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$40m handout a worrying policy decision

IN deciding to dole out $40 million to the Kowloon Motor Bus Co from public revenue, the administration has set a precedent with far-reaching ramifications.

For those mindful of this Government's basic policy of economic non-intervention this represents a worrying setback in the face of political expediency.

Admittedly bailing out exercises are increasingly becoming standard practice, to a greater or lesser extent, in other free economies.

But in opting for the cash award to KMB, this Government may have made a blunder in not having adequately thought out the implications involved.

And in so doing, albeit after a series of agonising and prolonged sessions involving the Transport Advisory Committee, policy branches at the Government Secretariat and finally the Executive Council, it has at best provided only an interim answer to a complex problem.

It is arguable that the broad public interest has been adequately taken into full account.

Apparently in giving the $40 million unconditionally to KMB, the Government had in mind the effects a loss situation would have on the confidence of its shareholders and other loan sources, discouraging them from pumping in additional money to meet the capital costs of expansion.

But this is unacceptable in principle. The Government has effectively breached one of the principles governing profit control schemes for public utility companies.

This says that should there be an insufficient balance in the development fund (a fund to take account of excessive profits which may be used to "top up" the permitted return in a lean year) to make up any shortfall, then there is no guarantee that such a shortfall may be covered later.

Also, the $40 million handout is seen by many as being aimed at subsidising the bus rides of a vociferous and sizeable pressure group by reducing the extent to which their personal purse will have been hit.

Such a politically expedient move may or may not be justified.

But by giving the cash award to KMB just to cover the company's losses so far this year is unsatisfactory in that no strings are attached.

The point at issue is whether the Government's fares-cum-handout scheme has raised more questions than provided answers despite its apparent attempt at ensuring that KMB will remain viable by the end of the year as far as its operations are concerned.

Let it be pointed out that whether KMB's operation will remain viable even after the Government's cash injection is open to dispute.

The question then is whether the handout should have been made a standby facility only to be drawn upon on condition that the company improved its services by the end of the current accounting year *and* if the company could be effectively shown to be suffering from losses.

The handout scheme raises one significant question: Despite the Government's announcement that this will be a "once and for all" payment, may not the authorities again opt for the same measure if the company's accounts suffer any further losses?

Indeed, the Executive Council has made a bold move in making a cash handout to a major public utility run by private enterprise.

And in so doing the council is left with the distinct possibility that it may have to do the same for other public transport services — not to mention utilities — provided by the ferry companies, Hongkong Tramways, the Mass Transit Railway Corpn and the Kowloon-Canton Railway, if the scales of future fare increases to be sought by them are such that they will cause similar, if not stronger, public reaction.

Official approval came last week from Exco for the fare increases for the two bus companies — just over 40 per cent for the KMB (another one is on the way when the study of the company's profit-and-loss account is completed in the next several months) and about 30 per cent for the China Motor Bus Co.

The Government said the cash handout for KMB is to cover the company's losses so far this year, brought about by the delay in approving the fare rise and the fact that the level of increase was lower than the company had sought.

The Secretary for the Environment, Mr Derek Jones, said this will simply permit KMB to break even, but not to make any profit and that the 40 per cent increase will in any case leave KMB with a substantial cash flow problem by the end of this year.

Mr Jones said the new fares are necessary so the bus companies can meet increased costs of operation, which also involve higher bills for fuel, wages, maintenance and spare parts, and for an expansion of services.

"It is emphasised that the capital costs of expansion, such as the purchase of new buses, are to be met by the companies' shareholders or by borrowing, not from the operating revenue," he said.

In approving the increases, the administration also accepted 16 recommendations by the Transport Advisory Committee on reviewing a memorandum of understanding and the profit control schemes involved, plus guidelines for supervising the operation of the bus companies.

This is significant because the 16 recommendations concerned are expected to effect a major and necessary overhaul of a substantial spectrum of issues relating to the operations of the bus companies.

On the existing profit control scheme for KMB, for example, which was agreed in 1975, the TAC says it not only encourages the company to boost the value of its net capital assets without necessarily improving bus operations, but it also provides the company with means to increase net fixed assets.

Further, the TAC claims the Government shows in the scheme a willingness to grant fare increases that will allow KMB to obtain the maximum return, which is 16 per cent of net fixed assets.

