

## Submission to Legislative Council regarding the Rail Merger Bill

Dr. HUNG Wing-tat  
Associate Professor  
The Hong Kong Polytechnic University  
25 September 2006

### INTRODUCTION

1. This is a submission of my personal comments on the proposed Rail Merger Bill proposed by Government on 20 June 2006. The Bill is being considered at the Legislative Council (Legco) Bill committee.
2. Commenting on this Bill is necessary as it affects the welfare of the public, in particular, it affects the re-distribution of social responsibility of Government as well as the accessibility of the public to railway and connecting services.

### GOVERNMENT'S RESPONSIBILITIES ON RAILWAY

3. It is the public expectation that the Government has an unsheltered responsibility on transport provision. Transportation in itself is a commodity and contributes to the economy of Hong Kong. Most importantly, it has a major social role to play. It provides mobility and accessibility to enable the community to function.
4. Provision of an efficient public transportation system is vital because i) it is fair to all in resources allocation, no distinction of the poor and the rich; b) it is more efficient in land consumption especially the case of limited road resources in urban city like Hong Kong; c) it enables the majority of people who have no choice of private transport to access jobs, schools and government facilities.
5. Equal accessibility to opportunities is an essential ingredient to equal opportunities which is a core value of the community. And, cost of transport has a very heavy bearing on the affordability and thus accessibility of the passengers.
6. Railway carries over 30% of public transport passengers in Hong Kong. The fare level of railway also has a leverage effect on other competing public transport modes. While all the road passenger transport services are provided by private sector which has no obligation to provide an affordable service, Government's control over the railway passenger services is of vital importance to ensure affordability through the careful exercise of fare leverage.
7. However, the tax paying public also has a high expectation that Government should not subsidize public transport services.
8. In brief, Government has the responsibility to provide a safe, efficient, cost-effective and affordable public transport system.

## PURPOSES OF RAIL MERGER BILL

9. Government in its announcements and papers to the public and the Legco has never stated explicitly the purposes/ objectives of the merger. It only explains the benefits of the merger. Obviously, Government does not want to get into the discussion of whether the merger is the only and best way to achieve its hidden purposes/ objectives.
10. We, however, can make reasonable educated guess through observing Government's policy on railway since its establishment.
11. The first railway in Hong Kong, i.e., the Kowloon-Canton railway (KCR), now the East Rail started its operation in 1910. The Hong Kong section of this railway was 100% owned and operated by Government of Hong Kong. The demand for an internal urban railway line emerged in early 1960s and Government did not grant the development and operation rights to the then KCR Corporation, the then only railway operator. Instead, a new corporation, the Mass Transit Railway Corporation (MTRC) was established on 26 September 1975 to undertake the construction and operation of the new railway. The MTR Ordinance (MTRO) clearly stated that the MTRC had to operate with prudent commercial principle. In the relevant Government reports, it is clear that Government for the first time tried the un-precedent experiment, i.e., granting the property development right to MTRC to finance the capital costs of the railway. Over the past 30 years, it appears that the "prudent commercial principle" and the "railway cum property" development model work well.
12. Large portion of the investment of MTR system are on loan and foreign export credit, Government has been trying to avoid any politically influence on the operation of MTRC so as to maintain a stable credit grade. The "prudent commercial principle" cast in stone in the MTRO basically allows MTRC to work independently with minimal political interference. This principle was extended to KCRC in 1983. However, the change in political situation in 1997 invoked Government to go one further step to ensure minimal political interference on the railway corporations. Subsequently, the MTRC became a listed public company, i.e., MTRCL in 2000. It is no more 100% owned by Government but many minority share holders. It is now crystal clear that MTRCL has a prime objective of money making.
13. In contrary, KCRC has many good-doings in compliance with social and environmental interests in recently years, including offering compensation of a wetland in the north-western New Territories as well as building the West Rail without asking for property development rights. These good-doings may not be considered as in compliance with "prudent commercial principle". The merging of KCRC into MTRCL completes the restructuring of the railway operation to work entirely under the "prudent commercial principle".

## ISSUES NEEDED TO BE ADDRESSED

### **Affordability**

14. The MergeCo will become the only railway operator, i.e., monopoly of the rail service. And, the MergeCo is a listed public company with a primary goal of profit-

making. Affordability somehow implies fare capping and control which appears to restrain the MergeCo from maximizing its profit.

