsidy tradeoffs - *Ferries on Auto Pilot: III*

Ferry fares are still on autopilot. Martin Crilly, the BC Ferry Commissioner, has released a 'supplementary' set of Questions and Answers which throw some new light on the calculations carried out by the commission in order to arrive at its preliminary decision on fare increases for the second Performance Term, 2008-2012. The decision assumed that there would be no increase in the basic 'Service Fee' to be paid by the provincial government to BC Ferry Services Inc., its 'privatized' ferry operating company; this would continue to be frozen at $91.8 million per year, as it was throughout the first Performance Term which ends on March 31, 2008.

This resulted in projected fare increases:

• on the main routes (between the Mainland and Victoria and Nanaimo) of 5.4% on April 1, 2008, followed by increases of 3 - 4% on April 1, 2009, 2010, and 2011

• on the other routes (Gulf Islands, Sunshine Coast, North Coast) of 3.6% on April 1, 2008, followed by increases of 6.7 - 8.1% on April 1, 2009, 2010, and 2011

These increases are on top of the final increases of the first Performance Term, on November 1, 2007, which were 2.8% for the main routes, and 4.4% for the other routes.

Crilly describes the April 1, 2008 increases as 'timing adjustments'. The ranges given for subsequent increases reflect a Consumer Price Index ranging between 2 to 4%.

It is clear that the continuation of substantial percentage increases in ferry fares is a result of no increase in the provincial 'Service Fee'. During the first Performance Term, the provincial government would not even contribute to the significant and unanticipated cost increases which resulted from increases in the price of fuel. The Ferry Commissioner's terms of reference required him to issue his Preliminary Ruling March 31, 2007 based on a continuation of the freeze on basic Service Fees. While he has not yet issued the details of his calculations, the latest 'Q&As' may help us to understand the nature of the relationship between the Service Fee and annual fare increases.

More than One Ferry Service

In setting up the 'autopilot' system for ferry finance through the 2003 *Coastal Ferries Act* and the creation of BC Ferries Services Inc, the government initially sought several objectives:

• an end to the cross-subsidization by the main routes of the other routes

• the other routes to move towards 'user-pay', with fares assuming an increasing proportion of their revenues

• debt incurred to operate the company and build new ships would be carried by the company and would not appear on provincial books

• the main routes to make sufficient profit (currently set by the Commission at 14% of equity) to enable BCFS to issue debentures and obtain bank credit to finance its operations and build new ships. (When BC Ferries was a Crown Corporation, it was not necessary to make a profit to ensure creditworthiness, since ferries' debt was issued by the provincial government.)

The result has been the evolution of two financially separate operations: the main routes, which are required to cover costs and make a profit, and the other routes, which are required to increase fares and, with the Service Fee, to break even. (This may be compared with the financing pattern prior to the creation of BCFS, which saw any profit made by the main routes go to subsidize the other routes, and any debenture financing required done by the provincial government.)

Service Fee Structure

Thus fares on the main routes are set high enough to cover costs (including the building of new vessels for the main routes) and make the necessary profit. The main routes receive no taxpayer support (or Service Fee).

Fares on the other routes are set to cover the costs that remain after the Service Fee has been taken into account. If the Service Fee does not rise at the same rate as the costs, then the fares must rise at a much greater rate than costs. This is what has been happening over the past four years, as costs (including the cost of fuel) rose, and the Service Fee didn't.

The Commissioner calculates that for the six 'non-major' (or 'other'—the term is awkward) route groups (which include the Gulf Islands, Northern, Horseshoe Bay-Langdale, Discovery Coast, Mill Bay, and Gambier/Keats Islands routes), the provincial basic Service Fee, unchanged in dollar terms, has decreased from 46% of costs in 2004 to 40% in 2007; the percentage covered by fares, including fuel surcharges, has increased from 40% to 44% in the same period. The Commissioner's figures also project that the Service Fee (assuming it continues unchanged in dollar terms) will cover only 36% of costs in 2008, decreasing to 28% of costs in 2012; fares would cover 45% of costs in 2008, increasing to 48% in 2012. The costs include a provision for paying off the accumulated excess fuel costs by 2012.

