



Comparing the efficiency of public and private ferry services on the Pentland Firth between mainland Scotland and the Orkney Islands

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ABSTRACT

Case study analysis is applied to investigate the efficiency of competing ferry services operating on the Pentland Firth between Scotland and the Orkney Islands. One operator is state-owned and subsidised via a tender arrangement; the other competing service is privately owned, does not receive any subsidy and operates independently of any tender process. Yet both provide more or less the same service in terms of carrying passengers and vehicles across the Pentland Firth, one costing the taxpayer (i.e. via operating subsidy) and the other not. Here we investigate reasons why a state-owned ferry operator running a tendered service requires a subsidy, whilst a competing private operator does not, both serving the same market. Analysis of the respective transport operations serves to highlight key differences in operating cost structure between the competing operators. This reflects different corporate strategies and knowledge, also influenced by key stakeholders objectives in respect of the state-run operation, and by normal corporate objectives on the part of the private operator. The study offers better understanding of the remote island ferry sector from an interdisciplinary perspective, highlighting outcomes in relation to state subsidy, competition, and transport policies which have implications for delivery and management of remote island ferry services.

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1. Introduction

Provision of domestic ferry services linking remote island communities with their respective mainland is an essential feature of regional economic and social development. Ferry services can be delivered in a number of ways, although principally either through a state entity operation or via a private sector operator. The paper explains how domestic ferry services in Europe are governed by the EU Cabotage Regulation, which sets out Public Service Obligations, Public Service Contracts, and State Aid conditions, also offering analysis of evolving trends in ferry service delivery and procurement. The literature is explored investigating ferry user requirements, particularly in terms of service quality and customer selection criteria, thus helping to explain the key needs of service users.

The focus then analyses ferry operators serving the Pentland Firth route between Scotland and the Orkney Islands, initially outlining the ports served and vessels deployed. The focus is on two directly competing operators, one of which is state-owned and subsidised by the state, the other being privately owned and entirely privately funded. This is followed by a comparison of each respective vehicle ferry operations, analysis of schedules and pricing, traffic volumes, and finally ferry CO₂ emissions.

The final part of the paper discusses the next tender arrangement for ferry services between Scotland and Orkney (for the period 2012–2018),

and the role of 'key stakeholders' in influencing and formulating service specification. This is followed by discussion of the findings and implications for managerial practice, and finally conclusions.

2. EU regulations on tendering ferry services

2.1. Cabotage Regulation

The 'Cabotage Regulation' 3577/92 (see [European Commission, 2006](#)) regulates the transportation of passengers and goods by sea between two points within member states of the European Union. The regulation applies the principle of free movement of services to maritime transport and obliges member states to allow community ship owners to operate freely in the European market.

The Cabotage Regulation recognises that maritime transport of passengers and goods is vital for the inhabitants of island and remote peninsular communities. As such, exceptions to the principle of free movement of services are allowed where, owing to special circumstances, market forces would not provide a satisfactory level of service. Recognising the need to protect such ferry services to islands and remote peninsular communities, the Cabotage Regulation allows member states to intervene in particular European transport markets by imposing public service obligations (PSOs) and/or providing funding to undertakings which operate a PSO route through entering into public service contracts (PSC).

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2.2. Public service obligations (PSOs)

Member states may impose PSOs in order to ensure provision of an adequate regular ferry service to and from a given location where community ship owners, in considering their own commercial interests, would not provide an adequate level of service or under the same conditions (European Commission, 2004). It is for individual member states to determine on which routes the market would otherwise fail or is failing to provide adequate ferry service and, thus, which require PSOs to ensure that the required ferry services are provided. The nature of PSOs that a member state may impose is limited to the following aspects:

- Requirements concerning the ports to be served;
- Requirements in relation to regularity, continuity, frequency and capacity to provide the service in question;
- Rates to be charged for the services; and
- The manning of vessels.

PSOs can be imposed by member states in a variety of ways, although mainly this will involve one of the following approaches being adopted for the route in question (European Commission, 2004):

- Entering into PSCs with individual operators for a given route; or
- Applying PSOs to all operators for a given route by way of a declaration regime, a licensing system or an authorisation system.

