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Getting More Value for Money

**Restructuring Saskatchewan's Bus
Transportation Subsidy Policy**

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and Steve Lafleur**

About the authors



Peter Holle is the founding President of the Frontier Centre for Public Policy, an award-winning western Canadian based public policy think tank. Since its founding in 1997, Frontier has brought a distinctive and influential Prairie voice to regional and national debates over public policy in areas such as core public sector reform, housing, poverty, aboriginals, consumer-focused healthcare performance, equalization, rural policy, and much more. Mr. Holle has worked extensively with public sector reform and has provided advisory services to various governments across Canada and the United States. His publications have appeared in various newspapers and journals including dozens of newspapers, the *National Post* and the *Wall Street Journal*. He has a Masters of Business Administration from the University of Wisconsin at Madison. He is a member of various organizations including the Mont Pelerin Society, an international organization of classical liberals.



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Introduction

The Saskatchewan Transportation Company (STC) is the main provider of bus passenger transportation services in Saskatchewan. Formed in 1946, the company is one of the province's original government-owned enterprises. Until the early 1980s, STC managed to provide province-wide bus service with little obvious cost to Saskatchewan taxpayers. Since then, the company has required millions of dollars in annual subsidies. It continues to lose money with no realistic hope of breaking even.

Losses are accumulating for many reasons beyond the company's control. The market is shrinking. Much of the market area served primarily rural Saskatchewan is losing population due to aging and migration to urban centres. Changing travel patterns compound the problem—more transportation consumers are choosing to travel by personal vehicle—generally, a cheaper and more convenient transportation mode.

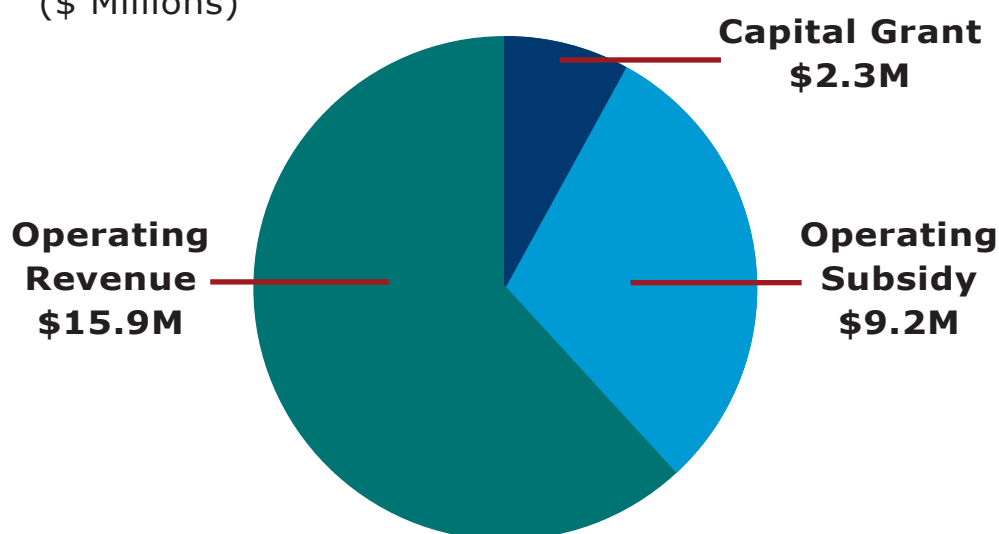
Most STC routes are so marginal that revenue does not even cover the direct operating costs. Of 29 routes, only the Regina-Saskatoon and the Saskatoon-Prince Albert routes cover over-the-road costs. STC buses lost \$2.63 per mile of service in 2012.¹

STC has been dependent on provincial subsidies since restructuring in 1997. Prior to that, STC merely borrowed money from the province that it never repaid. As part of the restructuring, the province extinguished \$26-million of STC debt.² In 2012, STC required an operating subsidy of \$9.2-million, up from \$1.75-million in 2000.³ The capital grant for 2012 was \$2.3-million.⁴ In addition to annual operating and capital subsidies, STC received \$26.2-million from the provincial government to build a new bus terminal in Regina, which was completed in 2008.⁵

CHART 1

Source of STC Expenses

(\$ Millions)



Source: STC Annual Report 2012.

