

Introducing market forces in public services in transport in an enlarged Europe

by Arthur Gleijm, NEA Transport research and training in the Netherlands

Introduction

Lack of market initiatives and entrepreneurship in public services in transport in Europe has led to services that do not answer the demand of passengers. Especially in competition with the use of private cars, public services have become less attractive over the years, leading to lost market share for public transport. Acknowledging this problem, the European Commission (EC) proposes to introduce more market forces in public services in transport.

In this paper the legal framework that the EC proposes for the introduction of market forces will be presented. This framework has to be implemented in an enlarged EU, where the role and position of public transport differs per country. Particularly, if current and new EU Member States are being compared. While in the EU resources for public transport are often available, passengers are difficult to attract. Contrary to this, in the new Member States in Central Europe the market share of public transport still is considerable, while, due to insufficient resources, adequate infrastructure and rolling stock lag behind.

Drawing on practical cases (Belgrade, Bratislava, Bucharest, Budapest, Sofia, Vilnius), the paper will conclude in recommendations on how to introduce market forces in public services in transport in an enlarged Europe, taking into account the particular characteristics of public transport in Central Europe.

Public services in transport in EU and Central Europe

Objectives of public services

The origin of public services very much depends on economic progress. Traditionally the purpose of public services is of social nature, to supply those groups, that have no alternative for public transport, either for financial reasons or just lacking the access to another mode of transport (often youngsters and elderly people). Additionally public services in Central Europe have always been crucial for labour mobility.

These objectives are still valid, in both the EU and Central Europe. However, the more countries develop themselves, the more other objectives become apparent. In more developed countries in the EU public services are defined from the perspective of accessibility, establishing an adequate traffic system, rather than from a social point of view. Land use and urban planning, reduction of congestion and environmental protection become additional objectives to promote collective transport. This is for example endorsed if one realises that more than half of the train passengers in a developed country as the Netherlands have an alternative for public transport, being the owner of a private car.

Provision of public services

In many countries in Europe public services in transport are publicly planned, owned and operated. Although governments are able to determine the public services themselves, the question is whether this outweighs the negative impact of lacking market incentives.

Leaving public services fully to the market would increase cost-effectiveness. However, full deregulation very often results in a serious fragmentation of the transport network, with an impact on the attractiveness of services.

Those countries in Europe that have introduced market forces in a controlled manner seem to take the best of both worlds, guaranteeing that public service requirements, such as affordability, accessibility and network integration are implemented while market incentives for quality and cost improvements are introduced. Through tendering of exclusive rights for providing public services for a limited period of time, operators are exposed to market forces, but able to develop a public transport market and willing to invest.

The table below compares trends in public transport in 30 large EU cities during the nineties of the previous century. The three above mentioned leading market forms in public transport in Europe have been compared.

Tendering out exclusive rights has led to both an improved market share in terms of an increasing number of passengers and a better financial performance with regard the fare revenues.

Table 1 Differing performance of public transport, annual change

(From the amended proposal for a Regulation of the European Parliament and of the Council on action by Member States concerning public service requirements and the award of public service contracts in passenger transport by rail, road and inland waterway)

	Annual change in number of passenger trips	Annual change proportion fares covering operating costs
Cities using controlled competition	+ 1.8%	+ 1.7%
Cities without competition in public transport	-0.7%	+ 0.3%
Cities using deregulation without significant role Authorities	-3.1%	+0.3%

Also in heavy rail, controlled competition resulted in a growth of market shares Especially those countries in the EU tendering out exclusive rights, such as England and Sweden, show the fastest growth in passenger numbers through the nineties of last century.

Policy developments regarding public services

The EC has clearly expressed its intention to become involved more directly in services of general interest. The aim is to find the balance between the requirements of the single European market and free competition in terms of free movement, economic performance and dynamism and the general interest objectives.

Within the EU operators entrusted with the operation of services of general economic interest shall be subject to the rules on competition. However, only insofar as the application of such rules does not obstruct the performance of the task assigned to them. State aid in this respect is allowed to co-ordinate transport or to compensate for the discharge of public service obligations. With regard to public service obligations, the Commission accepted the restrictions of free competition. However, the exception made for inland passenger transport

was always to be kept to a necessary minimum, taking into account the distinctive features of the sector.