15. In response, Government has a) incorporate a more transparent fare adjustment mechanism (FAM) and b) to reduce fare upon merger. However, these arrangements are outside the ambit of the current proposed Merger Bill. While these two measures certainly address the affordability issue, it is crucial that the fare reduction can bring the fare level down to a level that most people can afford and the FAM simply maintain this level in real terms in the years to come. A proposed five year review period of FAM is considered adequate. And, the FAM arrangement must be written down as a binding term in the integrated railway operation agreement (OA) between Government and MTRCL.
16. Affordability on the other hand, links closely to ridership which in turn directly impacts on the operational income from the fare box. The competition from other road transport modes may not allow the MergeCo to increase fare to a level unaffordable by most. On the other hand, the FAM restricts the MergeCo from cut-throat competition with the road transport passenger service providers. To provide an affordable high-quality railway service is to the best benefits of both the MergeCo and the public. Only when the railway service is affordable, can the railway service increase its market share from the current 30 percent to the target over 50% in 2030.
17. To this end, the MergeCo should seriously consider incorporate “to provide an affordable high-quality railway service” as one of the missions of the corporation.

### **Funding of new railway projects**

18. The construction of all the current railway lines are funded by Government, either by a) direct injection of funds, b) serving as loan guarantor or c) granting property development rights to the operators; i.e., MTRC or KCRC alike. No new funding arrangement has been reached with the MTRCL since its establishment in 2000.
19. The existence of the minority share holder in the MTRCL and the future MergeCo obviously complicates Government’s consideration of direct fund injection or property development granting to support new line construction. Government will have difficulty to justify funding or subsidizing a partially privately owned corporation.
20. It is highly unlikely that the capital investment of a new railway line can be recovered by any railway company if the only income is from the fare box. Government in the past allows the MTRC to have incomes from property development along the railway lines. This is a form of Government subsidy. This form of subsidy has many merits. It allows the railway operator to plan the stations and properties above and adjacent to the stations to best facilitate and attract the riders, i.e., the integration of the stations and nearby development can best be achieved.
21. While it is to the best benefit to the community to have integrated designs of railway stations and its adjacent developments, Government has to devise new arrangement with the MergeCo so that no injustice of transfer of public money or land is being seen.
22. One of the possible arrangements is to allow KCRC to develop and own the new railway lines and lease to the MergeCo to operate. This is the sort of situation that

Government describes (in Appendix B of the Legco paper: ETWB(T)CR 1/986/00) for building new railway lines which would be of benefit to the community but not commercially viable. In fact, to my understanding, all railway projects are not commercially viable if they are required to recover capital investment. The “railway cum property” projects are commercially viable only because Government grants the development rights.

23. Government must clarify the funding arrangement of new railway projects. Otherwise, all the railway projects including the Shatin Central Link (SCL), Northern Link (NOL), and Express Rail Link (ERL) will be delayed and the entire economic development will be jeopardized.

### **Planning of railway development**

24. Currently, the planning of further railway development is conducted regularly by Government, independent of the railway operators. The major consideration for new railway lines proposal is economic returns to the entire community rather than financial return to individual railway operator.
25. MTRCL and KCRC simply implement the railway projects once the decision is made upon the completion of railway development studies. The influence of the railway operators on the railway projects is limited to the exact number and location of railway stations. This is so, partly because of the existence of more than one railway operators; Government has the freedom to choose an operator which can offer a better deal.
26. In the future, with only one operator, MergeCo, which has a prime objective of profit seeking, Government may not have the liberty of a choice. The influence of the operator will not be limited to the stations but the implementation of the entire railway development programme. The consideration of the financial returns for the operator will dominate railway development programmes. This may not be to the best benefit of the community.
27. While the practice an independent study on railway development for the best public interest should be maintained, Government should seek ways to ensure the timely implementation of the railway development programme. It should not be hindered by unpredictable consequences of negotiation with MergeCo. Again, construction and ownership of new railway lines by KCRC should remain as a possible option before Government identifies effective ways to implement railway programmes.

### **50 years Concession Period**

28. The practice of rail concession is new to Hong Kong. It is prudent to allow a reasonable period for reviewing the terms in the integrated OA and the entire concession arrangement; 50 years appear to be a very long period for remediation if anything is found wrong.
29. According to experience in Europe, an OA of 10 to 15 years appears to be the norm.