Despite the subsidies, which accounted for 40 per cent of STC's 2012 expenses, the company continues to lose ridership and close routes. STC had just over 282,000 riders in 2012⁶ compared with roughly 787,000 in 1980.⁷ STC provided over 5.5-million service miles in 1990,⁸ which declined to 3.1-million by 2012.⁹ The number of routes decreased from 43 in 1992¹⁰ to 29 in 2012.¹¹ Three more routes will close in 2013, since they average between one and two riders per trip.¹²



Source: Saskatchewan Transportation Company 2012 Annual Report.

Another potential indirect cost is deferred maintenance. While it is difficult to know whether STC is putting off maintenance, it does not have the same incentive as private operators do to provide proactive maintenance. For the private sector, it is an investment decision: Paying for maintenance up front reduces long-term costs. For the public sector, it is a political decision: Deferring maintenance costs hides short-term costs even if it results in higher costs down the road (when the top officials and politicians of the day may not be around to answer for any problems). This is a typical political dynamic in Crown corporations.

STC will be the only government-owned and government-operated bus company in Canada when Ontario Northlands Transportation Company is discontinued, and it is the only monopoly bus company. STC is designed to cross-subsidize money-losing rural routes with the profits from the higher traffic routes between major urban centres. The rationale for the monopoly is that private firms would skim the profits that are required to cross-subsidize the routes that are more marginal.

The regulated bus monopoly model has tripped financially over several contradictory goals and objectives. STC ostensibly attempts to be profitable (or at a minimum, not lose money) while operating mostly low-volume, unprofitable routes. Uncompetitive, high fare levels have suppressed demand and revenue on high-volume routes. While the system technically cross-subsidizes service to less populated areas through higher prices on profitable routes, it is also likely inflating overall operating costs.

Moreover, the current monopoly system is likely hindering the expansion of low-cost busing between Regina and Saskatoon, as well as between the cities and their suburbs.

As was pointed out in a recent Frontier Centre study on intercity busing in North America, downtown to downtown curbside busing is the fastest-growing mode of transportation in North America.¹³ Companies such as Megabus and BoltBus, which originated in the U.S. Northeast, are expanding continent wide, including into Ontario. They have been spreading westward, including into the U.S. Midwest. The now former finance director of First Group (owner of Greyhound and BoltBus) stated that he thinks this business model will work throughout America.¹⁴ There is no logical reason that it cannot work between Regina and Saskatoon when it works between Des Moines, Iowa, and Iowa City. Discount service between Regina and Saskatoon would almost certainly emerge under the proposed model.

With declining ridership levels and rising costs, and without a fundamental restructuring of both its internal operations and the regulatory regime in which it operates, STC will continue to experience losses.





Rationale for Restructuring

Politicians and interest groups rationalize STC's growing losses as the price it pays for providing rural areas with access to good bus services. However, in today's uncertain fiscal environment, governments must find the most efficient way to achieve policy outcomes. One must ask the question: Given the objective of providing accessible province-wide bus service, is it necessary for the Saskatchewan government to directly own and operate a fleet of 43 buses?

The need for continued government operation of bus transportation services in Saskatchewan can be seriously questioned. When STC was set up, car ownership was not as widespread as it is today. The province now has one of the highest per capita automobile ownership rates in Canada.¹⁵ Since there are 1,500 bus companies in Canada, there is ample room for increasing the supply of privately provided bus services in Saskatchewan.¹⁶

The present regulatory environment restricts the private provision of scheduled passenger bus services. If the government removed the legal roadblocks to market entry, other bus companies would provide service where demand warranted it. Those same carriers would supply service on uneconomic routes provided there were direct government subsidies. This approach, now common around the world, would save Saskatchewan taxpayers millions of dollars annually while maintaining existing service levels.¹⁷

Historically, the Saskatchewan government has chosen to achieve its public policy goal to provide bus transportation services through a Crown-owned bus monopoly financed by cross-subsidies from profitable parts of the province-wide route system.

Evidence from around the world suggests that this monopoly and/or cross-subsidy model is not the most cost-effective or efficient means of ensuring access to province-

wide bus service. This model increases costs and wastes resources by over servicing portions of the transportation system. Empty, or near-empty buses, on little-used routes waste capacity and increase the operating costs for gas consumption, maintenance and repairs. Costs to society (externalities) include more pollution and highway damage caused by heavier vehicles.

The monopoly and/or cross-subsidy model incurs substantial, yet often ignored economic and administrative costs. Significant economic losses occur because the monopoly model prevents competition—the regulatory regime creates the conditions for rising operating costs that in turn restrict market size and development. Staffing levels, wage and salary costs tend to be higher and increase at a faster rate because costs can be factored into cross-subsidy calculations and regulated fares. Without competition, it is difficult to determine if the STC is spending money efficiently.