PSOs may be implicit within PSCs, by virtue of the specified service obligations included in the contracts (European Commission, 2009). It has been argued that the PSO is a separate matter from a PSC, and that a PSO must first be established for each route which is considered to require intervention in some form or other in order to meet the needs of the community concerned (Kay, 2008). However, the commission has concluded in line with the Altmark criteria (see below) that PSOs will be clearly defined within PSCs (European Commission, 2009). A PSC can therefore be used to impose public service obligations, with the obligations set out in the contract.

In a European court judgement it was stated that the combined provisions of Article 1 and Article 4 of Regulation No 3577/92 applying the principle of freedom to provide services to maritime transport within member states (maritime cabotage) permit the provision of regular maritime cabotage services to, from and between islands to be made subject to prior administrative authorisation only if (European Court, 2001):

- A real public service need arising from the inadequacy of the regular transport services under conditions of free competition can be demonstrated;
- It is also demonstrated that a prior administrative authorisation scheme is necessary and proportionate to the aim pursued;
- Such a scheme is based on objective, non-discriminatory criteria which are known in advance to the undertakings concerned.

2.3. Public service contracts (PSCs)

Public service contracts (PSC) are the instrument generally used to impose a PSO where the imposition of a PSO on all ship owners would not support an area's transport needs. A PSC will be used where compensation is payable for providing the PSO. A PSC can cover broader issues than those covered by the PSO and may include a requirement to satisfy fixed standards of continuity, regularity, capacity and quality and require services to be provided at specified rates.

The PSC can be used to ensure that ferry operators provide year-round services, where the market would not otherwise provide such services. In limited circumstances, exclusivity to provide a service may be appropriate. The PSC:

- Is ship owner specific;
- Is concluded between the state/region and a specific operator on a given route or routes.

A member state may impose a PSO that affects some or all shipping companies operating on the route(s) concerned and, at the same time, conclude a PSC with others for the same route(s) to ensure that appropriate service levels are in place for the carriage of traffic to, from or between islands. This is possible provided:

- A real public service need can be demonstrated; and
- That application of the two methods concurrently is not discriminatory and is justified in relation to the public interest objective being pursued.

The Cabotage Regulation requires that, for both imposing the PSO and concluding any PSC, the member state shall do so on a non-discriminatory basis in respect of all community ship owners. Any subsidy for ferry services must be available to all community ship owners. All community ship owners are entitled to apply for compensation in exchange for accepting the PSO and (given that subsidies are paid via a PSC) all community ship owners are entitled to tender for the provision of services for which subsidies will be paid.

2.4. State aid

Where any support granted falls within the following conditions, it is deemed to constitute state aid and will need to be assessed to establish whether it is compatible with EU rules (European Commission, 2004):

- The measure is granted by the state or through state resources;
- The measure confers an advantage to an 'undertaking' (an 'undertaking' covers any entity engaged in economic activity, and the legal status of the undertaking is not important);
- The measure is liable to distort competition by favouring certain undertakings – the competitive position of the undertaking being selectively targeted is improved by the giving of the aid in relation to other competitors; and
- The measure must have the potential for affecting trade between member states.

The "Altmark" decision confirmed that a state measure will not be treated as state aid where it compensates an undertaking for discharging the PSO in a way that the undertaking does not enjoy a real financial advantage in exchange for discharging such obligations (European Court, 2003). To fall outwith the definition of state aid, the following four conditions must be satisfied:

- The receiving undertaking must actually have PSOs to discharge and these must be clearly defined;
- The basis of compensation must be calculated in an objective and transparent manner;
- Compensation cannot exceed what is necessary to cover the costs in discharging the PSO, taking into account relevant receipts and a reasonable profit;
- If the undertaking concerned is not chosen under a public procurement procedure, then the level of compensation needed must be determined on the basis of an analysis of costs which an efficient undertaking would have incurred.

2.5. Trends in ferry service delivery and procurement

Analysis of subsidised ferry operations in Europe suggests that states are continuously revising procurement strategies (Baird & Wilmsmeier, 2011). EU regulation is in general not seen as a barrier for development, but rather one more argument that supports the idea to secure efficient ferry services via tendering. The procurement of ferry services is approached based on the same principles as the procurement of transport services across other modes. Transport authorities at local, regional and national levels are managing ferry tenders, as well as managing tenders for local bus, air, and at the national level rail services.

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