

Regulatory Impediments in the Land Transport Sector of Sri Lanka

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Sri Lanka's land transport sector is made up of a number of modalities. As shown in Table 1 the key contributions in passenger transport are made up of buses carrying 68%, private vehicles carrying 24% and railways in third place, accounting for 5% of passenger trips. In spite of the visibility of large numbers, the actual contribution by three wheelers is just 2%. For the transportation of goods, the truck is the dominant mode of transport carrying over 97% of the ton kms while the railway contributes only 2%.

Mode	Vehicle Kms Operated (mn)	Passenger Kms Carried (mn)	Ton Kms Carried (mn)
Bus	966 (08%)	45,407 (68%)	
Private Vehicles	7,861 (64%)	15,831 (24%)	
Railways	11 (00%)	3,600 (5%)	102 (02%)
Three Wheelers	1,548 (13%)	1,161 (2%)	
Truck/Land Veh.	1,813 (15%)	907 (1%)	4,532 (97%)
Water Transport	3 (00%)		32 (01%)
Total	12,202 (100%)	66,906 (100%)	4,666 (100%)

Table 1: Modal Contribution to Sri Lanka's Transport Market (2001)

Sri Lanka's present transport market has evolved over many years changing with the advances in global technology. During the 16th and 17th centuries it centered around water transport but was replaced by the railways in the latter part of the 19th century. Road transport became popular after the Second World War. At present, the different modes of transportation have widely varying regulatory structures: these are summarized as follows.

Bus Transport: This began as an unregulated private enterprise in 1907 and remained so until 1927 when problems of competition began to surface. From then on until 1958, gradual regulation was introduced in terms of licensing, fares, safety measures, and also corporate structures. However, the problems of accidents, neglect of rural services and intense competition on popular routes remained unresolved. This situation led to the nationalization of buses in 1958 and the formation of a State monopoly, the Central Transport Board, which eventually became one of the world's largest public

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bus corporations. Even though the first decade after the nationalization of buses showed visible benefits to society, its gradual politicization, and lack of a clear fares policy led to service delivery problems. As a result, the private sector was reintroduced to service. The re-entry of the private sector brought in competition to but contributed little to the improvement of the quality of service received by passengers. Regulation was minimal with permits for bus services issued on an individual basis with no pre-requisites required to qualify to operate such services. There was in fact, no regulator until 1991 and even then the National Transport Commission Act did not adequately deal with offences, service monitoring, route planning, fare determination etc. Moreover, the act only introduced the Permit System where licenses were issued on the basis of a permit per bus resulting in 18,000 buses being owned by over 15,000 individuals. Although fares are not regulated by law, quasi-controls have continued to date. It is within this framework that a Fares Policy was first introduced in 2002 in order to determine the fare levels annually based on cost of inputs and quality of output.

Presently, most owners have little control over their buses. Some are leased for the day to 3rd party crews that are untrained and often unlicensed. Productivity is low, the costs are high and worker conditions are dismal as many work upto 13 to 15 hours. Meanwhile, competition between buses has led to dangerous driving and as a result accident rates have doubled. There is no assurance regarding the quality of service and as such regulation by both the national and provincial authorities is ineffective. For example, times are not observed and over-crowding is not controlled.

Railway Transport: As opposed to bus sector, railways in Sri Lanka have been fully regulated as a government monopoly since its inception. There are however, problems in the form of a visible lack of commercial or passenger interests, pre-occupation with employee rights and disruptive trade union actions. There is some interest to begin Joint Ventures such as that of the proposed Airport Express and also freight movements such as in carrying fuel and flour. Even though privatization has been studied, there have been concerns about the eventual quality of service and the impact of privatization on fares, which are presently lower than those for bus travel.