Another ignored cost to Saskatchewan taxpayers is the opportunity cost of lost tax revenue. As STC is a government-owned corporation, its income is exempt from taxation. Private carriers would return at least some tax revenue to the provincial and federal treasuries.

The regulated bus monopoly approach increases operating costs per unit of service over time. Wage costs and employment levels continue to escalate even while revenue passenger miles decline.



The Plan

Saskatchewan can achieve better value for money while maintaining universal access to bus transportation services by purchasing them directly from the commercial marketplace. The following steps outline a plan for producing this same social outcome at a significantly reduced cost to Saskatchewan taxpayers.

Saskatchewan policy-makers must focus on the ends, not the means. Linger- ing sentimental attachment to the government-ownership model comes at an increasingly unaffordable price. The government must re-evaluate its role as the main direct provider of scheduled bus service in Saskatchewan since direct provision through the regulated STC monopoly is the most expensive method of achieving province- wide access to bus services.

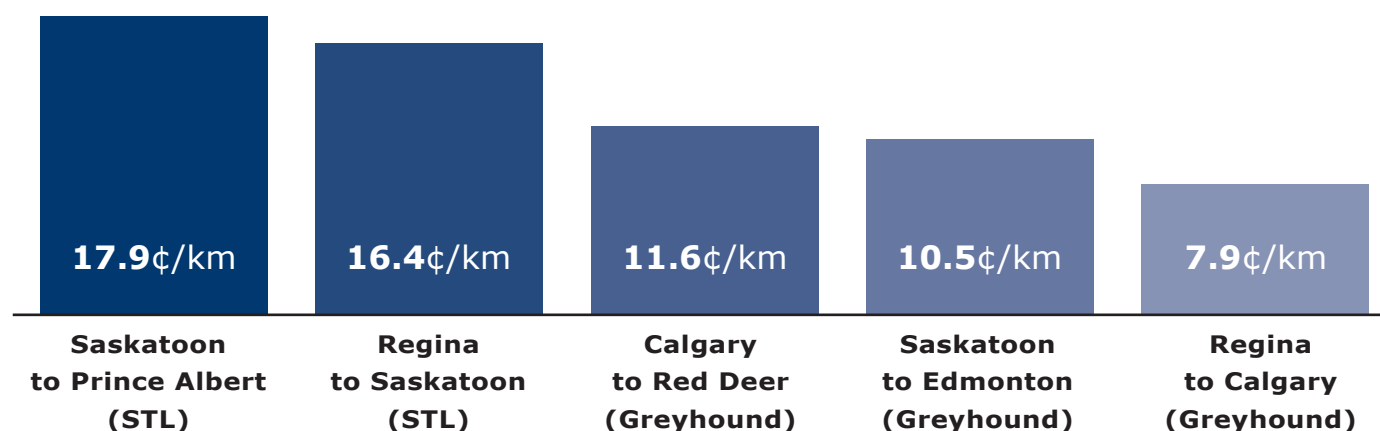
A) Deregulate the passenger bus market

The Saskatchewan government should introduce elements of choice and competition into the supply of scheduled passenger bus services by changing its role into that of a facilitator of bus service versus a direct producer of bus service. If the government purchases bus services directly from competing suppliers, costs will decline.

To achieve a competitive framework that reduces the province's bus subsidy while maximizing consumer welfare, the government should phase out economic regulation of the Saskatchewan bus transportation industry (i.e., the barriers to entry and the fare levels).¹⁸ Many operators would enter the markets for higher volume routes, thus increasing frequency of scheduled services while reducing prices to attract customers. Lower prices would stimulate more demand and substantially increase the use of passenger bus service in the province's urban corridors. This is consistent with trends underway in deregulated markets in Southern Ontario and the United States.

CHART 3

Intercity Travel Price (¢) per Kilometer (31 day Advance Fare)



Source: Saskatchewan Transportation Company, Saskatchewan Transportation Company 2000 Annual Report.

Deregulation would dramatically reduce bus fares on the most heavily used urban corridor—Regina-Saskatoon-Prince Albert, which partially subsidizes low-usage routes. Compare the cost per kilometre for tickets purchased 31 days in advance on STC routes with deregulated routes: Saskatoon-Prince Albert is 17.9 cents per kilometre compared with 11.6 cents between Calgary and Red Deer; Regina-Saskatoon is 16.4 cents per kilometre, while Saskatoon-Edmonton is 10.5 cents and Regina-Calgary is 7.9 cents.¹⁹ Competition would drive fares down to cost levels, thus rewarding the most efficient operator. As companies competed on price, service frequency and amenities, the regulatory focus would shift toward enforcing basic safety standards. The government would no longer require regulatory personnel involvement in setting system prices, fare schedules, etc.