The principle that, for the fulfilment of public service obligations, competition could be restricted, needed to be specified and implemented at Member State level. For this reason, a Council Regulation on public service in inland transport was adopted back in 1969 (Council Regulation 1191/69/EEC of 26 June 1969 on obligations inherent in the concept of public service in transport in rail, road and inland waterway)

The general aim of the Regulation is the termination of public service obligations and the duty to pay compensation with respect to any financial burden that may be transferred to the transport operator. However, obligations may be maintained insofar as they are essential to ensure the provision of adequate transport services.

Public transport services throughout Europe are established in many different ways depending on the regional and local situation. Different systems are distinguished, and traditionally operators were obliged to render them. This did not lead to the most optimal services.

The European Commission acknowledged that the introduction of competitive pressures and more initiative for transport operators is more likely to enhance the efficiency of services. Also it would deliver products which will be tailored to the needs of the customer, who becomes more demanding, having more need for mobility and individual alternatives for collective transport.

In response to this changing need the European Commission aims at introducing more market forces in the provision of public transport services. The strategy is to introduce a commercial relationship between the authority responsible for transport and transport operators, through the conclusion of public service contracts. These contracts should then be allocated in open competition, through a transparent, non-discriminatory procedure for the allocation of exclusive rights for a limited period of time.

By doing so the benefits of competition will be seized, while the temporary exclusivity guarantees that public service requirements are safeguarded. The period the exclusive right is valid enables operators to develop a public transport market and offer continuous and integrated services.

Presently the European Commission has proposed a new Regulation (amended proposal for a Regulation of the European Parliament and of the Council on action by Member States concerning public service requirements and the award of public service contracts in passenger transport by rail, road and inland waterway) with the following objectives:

- The stimulation of efficient and attractive public transport, through the use of controlled competition.
- Making a reality of the right of establishment, both in terms of access to public financing and to exclusive rights.
- The promotion of legal certainty for authorities and operators in limiting competition law by awarding exclusive rights (limited in time and space) to ensure the provision of the service.
- Establishment of a single market, balancing state aids and the provision of public passenger transport.

The key elements of the proposed Regulation are;

- Applicable on national and international operations of public passenger transport by rail, road and inland waterway.
- Lays down the conditions under which competent authorities may compensate transport operators for the cost of fulfilling public service requirements and under which they may grant exclusive rights for the operation of public passenger transport.
- Imposes authorities to secure adequate consumer-oriented public passenger transport services, that are of high quality and reasonably priced, providing integration, continuity, safety and full social coverage.
- Obliges the use of public service contracts if payment of financial compensation for the cost of complying with public service requirements or the award of exclusive rights is involved.
- Prescribes that contracts shall be put out for competitive tender by fair, open and non-discriminatory procedure and will last no longer than eight years for bus services and fifteen years for rail and inland waterway services.
- Public service contracts, having an estimated average annual value of less than € 1,000,000 and if all public service requirements are incorporated, an estimated average annual value of less than € 3,000,000 may be awarded directly.
- Authorities may decide not to award public service contract to any operator that already has or would, as a consequence, have more than a quarter of the value of the relevant market for public passenger transport services.

Making policies happen

Acknowledging that public services in the EU and Central Europe have divergent objectives has its implication on making public transport policies happen. The challenge is to allow countries in Europe to define their own public services, within a common legal framework. The accents should be put on the implementation. Also according to the principle of subsidiarity, it is up to the countries themselves, depending the particular objectives of public services, to determine the way they should be pursued and the role and responsibilities of the authorities and operators.

Also in Central Europe, lack of market initiatives and entrepreneurship in public services in transport has led to transport services that do not answer the demand of passengers. State owned operators have proven to adapt slowly to market changes, also due to political powers and trade unions opposing reform. Especially in competition with the ever growing use of private cars, public services are becoming less attractive quickly, leading to lost market share for public transport (in the nineties of last century the sector bus & coaches lost about 40% and the railways about 45% in terms of passenger kilometres).