(The provincial government has, in fact, increased the Service Fee for the Northern Routes, starting in 2007, to cover the costs of the accumulated fuel surcharge and the costs of the rebuilt *Northern Adventurer* over the insurance proceeds from the sunken *Queen of the North*. Since the government has also decreed that fares on all 'non-major' routes should rise at the same rate, the result is that some of this increase in the Service

Fee is re-allocated to other 'non-major' routes. This may have been an unintended effect.)

Variations between Route Groups

The Commissioner has also provided us with an interesting chart showing the variations between Route Groups in fare and Service Fee contributions.

Among the 'non-major' routes, the Horseshoe Bay–Langdale route is projected to reach 89% 'user-pay' in 2007; it then declines somewhat to the 83-85% level over the next four years, but the Commissioner says that it has been promised a newer vessel. The Commissioner speculates that in the third Performance Term, (starting April 1, 2012) that this route could join the main routes in requiring no subsidy and thus become eligible for lower levels of fare increase.

If it did, of course, the percentage 'user-pay' for all the non-major routes (excluding northern routes), currently about 50%, would drop. To give some idea of the variations:

- Gulf Islands routes 41%
- Northern routes 30%
- Discovery Coast 43%
- Mill Bay 43%
- Gambier/Keats 21%

Increasing the Service Fee

It is clearly time for the government to change course on the financial autopilot.

The question for ferry users and the government, though, is how much does the Service Fee have to increase to bring fare increases down to a manageable level? The Ferry Commissioner, in his latest Q&A document, puts forward two examples:

• If the basic Service Fee were increased each year at the rate of inflation (assumed to be 2%) the average annual fare increase drops from 6.7% to 5.4%. This is not much of a reduction.

• In order to reduce the annual average fare increase to the 2% rate of inflation throughout the second Performance Term, the annual basic Service Fee would have to be increased throughout the Term by $15.6 million (about 17%), from the present annual $91.8 million to $107.4 million each year. Considering the level of other government expenditures, this is not much of an additional cost to the government. We were, after all, promised fair fares.

Clearly, the government is in a financial position to increase the Service Fee, impeded only by its predetermined policies of moving towards 'user pay' and avoiding cross-subsidization. It has already shown its willingness to adjust fares through its additional Service Fees for the northern routes, which otherwise faced massive increases in fares to pay for new vessels.

But southern routes face massive increases too; it's not clear where the tipping point is (the Ferry Commissioner insists that ferry users are not making enough fuss to convince him that it is near) but ridership has been essentially flat over the last ten years, while population on all the Islands (including the big one) has been increasing and the economy booming.

Express Your Views by June 30, 2007

If ferry users want to influence this situation, it's time they communicated with the government, the Ferry Commissioner, and the ferry corporation.

There won't be any public meetings but, as the Commissioner says, 'We shall be pleased to receive comments on our preliminary decision from the public by e-mail, fax or Canada Post by June 30 2007. Please contact us by email at the BC Ferry Commission, by fax at 250-285-3740 or by regular mail at BC Ferry Commission, P.O. Box 1497, Comox, B.C.' Crilly's email is martin.crilly@bcferrycommission.com.

To comment on any aspect of provincial government policy, taxpayer funding, the frequency and capacity of sailings on any route, and any other aspect of the Coastal Ferry Services Contract, readers should contact: Minister Kevin Falcon via email: Minister.Transportation@gov.bc.ca; or mail: PO Box 9055, Stn Prov Govt, Victoria, BC, V8W 9E2; and BC Ferries via email: www.bcferries.com/contact_us, or phone: 1-888-223-3779. ✐

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