B) Buy services for “social” routes directly from the marketplace

With the loss of the cross-subsidy, marginal routes would require a new funding source. A semi-independent transportation commission (conveniently named the Saskatchewan Transportation Commission, to avoid the need for rebranding) would identify bus routes where continued operation is justified for social policy reasons initially the most marginal and uneconomic routes in STC’s network, routes that will not support a competitive operator. The Commission would then identify the quality and quantity of service it is prepared to purchase in order to operate social routes and then seek competitive tenders from parties interested in operating these routes.

Tenders for the so-called social routes would be accepted on a least-cost subsidy basis. The party requiring the lowest subsidy level from the government would receive a limited franchise to operate the social route for a specific period. Operators would lower costs by using more-appropriately sized vehicles and by contracting out repairs and maintenance. They would likely use part-time, locally based labour and utilize their equipment more intensively.²⁰ The threat of losing the franchise to a more-efficient operator at contract renewal time would maintain a competitive stimulus for lower costs.

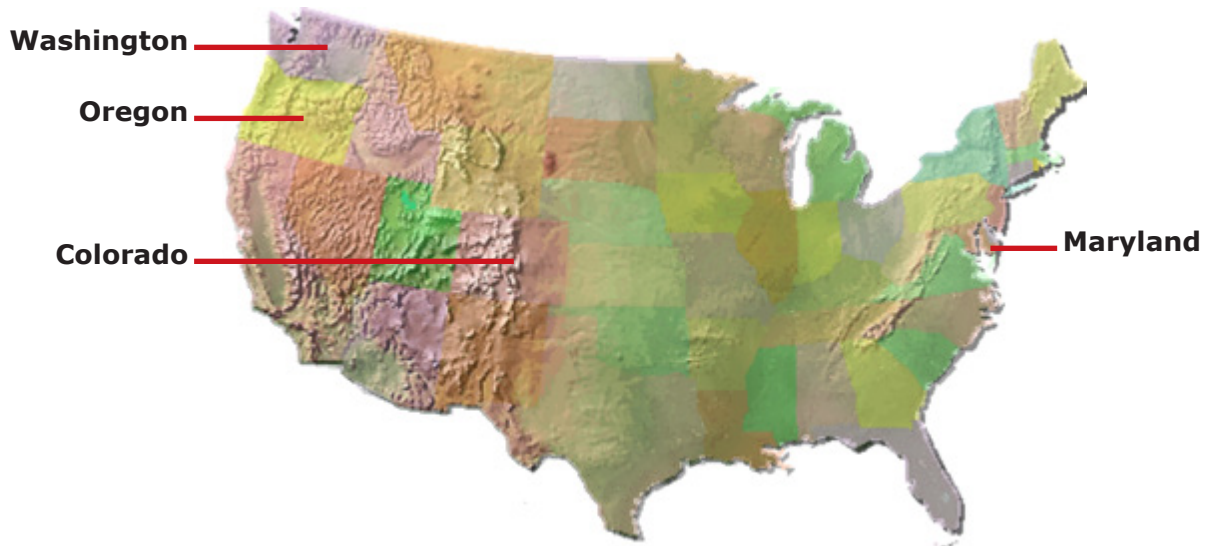
In time, as costs decline due to competitive pressures, the number of marginal routes requiring direct subsidy would be expected to decline, thus reducing the government’s expenditure on the social policy routes.

C) Restructure STC

STC, as a high-cost producer of bus services, would require substantial restructuring in order to function in a more competitive environment. As other suppliers enter the market, STC would need to shed considerable staff, equipment and facilities. The transition phase would require a sensitive adjustment program for affected personnel including early retirement packages, generous severance packages and perhaps assistance for displaced employees who want to start their own competitive bus operations on selected routes.

CHART 4

States with Least Cost Subsidies for "Social" Routes



Source: Steve Lafleur. Frontier Centre for Public Policy, "Inter-city Busing: A New Regulatory Framework for Canada."