Naturally Central European countries have to catch up with the mobility patterns of the market economy. However, public transport encounter structural problems that may even endanger normal markets shares in the future;

- **Immature markets.** Limited number of market players, with the incumbent (often state owned) operator having a dominant position. The latter often lacks competitiveness and incentives to develop attractive services. Bearing only production risk, they feel little responsibility towards rider ship levels and the revenues from operations. Attractiveness of services has decreased, especially in comparison with the use of private cars, which becomes both appealing and realistic alternative for a

growing number of passengers. The danger is that public transport becomes an inferior product, suitable for an ever diminishing number of customers, who will be difficult to regain in the future.

- **Poor regulatory framework.** With an increasing private sector, there is a need for a clear regulatory framework. Especially to ensure a level playing field. New private entrepreneurship, in particular in urban areas has evolved beyond existing services. Due to a poor regulatory framework, they are often quite free in the services they offer without too much integration in the whole public transport system. They do however meet a demand, often by hail and ride, as they often work without any compensation on a competitive basis.
- **Weak tendering process.** First experiences with tendering has not yet led to improved quality of service and better value for money paid in compensation of public services. The rapid loss of market share in Central Europe has not yet come to a standstill. So far there is little interest of professional public transport companies to step in the markets.
- **Poor transport infrastructure, rolling stock and services.** In general, transport infrastructure and rolling stock in Central Europe is deteriorated. Cost recovery is low. Operators are under pressure to cut costs and services, mainly due to an increased unwillingness of the government to compensate loss-making operations.

How should above problems be overcome while taking the particular characteristics of public transport in Central Europe into account?

- **Transferring of risks.** Within the EU legal framework and given the growing unwillingness to pay for public services, risks in the provision of public services need to be transferred. At the present moment governments take full responsibility of the public transport system, being the owner of the public transport operators. Resources that are now used to keep large and inefficient state owned companies going, should be allocated in a more competitive environment. By taking the chance to exploit public transport more market oriented and efficiently, the sector should be able to convince governments that they get more value for money in the end of the day (as an indication of the money involved, in the EU governments pay about € 10 billion for public services in railways only). This process will be facilitated if one is able to pinpoint, beside traditional benefits of public services, the expected savings of decreased congestion and environmental pollution.

The risks should be transferred through public service contracts that in the first place result in reliable services of sufficient quantity. Besides more efficiency of operations should be the key focus, as price is the prevailing reason for passengers to use public transport in Central Europe. While countries develop, the emphasis will slowly shift to quality of services.

- Differentiated transition path.** Taking into account the different interests of the market players and the fact that the competitiveness of incumbent operators is often poor, transition should be differentiated. For public and private companies different market organisation forms may be established, taking into account their professionalism, commercialisation and position in the market. This will also increase the acceptability of the reform process, given its social consequences. While private companies may be exposed to competitive pressure, public operators should, within a certain period of time, get the chance to grow mature under a specific, more regulated regime. The duration of the transition period very much depends on the resources available for the reform process. This may lead to the following approach;

Differentiated transition path for the public transport sector

Time	Legal		Contractual		Organisational	
	Public sector	Private sector	Public sector	Private sector	Public sector	Private sector
1st. step	Regulated	Controlled competition	Direct contracting of temporary gross cost contracts + incentives	Tendering of temporary gross cost contracts + incentives	State owned	Independent
2nd. Step	Benchmark	Management Contracts for public private partnerships	Direct contracting gross cost contracts + incentives in lots	Tendering gross cost contracts + incentives in lots	Establishment of Public Transport Authority	
					Introduction of a unified timetable	
					Introduction of a revenue allocation system	
3rd. Step	Limited competition		Tendering of net cost contracts and gross cost contracts		Introduction of a Uniform Tariff System	
					Business-based entities	Independent
					Medium-sized independent and business based companies, mostly private	

In the first step a regulatory framework for public services should be developed for both the public and private sector. The intended results are;

- Attracting professional entrepreneurs in public transport, operating independently from the authorities.
- Fair and efficient tendering and contracting of services, optimising the impact of subsidies.
- Increasing efficiency of operations of public and private transport operators competing on a level playing field.
- Maintaining network integration and attractive services.