Trucking: Trucking is an example of a fully deregulated industry in Sri Lanka. There have been no instances of rate regulation and the only regulations pertain to restrictions of vehicle sizes; something that has also been flouted widely. At the organized corporate level, the efficiency is generally acceptable but such trucks are not available for public use. At the lower end of individual owned trucking however, there are a multitude of problems such as un-road worthy vehicles, long term parking on roads and high accident rates etc. Trucks for hire often congregate at specific locations and due to daily use being quite low semi-cartelization exists with significantly higher prices for the occasional hirer. However, this is an avenue of self employment and therefore has an important social interest. Trucks do not pay the actual road user charge and is thus a subsidized industry; at times a disadvantage to rail freight.

Three Wheelers: This has become a popular mode of transport in recent times largely due to the breakdown of public transport services and also due to parking problems in the central business areas such as Colombo and Kandy. These too serve primarily as an avenue for self-employment, with increasing numbers collecting at road intersections, thus continually eroding the efficiency of the fleet. Cartelization occurs at most such locations and fixed pricing exists. A number of negative externalities such as parking problems, air quality and accidents have also arisen. There are at present 142,000 three wheelers carrying between them 2% of the passenger trips compared to the bus industry which employs around 24,000 buses but carries 68%.

Private Transport: Regulation of public transport is done through the tax on imports. Presently, motor cycles have the lowest band of import duty at 20%. As a result nearly 50% of the vehicle fleet in Sri Lanka is made up of motor cycles. Vans and other utility vehicles have import taxes around 35%. These make up 15% of the vehicle fleet. Cars have high taxes ranging up to 200% depending on

fuel and value. These however make up only 10% of the fleet. Studies have shown that 73% of the road space in Sri Lanka is taken up by these vehicles which contribute to only 24% of the trips. Other than annual licensing and insurance there are few or no regulations applicable to the use of private vehicles. Parking regulations are scarce and fees only recover around 10% of the opportunity cost. Moreover, there are no specific road user charges, entry restrictions or tolls while some types of vehicles, such as diesel powered passenger vans and cars, are heavily subsidized.

The need for Reform

The transport sector in Sri Lanka has not seen the qualitative development required to provide for the competitive markets of the modern world- especially as demanded by the commercial and industrial sectors. An efficient and cost effective public transport system is imperative however, for Sri Lanka is one of the more densely populated countries of the world. In fact most of its cities and regions can only cope with limited amounts of private vehicles². However, the deteriorating quality of services offered by public transportation as opposed to the increasing comfort of private transportation, has resulted in increasing numbers of people using private vehicles. Privately owned public transport needs reforms that are aimed at improving the quality of services provided, while state owned operations which have large overheads need management reforms for more cost effective services.

The Status of State Owned Public Transport Services

The land transport sector in Sri Lanka is estimated to consume economic inputs of over Rs. 170 billion annually (Table 2). Of this, the public transport services account for nearly Rs. 34 billion while the State Owned Transport Companies (SoTCs) provide around 25 to 30 percent of the service. In terms of bridging salary shortfall payments and subsidizing the operation of uneconomic rural routes, the state support for the bus sector amounts to around Rs.2-3 billion per annum. New buses therefore, have to be in addition to this. This has not however always been the case, as the same companies under better management have been known to make profits before depreciation in the year 2001. The railway on the other hand has had to be supported by the State by an amount of around Rs. 3.5 billion per annum. On a percentage scale the State Bus Sector is presently subsidized by around 30 percent. It is less than in countries in Europe, where bus sector subsidies range between 30 (U.K.) to 80 percent (Sweden) of costs.

Sub-sector	Value of Annual Inputs Rs mn
Railways	4,700
Buses	29,000
Three Wheelers	18,730
Private Vehicles	73,350
Trucks	42,300
Other	7,000
TOTAL	170,000

Impediments to Transport Regulation

The foremost impediment to transport regulation is the continuing inability among policy makers to consider the transport sector as a whole and thus address reforms and regulations so that the entire sector is developed to serve the different economic and social needs of the country through the modes that are optimally suited for providing such services. There is also a lack of clear policy on what end product is required from the transport sector. At times policy refers to profitability as the governing criterion while at other times it refers to service satisfaction. There are also conflicting messages on the importance of public transport. In this respect there is a lacuna on the issue of sustainability of private transport given that increasing road space is both difficult and expensive. There is also the

² Kumarage Amal S, 'Traffic Congestion: Problems and Solutions', Economic Review, July 2002.

political factor where the lack of clear policies and strategies are exploited by trade unions in the case of state owned operations and by service providers in the case of privately provided transport services. Moreover, the absence of a policy on the resulting traffic and its management presently costs the economy a staggering 20 billion rupees. It is among these wider issues that the impediments for bus transport are discussed.