STC's background and experience in managing a province-wide bus service make it a natural candidate for managing terminal slots and interlining agreements (which allow ticket buyers to purchase a single ticket for a destination that requires travelling with more than one carrier) and co-ordinating scheduling between the various operators that would provide service in a competitive bus marketplace. However, this would require only a small core of managers and personnel from the present staff. Optimally, funding for this service and the operation of key bus terminals in the major cities would be financed by the industry itself. However, some initial direct government support would likely be required, as the structure of the market adjusts to competition.

STC assets including terminals, real estate, maintenance facilities, vehicles and equipment were valued at \$40.6-million in 2012.²¹ Proceeds from divesting these assets should be used to finance the aforementioned employee transition program.

Benefits of Restructuring

Saskatchewan is still in the midst of a boom, but global economic instability highlights the need for fiscal prudence. If the province wishes to maintain current service levels through good times and bad, it should create a more efficient busing industry. Fare hikes will only reduce ridership and revenue. Continuing the cost-plus regulated government monopoly model will only make the unit cost of service more expensive over time. The Saskatchewan public will benefit in two ways:

1. Lower total subsidies

By deregulating the bus passenger market and purchasing service directly on social policy routes through a direct subsidy system, Saskatchewan can expect substantial reductions in total subsidies devoted to rural bus services. While it is difficult to determine the required level of subsidy in advance, Washington State, for example, spends less than \$1-million annually to provide rural intercity bus service under a competitive tendering model.²² For the sake of providing conservative estimates, we will assume that the initial subsidy requirement will be half of the \$9.2-million 2012 operating subsidy, which adds up to \$4.6-million. Combined with eliminating the capital subsidy, this would lead to a \$6.9-million savings. Factor in corporate taxes from private operators and the total projected savings amount to \$7.03-million (see Chart 5).

CHART 5

Estimating Savings to the Saskatchewan Government and the Taxpayers

Change in Operating Costs (\$ Millions)	STC Monopoly	Direct Subsidy	Savings
Subsidy Required			
Annual STC Operating Loss	\$9.20	\$4.60	
Direct Subsidy	\$2.30		
Subtotal	\$11.50	\$4.60	\$6.90
Change in Tax Revenue			
Saskatchewan Income Tax Revenue	\$0.00	\$0.12	\$0.12
Total Annual Savings from Competitive Model			\$7.02

Assumptions

- The annual subsidies for STC in 2012 were \$11.5-million.
- Direct subsidy calculated at 50 per cent of STC 2012 operating loss.
- Income tax revenue based on a 12 per cent rate levied on \$1.02-million annual industry profit (based on 5 per cent profit on \$20.5-million (\$15.9-million of 2012 operating revenue and the proposed operating subsidy of \$4.6-million).

In addition, there will be significant consumer benefits with more departure choices and lower fares on high-volume corridors. Injecting competition could provide lower-volume routes at a lower subsidy level without compromising service. However, these benefits are beyond the scope of this proposal, and no attempt was made to estimate them.

2. Make subsidies transparent

The direct, least-cost subsidy system would highlight the Saskatchewan government's commitment to accessible rural bus services. At present, the government cannot precisely identify its commitment level to this bus service. While reforms in the late 1990s made STC subsidies more transparent, providing lump-sum operating subsidies helps hide the true cost of each route, thus making it difficult to judge how well these subsidies are used. Additionally, a lack of private sector operators means we do not have price benchmarks that we can use to determine whether routes are optimally priced.

The proposed system would allow STC to target the economic benefits more directly to rural areas receiving subsidized service. It would provide more room for local stimulus in the hard-pressed rural economy by giving rural operators an opportunity to offer bus services locally.^{[23](#)}

Conclusion

In conclusion, a visible subsidy invites informed public discussion. The total subsidy provided to accessible rural bus service is large relative to the social benefit produced. Few people are aware of this. When the real costs of subsidizing bus service are highlighted, the public will be in a better position to rank the true social utility of government-supplied bus services against other potential expenditures.



ENDNOTES

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23. The present system concentrates STC salaries, wages, maintenance and service expenditures overwhelmingly in Regina and Saskatoon.

Further Reading

December 2012

Inter-city Busing: A New Regulatory Framework for Canada

By Steve Lafleur

http://www.fcpp.org/files/1/PS147_IntercityBusing_DC03_F4.pdf

May 2001

Urban Public Transport Moves to the Purchaser/Provider Split

By Wendell Cox

http://www.fcpp.org/pdf/urban_transport.pdf

September 2000

Deregulation, Privatization, and the Birth of the CNR

FC Backgrounder

<http://www.fcpp.org/publication.php/183>

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