POLICY TOOLS - PROVISION OF MEANS OF TRANSPORT

4.12 FINANCING, CREDIT AND SUBSIDY

Problem: **There is little financial support for the rural transport sector either from private or public sources**

Solution: **Government should seek to develop incentives that encourage investment in rural transport possibly through a Public Private Partnership**

BACKGROUND

The economics of providing rural transport services (freight or passenger) are weak: demand is thin due to the low population densities, while costs are high because of the poor nature of access roads, the long distances and consequent poor vehicle utilisation. With little money in the sector, investment goes on vehicles which may be old and inadequate. Even where road access is good, there may still be little financial incentive for operators to provide regular services to isolated rural communities who have limited paying capacity.

Fare levels are rarely set in a competitive spirit: they are either government fixed, or controlled by an association. In an often monopolistic environment, the only control on fare increases is violent public reaction. Even so, revenues rarely provide more than a bare living, and provisions for major repairs and vehicle replacement are hardly considered. These conditions are not encouraging for private investors in transport, and even where good returns can be made, the availability of credit to the transport sector is poor. Commercial banks view transport operators as a high risk sector because any collateral which can be offered is likely to be non-fixed (vehicles), rather than preferred fixed assets.

Historically, parastatal transport companies have had some form of social obligation to provide passenger services to outlying rural communities. Similarly state marketing boards have provided for the distribution of farm inputs and produce via local depots which were serviced by their own-account trucks, or contract hauliers. These services were reliant on heavy subsidies, and have been abandoned in most cases in the wake of economic restructuring and recovery programmes. Parastatals have been run down, liquidated and/or privatised. Where this has happened, there is evidence that the vacuum created has not been adequately filled by the private sector, and this has had some impact on agricultural production and rural livelihoods.

Credit availability is also an issue at the community and farm level. IMTs (bicycles, tractors, animal carts, etc.), which would contribute to improved local access, mobility and farm support, require investment on a scale which is beyond the reach of most. Small credit facilities are becoming increasingly available, particularly under the auspices of NGOs, though have not yet been directed at transport on a wide scale.

For these reasons it is important that there is close co-operation between the private and public sectors in delivering rural transport services. The following provide some options on how public and private sector investment can be used in the delivery of these services.

KEY PRINCIPLES FOR A PUBLIC PRIVATE PARTNERSIP

In a Public Private Partnership the efficiency and financial resources of the private sector works hand in hand with the social and economic considerations of the public sector. Projects are successful when the parties work with each other and share with each other their individual attributes to meet a common goal. Hopefully the flexibility that this operation offers means that there should be minimal risk of mis-identification of potential projects, as each operation is tailored to conditions in its locality.

Within the transport sector a variety of forms of public/private co-operation could be adopted which include leasing, franchises, and concessions, (although the term "concessions" is applied to all three). For all three of these procedures an agreement is reached defining objectives and allocating risk. Specific rights and obligations are granted to the company, which are specified in terms of time and geographical area. With a lease the operator leases equipment to supply the service. With a franchise operators provide services that are fully specified by the franchise authority and may be responsible for some investment. The franchising authority may control for common functions like marketing. With a pure concession (such as the Build, Operate and Transfer BOT arrangement) the operator covers investment costs and more commercial risks.

In terms of rural transport these types of arrangements might be most useful where private finance and expertise is being sought to build improved transport facilities such as bus and truck parks or where the government particularly wants service provision on certain routes.

Financing bus and truck parks

Most bus and truck parks serving rural areas are in a poor state of repair and ill-equipped. Municipal authorities often contract out the management of the parks to local associations who act in a monopolistic way. The associations collect park fees, allocate routes and set fares, regulate loading procedures and are responsible for the general discipline at the site. The municipality receives a set revenue from the park fees and the association keeps the rest. *This type of arrangement should be strongly discouraged because*:

- Little or no money is spent on rehabilitation or maintenance of the facilities
- The municipality/ district authorities do not maximise their revenues
- The user receives a poor service both at the parks and with the transport service

Many municipal and district authorities are now looking at the possibility of encouraging domestic or foreign companies to rehabilitate the parks and invest in new facilities such as ticket booths, toilets, electricity and shops. The companies would build and operate the new parks and hand over an agreed revenue to the authorities. At some point in the future the company would transfer the park back to the authority. The advantages of this arrangement are potentially very great:

- Private investment is encouraged into the transport sector
- Users receive a much better range of services at the new facilities
- Greater competition can be introduced in the provision of rural transport services

The final point is most important because without greater competition the rural user will not benefit from improved, lower cost and more frequent services. In addition, if these interventions are not undertaken there should be *no* consideration given to subsidising rural routes.

Options for the provision of subsidy

Government subsidies for transport operations have been mostly abandoned. Apart from their distortion effects on prices, they have been associated with the proliferation of inefficient practices through lack of competitive enterprise. They have also been discredited for their indiscriminate application, and for their unsustainable nature, particularly in times of economic depression. Advocacy of subsidies is likely to receive little attention, unless the subsidy is targeted (to, for example, socially deprived groups) and preferably can be 'bid for' by competing suppliers.

Government support for investment may still be appropriate where they wish to promote a particular policy like improved rural transport. Investment support is less likely to encourage inefficiency in operations. Incentives can take the form of import duty waivers, sales tax reductions, fuel duty rebates loan guarantees, loan funding and the like. It is important, however, that the incentives are targeted, and that the beneficiaries are those intended.