Case Study: Impediments for Bus Transport

In a number of cities worldwide, bus companies are funded and owned partly by public authorities and partly by private enterprises. Usually both such State and private companies operate under a contract with a government ministry or the local council. The government's obligations are to approve timely fare increases in line with rising costs and to provide a subsidy for un-remunerative services or 'concessionary' fares. It is also responsible for planning studies and preparing routes and services for contracting out. On its part, the companies finance and supply the rolling stock and are required to operate a specified quantity of bus trips to meet agreed performance (quality) targets.

Why we need the Privately Operated Bus Services?

1. When scope of the demand for bus transport is extensive and the State is not able (or willing) to provide adequate (a) investment or (b) management supervision or (c) both in order to offer the required quality and quantity of bus services demanded.
2. To reduce the risk of a potential (particularly sudden) discontinuity of all bus services (the dominant mode of transport in Sri Lanka) due to trade union action when bus services are operated by a State agency.
3. To bring about innovation, marketing and risk-taking that is necessary to systematically improve bus services, for which the private sector is better equipped.

Do we have a responsible and competent Private Sector?

The entry of the private sector in to the bus industry has seen mixed results over the last 25 years. On the credit side, they have made large investments (though mostly by single bus owners as opposed to corporate bodies), they have also responded to the introduction of higher quality (air-conditioned) services and new services. On the negative side, reliability of services have deteriorated, idling of buses at terminals and stops have increased, accident-risk factors have increased, productivity of crew and buses have decreased. These factors have combined to cause sharp increases in over-loading of buses as fares have been fixed. Fares have not come down in real terms despite increased competition. In contrast, most indicators show that the quality of service has deteriorated. These issues have recently been analyzed and well documented.³ Clearly, the benefits of private sector investment and management of services have not brought about the desired results. Additionally the entry of the private sector has fragmented the integration of the bus network and transfers have become difficult.

The services provided by single private bus operators have clearly demonstrated that they only operate when and where it is profitable to do so. As such, for the routes and times of the day that are not financially remunerative, bus services are not provided. The regulator is unable to enforce a time table and this has resulted in severe consequences such as constraining the mobility of labor, distorting land use development, and abandonment of rural areas.

³ Bus Transport Policy Report, Ministry of Transport, September 1999 and A Review of the Household Incomes and Public Transport Services and Fares in the Colombo Metropolitan Region, Report to World Bank, Amal S. Kumara, December 2000.

With a few exceptions, it could be generally held that the private sector has failed to provide the quality of service that has been expected from it. Although regulated fares and single bus ownership have been quoted as the reasons for this state of affairs, recent study and documentation reveals that a host of *regulatory lapses*⁴ are in fact the primary cause of this situation.

Can Bus Companies Make a Difference Today?

The last 25 years of private bus operations have seen a number of formal companies entering and leaving the industry. It has and still is composed mostly of single-bus owners, some of whom own upto five or six buses.. The present manner in which the industry operates does not provide economies of scale for the larger operators. It is only by employing bus-crews for illegally long hours, by denying them EPF, and by the crews themselves making a host of illegal payments and breaking all the rules required for the safe and courteous carriage of passengers, that they continue to exist and to compete with one another. Formal cooperate entities have not been able to resort to such practices and have quickly left the industry. It is therefore, a pre-requisite that the presently oppressive and wasteful climate of bus operation be changed in order for high-profile companies to enter the market and provide qualitatively improved services. This should be done mainly through strengthening regulation.

Can Subsidies be Eliminated from Public Transport?