An example of this is afforded by CMB's 162 per cent increase in profit, after tax, for the second half of last year — information which was only publicised as a newspaper advertisement on Monday after the 30 per cent fare increase for the company was announced on Friday.

Clearly the Government gave the fare increase to CMB with a view to helping the company reach its permitted return of 15 per cent of net fixed assets.

The TAC recommends that apart from a general review of the profit control schemes, the Government should also consider "relating the maximum permitted return to the size of shareholders' funds."

Mr Jones said in its consideration of the applications the Government accepted that the bus companies should ultimately operate at a level of profitability which allows them to continue to provide a vital public service which carries a total of 3.4 million passengers daily and to make a reasonable return on their assets.

By definition, profitability being the byword in a private set-up, running a basic public service and the public interest consideration are mutually exclusive.

In a forum on the Government's role in supervising the operation of all public utilities held at the University of Hongkong last week, the university's senior lecturer in political science, Mr Norman Miners, revived a 22-year-old suggestion that the Government should nationalise all public utilities as the most feasible way of providing satisfactory services to the public at the cheapest price.

However, Chinese University political science lecturer, Mr Wong Wang-fat, said that this move risks a deterioration of services due to the effects of bureaucracy.

Between the two extremes of full-scale nationalisation and allowing the bus companies to maximise their profits regardless of the welfare of the travelling public, the administration has so far opted for a compromise in seeking to boost its control, based on the recommendations of the TAC.

Mr Jones stressed that a review of profit control schemes will include a study of sources of income, which is currently excluded, and the position of KMB's subsidiary real estate company, Tyleelord.

According to the TAC, the potential for profit from Tyleelord is "very large and could lead to a situation where despite the bus operation losing money, the company as a whole might be profitable.

"In such circumstances," the committee says, "it would be most difficult to defend fares increases to the public, however well justified the increase might be when viewed from the bus point of view alone."

Mr Jones said the Government views studies both of the profit control schemes and the memorandum of understanding as urgent and that every effort will be made to complete them as soon as practicable.

This is as essential and welcome as the Government's acceptance of another important recommendation by the TAC which calls for setting up a "value for money" audit system for the bus companies.

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In making such a recommendation, the TAC has drawn the administration's attention to the difference in standards employed by KMB's external auditors, for example, and those employed by the Director of Audit in dealing with Government departments and subvented bodies.

External auditors are charged merely with the job to conduct a regularity audit which establishes that the accounts give a true and fair picture of the finances of a company while the Director of Audit performs a "value for money" audit which examines also the efficiency of the organisation.

In looking at the Government's undertaking to plug existing and potential loopholes in matters relating to operations of the bus companies, the one main question to be asked is whether the resulting new measures will suffice in safeguarding the welfare of commuters.

At present, it is understood that the Government is considering the possibility of appointing its own administrators to the bus company managements.

Amendments to the laws covering bus operations are being considered following the initiatives of the TAC strongman, Mr T.S. Lo.

Mr Lo purportedly wants the Government to appoint administrators to the companies if they fail to fulfil pledges to improve or maintain adequate services.

The idea is for the administrators to run the companies which will, however, still keep their profits.

But as this scenario allows no possibility whatsoever for the public administrators to maximise the companies' profits, this is expected to reduce the flow of investors' funds and deter banks from making loans to meet expansion costs.

Specifically then, the question is whether the Government should not go one major step further — partly drawing on Mr Miners' suggestion — by modelling major public transport operations on the statutory Mass Transit Railway Corpn.

Or, should not the Government buy its way into each of the bus companies, with the equity involved pitched at a level where official participation in their management would be a matter of right?

In many ways this would be equivalent to a semi-takeover which would feature both public and private expertise.

It can be argued that this arrangement would not unduly affect the companies' ability to attract investors' funds but would reap the benefit of effective control on behalf of the travelling public.

The nitty-gritty of the matter is the ultimate fare structure which could be afforded by the public.

At present the Government is planning to give travel concessions to students on all franchised public transport, including the MTR and the KCR with effect from September.

If, in addition to this scheme, the Government is forced to subsidise, across the board, the cost of commuting and if it opts for an equity deal with the bus companies, at least it can do so by injecting funds into companies which it partly owns without risking criticism such as the $40 million handout to KMB has attracted — the benefiting of a company in which the administration has no equity.