When might subsidy be considered:

- To establish rural transport services in poor areas with low density of demand
- To maintain a minimum level of service on social grounds
- To encourage adoption of particular vehicle types

Type of subsidy	Mechanism for Implementation
Direct subsidy	
Route subsidies	Different operators could compete to supply the service, specifying the minimum subsidy they would need to operate the route. Where direct competition is not possible, efficiency can be increased through a contract to supply the service. Competition occurs before the contract is signed and when the contract is up for renewal. Route frequencies, fares, and subsidy amounts made explicit in the bidding and negotiating process.
Market subsidies	As above but license a number of routes together and require operators to competitively bid for the market.
Indirect subsidy	
Operating incentives	Lower taxes and duties on vehicles, spare parts and fuel can provide an important incentive to rural operators to start, or increase the frequency of, service provision. The adoption of means of transport is strongly influenced by cost. The case for reductions in taxes and duties on vehicles used mainly in rural areas such as tractors, bicycles and other non-motorised means of transport is easier to make than on large motorised vehicles.
Start-up loans	The purchase price of vehicles is usually beyond the means of rural people. Subsidised credit can increase the chances of adoption of new technologies. Government may support through loan guarantees and loan funding.

All the types of subsidy described here have a cost to either central/local government or the various interested agencies. As noted earlier, use of road fund monies for supporting some of these initiatives could be considered; however, this might require changes to the legislation governing the road fund. In this context the fund might better be described as a mobility fund. Given the problems of finding sustainable funding sources it is likely that subsidy will not form a large component of any rural transport policy.

Credit for transport operators

Some of the risk to commercial banks on loans to the rural transport sector could be shared by government through loan guarantees or insurance. Associations of operators provides another mechanism for guaranteeing loan repayments Even so, commercial interest rates might still be a deterrent to borrowing from the commercial banks.

Associations can also pool funds in order to source investment; this has the advantage that repayment is very much the subject of peer pressure. However, the scale of funds is unlikely to be large. In exceptional circumstances, and where the association is a major undertaking, funds may be available through government channels (e.g. bilateral aid and supplier credits). The problem for the rural sector is that this investment is unlikely to be directed its way; the only benefit may be a trickle-down effect of old discarded vehicle stock to rural areas.

Financial instruments for facilitating vehicle purchase (hire purchase, rental schemes) are not well developed, and in any case suffer the same risk analysis as bank loans. These mechanisms should become more acceptable in future, but may require new legislation to underpin the transactions involved and to resolve any conflicts with current traffic law (on for example, the issue of who constitutes the owner of a vehicle subject to a hire purchase agreement).

Although operators often complain about lack of credit to purchase vehicles the evidence suggests that the problems of access to credit is not as great as is sometimes perceived. There is often an over-supply of vehicles in urban areas at the same time that there is a shortage in rural areas. This suggests that the emphasis should be on providing the necessary incentives to encourage these operators in rural areas.

Credit for local communities and farmers

Although the cost of acquisition of IMTs is relatively small, it is still a major barrier to ownership at the local level. Small scale credit schemes are finding increasing favour as a mechanism for supporting local entrepreneurs, and use of these funds for purchase of IMTs might be considered an appropriate investment.

The idea of credit is a relatively new concept to rural communities, and any scheme must include an educational component which explains the nature of loans and their repayment, as well as how an application is made and evaluated. Schemes will evidently be looking for value added, and hence the means for repayment. The concept of collateral and/or guarantors will need explaining; the loan may best be made to a group rather than an individual, on the basis that collective responsibility for repayment is a more assured way of meeting the obligation.

Small scale credit facilities are being promoted by commercial banks and NGOs (see **Box 1** for a case study of Thailand). Interest may be charged at commercial rates or higher, because of the additional administration involved. Even so, these rates are likely to be less than those charged by private money-lenders, and are also likely to be more fairly and compassionately administered.

Box 1: The Bank of Agriculture and Co-operatives in Thailand

In the rural areas of Thailand the most important credit organisation is the Bank of Agriculture and Co-operatives (BAAC) which provides loans for agricultural inputs, farm machinery, farm vehicles and longer term agricultural projects such as plantations. Farmers wishing to qualify for a loan must receive their equipment directly from the BAAC who have a department buying machinery in bulk from manufacturers. This has two main advantages. Firstly it means that farmers can buy their machinery cheaper than from conventional retail outlets and have a guarantee that the quality is good. Secondly the BAAC can ensure that the loan is being used for its intended purpose.

The BAAC provide loans at an annual rate of interest of 12 % repayable over 2-10 years. Commercial banks, finance companies and retail outlets charge an annual rate of interest in the range of 20-30 %. The traders charge in the region of 5 % per month. An official from the BAAC will come around every month to collect repayments whereas traders will only collect their money after the harvest. Farmers who do not have deeds to land or other collateral to secure their loan can form groups with other farmers in their village and they all take responsibility for the loan. In this way if the farmer who has applied for the loan defaults on repayments the whole group becomes liable for his debts.

Government is the major (and usually sole) supplier of road infrastructure in rural areas, and hence a major consumer of finance. Traditionally, funding for roads maintenance and development has come from consolidated funds. Increasingly, however, governments are looking to user charges to cover these road maintenance costs and in some cases other associated costs, e.g. the costs of road safety projects. There is no intrinsic reason why such funds could not be used for funding transport projects, and this mechanism is mooted for many urban road-pricing schemes.

Such road funds may include road toll charges, fuel duties, and vehicle examination fees. Two problems often arise with these sources: the amounts raised may be insufficient to cover the road maintenance programme, and the finance ministry may be unwilling to bridge the gap; prioritisation of expenditure between regions and road types is a source of contention.

KEY REFERENCES

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