No country has an effective bus or rail service that is entirely free of State subsidy. Subsidy is often used quite productively to influence parameters such as urban traffic congestion, urban sprawl, rural development, mobility for the ultra poor and the social upliftment of under developed areas. There is a need therefore, to determine the level of subsidy and the targeted benefits of such subsidies in a new transport regulatory framework for Sri Lanka. In this respect, it is reasonable to question if the government's subsidy given to the State sector (SoTCs) has been well targeted and if the desired benefits have materialized as a result of these subsidies. Some independent studies show that most subsidies are considered as a part of general subsidy to the SoTCs and that they do not consider them as been given for specific targeted un-remunerative services. Furthermore, the non-existence of methods of subsidy computation and monitoring methods have not allowed wide scale extension of these subsidies to the private sector operators. There are successful examples however, such as in Queensland in Australia, where Public Service Obligation contracts have been negotiated with negative concessions for servicing community needs where the fare box revenues are inadequate.

What is the Role of the Regulator Today?

The weakest link in the industry today is the Regulator. The National Transport Commission, set up in 1991, has had most of its senior staff from the CTB. It has largely been functioning as a permit issuing office and has not grown into the role of a regulator. It does not as yet have a mechanism or the data to determine supply levels, fare levels or the routing and scheduling of buses. Since the national agency has not progressed, the provincial regulators have also not developed. Thus, most of the bus routes today are over- priced and consequently over supplied or they are under-priced and consequently under supplied. Moreover, even though the system of issuing annual permits has been found to be quite unsatisfactory for most routes, alternatives such as franchising, tendering or contracting have not even been investigated by the NTC. However, credit should be given to some Provincial Councils for experimenting some of these.

More Regulation or de-regulate more.

One of the most unproductive debates over the last decade has been the question of how much regulation the bus industry should have. There is little doubt that buses have to be regulated, given that qualitative measures of service are difficult to measure and given that the consumer has little choice but to accept the service that is offered. The alternative of using private transport , has heavy economic

⁴ *Ibid*

costs. The foremost impediment in this respect, is the inability to measure the qualitative aspect of the service that is provided. Unlike the supply of a unit of electricity or even the carriage of a tonne of cement, passengers can be taken from place to place in different manners, all affecting the condition with which he reaches his destination. Thus, specification of quality is an important first step in determining the required services.

In the UK, which spearheaded the de-regulation of buses, there is pressure now to re-regulate the nation's buses as a means of attracting passengers back. It has been argued that 'since privatisation and deregulation under the previous Conservative government, a wholesale takeover by the private sector based on competition first, communities second and leaving workers a poor third would ultimately benefit no one'.

Why an Effective Regulator for Bus Transport is needed?

This function may be described as a means of imposing greater regulation through a framework of public control over private operations.

1. To **manage the supply of buses** in order to ensure that the most efficient utilization of resources is achieved. This efficiency can then be transferred to the passenger through lower fares and higher quality and to the operator through the creation of a more stable environment for growth and continuity of the industry. For example, inadequate supply (widely experienced towards the end period of the era of nationalized bus transport) is characterized by rampant overloading, unreliable services, an aging fleet with regular breakdowns and conspicuous disregard for passenger needs. On the other hand, oversupply (as seen on most routes today) also has similar characteristics namely, the 'restriction of supply' leading to the accumulation of buses at terminals, 'anti-competitive' behavior between operators, socially unacceptable practices such as inflated fares, lingering at halts, systematic overloading and also 'predatory' practices such as speeding between halts. Thus, service quantity monitoring is essential. Applicants for new permits are generally new-comers to the trade and are often unaware of the costs and benefits and the management expertise that is required to operate such a service. Once they enter, rather than leave the route if they are unable to make the required revenue, they stay on by lowering the quality.
2. To ensure the **qualitative continuity of non-profitable services** which if left entirely to market forces would result in neglect, especially to the rural and poor communities and the 'late-night' and 'early-morning' services, on even the generally profitable routes. The present freedom to withdraw from such services (without penalty) and provide only profitable services has caused major social distress, the burden of which, the State bus sector has been called upon to bear.
3. To maintain the service parameters between '**quality and fare**' by studying and negotiating a fares policy, standards and operating costs of services and any level of subsidy payable for specific services needed for providing external socioeconomic benefits.
4. To ensure that there are **no barriers to entry of bus operators** created by either the State or private sector through monopolistic behavior and other unethical practices
5. To systematically plan and **develop the bus service as a network of services and routes**, integrated to each other and to all other modes of transport and to be responsive to the constant changes brought about by the progress of technological innovation, land use development, social mobility and economic conditions.

6. To **protect the rights of the bus passenger**, by formulating regulations and continuously improving them and by investigating complaints made by passengers and taking action against violations of rules and regulations by operators.

Possible Models for Developing Bus Operations

In order to improve the quality of both the State run services and the privately operated services, it is necessary to consider which of the following models, used in other countries, are most appropriate for managing bus passenger services in Sri Lanka.

- A. **Permit System**, (which is presently in practice in Sri Lanka) becomes unwieldy when there are many operators. It is best as a self-regulatory system, where the State sector operator is the dominant operator and a selected few services are given to private operators. The permit system began in Sri Lanka under such conditions, but has long outlived its appropriate use as the permit system cannot effectively monitor a system with a large number of private sector operations. Permits are usually renewable between 1 to 3 years and not cancelled unless the conditions are found to be violated. There is no competition for permits as it is issued on demand or in order of application. It breeds corruption when there are more applicants than there are vacancies for buses on routes: oversupply can also occur as a result.

Applications: Sri Lanka

- B. **Supervised Competition through Route Associations:** In most third world countries, there are operators' route associations, operator's unions or cooperatives. In addition to providing miscellaneous services to their members, these organizations often exercise a degree of supervision and control that provide an improvement from a complete free for all (under the permit system). However, these unions should be 'democratic' and business oriented in order to achieve such goals. Steps should be taken to prevent a few influential operators from taking office and exploiting the system for their own advantage (e.g. Private Omnibus Associations that were disbanded in the 1990s).

Example: In the case of Buenos Aires, a total of 15,000 private buses are formed into around 300 route associations. The owners are responsible for operating and maintaining their vehicles, while the route associations assume responsibility for scheduling bus services. They provide their members with administrative and legal advice. Since the government fixes bus fares, the unions also negotiate fare increases with the government. In most cases, the owners keep the fares collected but the union ensures equitable earnings by interchanging routes and schedules on a weekly basis.

Suitability for Sri Lanka: The operators on each route could be formed into an association. The route association is then contracted to manage the required scheduling of services internally, through trained managers who can provide 'professional' leadership to perform these functions. There are however problems with this method too, for there is the possibility that the MFO's that would be essentially 'route-based', would later make claims for indefinite and continuing rights to provide services on that particular route. This could eventually result in the possible return to the pre-nationalized era of private buses.

Applications: Caracas, Istanbul, Manila.

- C. **Route Franchising (also known as Transport Provision Contracts –TPC's)** this method uses dynamic market forces to secure the supply of bus passenger services at competitive prices. Under this method, a route, a particular service on a route or even all services in a region

could be tendered periodically. The quality of service is pre-defined and the maximum fare collectable is stated. In this system, both the operator and regulator should do market surveys to submit and evaluate tenders. This method also has an in-built mechanism to deal with un-remunerative services. It does however, require the regulator to study each route, its required services and the specification of standards. Most importantly, for this method to succeed, the regulator should possess the required technical and legal strength. In this system, private and public companies may be allowed to compete with each other for tenders.

Applications: London, Other areas of UK (un-remunerative services only), Costa Rica, New Zealand.

Suitability for Sri Lanka: Sorting out the competition between the State and Private sector may remain a problem. Large routes may require the creation of large companies that will in turn create monopolies. There would be enormous pressure on the regulator to keep a particular operator in service even if he is performing well below par. Can be successful only if a strong and independent regulator who will plan and manage the bus industry on professional lines is set up.

- D. *Market Partitioning:*** In this approach, the industry may be partitioned into smaller (and more manageable) segments. For example, bus services may be partitioned into (a) Basic Services and (b) Premium (Value Added) Services. The first group consists of basic bus services at the regulated fares so that each route is ensured of a basic level of service at an affordable fare. The second category comprises those services wherein services are customized for particular market needs and priced at a premium according to the market demand. These services could extend to several class categories such as luxury air-conditioned services, services where seating could be reserved, school services and special services for office and factory workers.

Applications: Dakar, Hong Kong, Bangkok

In this system, competition is maintained between regulated (low fares) and the higher quality at premium fares. In order to remain in business and not lose passengers to the premium services, the basic price system has to ensure that it provides as much quality as they can. On the other hand, the customized services will have to improve their services and charge reasonable fares in order to maintain a sizeable market share.

Suitability for Sri Lanka: This approach is considered suitable and is broadly what has been recommended in the Bus Transport Policy. This has the advantage of reserving the 'basic bus service' for the State bus operator/s and encouraging the private sector to enter customized and/or contracted services under the TPC's. There are distinct quality parameters when services on a given route are offered by a single operator. It is expected that at least 30% of the market may be thus contracted.

As a first step, what appears most appropriate for Sri Lanka may be to use Route Associations for large routes with Concessions for smaller routes. Route Associations could be franchised over the long-term after market partitioning. For example, routes that require up to 6 buses for operations could be served by a Route Association. However, larger routes could be partitioned into concession for parcels of 30 buses, with each parcel having a unique set of service characteristics such as value added services. Luxury or semi-luxury therefore, could be separated from the normal services and all three services could be franchised separately. This would then result in the competition between quality and cost as well.

Reforms in Other Sectors:

Railway reforms have to be tackled completely differently from bus transport reforms. The UK example of unbundling operations, track and support services ran into several problems and cannot be considered as appropriate for Sri Lanka. Sri Lanka's railway is around 1,500 kms and cannot be partitioned off for different users, except those lines which do not serve the day to day functions and thus may be converted to tourist railways or freight services. Reforms in the railway will necessarily be through concessions for ancillary services while the railway retains the operational control of trains. Thus, investment and management of supplementary services such as the proposed Airport Express, station developments, container transport etc could be attempted under joint venture projects with either other State agencies or the private sector. The primary obstacle to this approach would be two fold. In the first instance the government would have to continue to fund the railways even though new ventures may recover costs and even, make a small surplus. The relatively large Treasury subsidy of around Rs 3.5 billion and investment for improvements would have to be justified on economic returns for which the railway should carry at least 20% of the urban passenger traffic and 20% of the freight movements. The second problem would be the reliability of service provision by the Sri Lanka Railways which will continue to be a fully owned government entity. Wild-cat strikes, poor efficiency and lack of interest could be problems that would stall such a program.

While the railway reforms look towards greater de-regulation, there are frequent calls for greater regulation in the three wheel sector. In this case, care must be taken to determine which regulations are useful. A minimalist approach would indicate that what is essential is to regulation the registration of drivers and the display of fare structure. Consumer concerns mostly revolve around the need for security and safety through the certification of the drivers. This is understandable since surveys have revealed that nearly 15% of three wheel drivers are without valid driving licenses. A further 10% of vehicles are without proper documents such as insurance, annual licenses etc. The second important manner through which to regulate the sector would be to require three wheelers to display fare per km. Occasional three-wheeler users feel they are often cheated by drivers who over-state distance and charge higher fares. Although three wheeler driver associations are divided on the issue, fare meters may be a necessary intervention.

Conclusions

The transport sector in Sri Lanka has a wide spectrum of regulation ranging from total deregulation in the trucking industry to monopolistic control of the railways. As such, Sri Lanka provides a platform for determining the pros and cons of reforms. Experiences to date, in the bus sector in particular, show that the correct formula has never been found and/or sustained. This paper outlines the impediments to reaching sustainability within economic and social service expectations. The pre-requisites for such an achievement together with a program for such reforms have been provided as a case study while using the bus sector as an example.