While the private sector is exposed to controlled competition, the public sector will be protected from competition. Authorities will however commercialise their relationship with the operators through public services contracts that will be awarded directly.

The outcome of the tendering process should be enhanced by the introduction of an access regime for the profession of operator, setting requirements for professional and reliable management, financial standing, but also obligations in the field of tax payments, safety and the environment, labour and health. Tendering should take place on an open and transparent, non-discriminatory, fair and efficient basis through exclusive rights that will be awarded for a limited period of time:

Ideally public service contracts should be on of gross cost basis, including revenue incentives. Gross cost contract means that the risk of producing the services and related costs are for the operator while the risk of revenues from ticket sales are for the authority. Normally these contracts are based on payments from the authority to the operator on the basis of vehicle kilometres related to a number of routes and timetables as specified by the authority. Gross cost contracts have the following advantages, in comparison with net cost contracts (meaning that the operator bears both the risks of the costs and revenues);

- All operators may receive the same subsidies and should accept all passengers, including those travelling under concessionary fares, which are now often only accepted by the state owned companies.
- New entrants and privatised companies may enter the market more easily, as they are reluctant to take those risks that are difficult to assess in advance, and in particular Central European public transport markets are not too transparent.
- Under the gross cost contract regime it becomes much easier to introduce an integrated ticketing system in the long run, as under this system it should be possible to buy and use the ticket anywhere the customer desires.

In due time priority should be given to tendering and contracting of groups of lines (lots) rather than separate lines, as this will;

- Ensure network integration through more optimal planning of routes and timetables.
- Attract professional public transport companies who will be able to increase quality and efficiency.
- Cause a concentration and rationalisation of companies, as the small companies will be too small to tender for the group of lines and will either search for co-operation and mergers or leave the market.

The establishment of a Public Transport Authority is an indispensable preparation on developing a mature public transport market, where public and private sector companies may

compete on a level playing field. Especially as in Central Europe authorities often bear responsibilities for the state owned companies, there is a strong need for an independent regulatory and monitoring body.

The objective is to enhance the Public Transport Authority, especially in its role of tendering and contracting public transport services. To make the Public Transport Authority more effective, powers and responsibilities of the authorities and the operators need to be clearly defined;

- The authorities, within above-mentioned regulatory system of tendering and contracting, should focus at all responsibilities and decisions at strategic level. Within this regime the role of the authorities is to develop a comprehensive public transport policy and implementation plan.
- The Public Transport Authority is responsible for all decisions at tactical level, basically entailing the implementation of the public transport policy set by the authorities.
- The public transport sector, both public and private operators, is solely responsible for the daily operation of the services.

The anticipated results are more co-ordination and planning of the public transport services, more efficiency and transparency in spending subsidies, and fair and efficient tendering and contracting.

The Public Transport Authority should have an intermediate position between the authorities and the public transport market. The PTA will be commissioned with tasks and responsibilities by law, and in this respect act independently from the authorities. An independent Supervisory Council, consisting of representatives of the authority, the transport sector and public transport customers, should monitor it.

Key tasks of the Public Transport Authority (PTA) are the following;

- Developing an optimal public transport network - The PTA will be responsible for the development of the public transport network and the development of the timetables. This task covers both infrastructure provision (transport infrastructure and technical systems, such as information and ticketing systems) and procurement of public transport services. This should be optimal in terms of interoperability, both with the modes and between the modes of transport. In this respect the PTA will be acting as the main advisor to the authority in the public transport policy development. The optimal public transport network should be the basis for the product specification, such as the modes of transport, routes, network and timetable, capacity and quality, fares, vehicles and labour conditions.
- Tendering and contracting public transport services – From the optimal public transport network the PTA defines the lines and groups of lines to be tendered out. On behalf of the authority, the PTA will act as the tendering and contracting body of public transport services. The PTA will manage the whole tendering procedure, from identification of lines and groups of lines to be tendered, to putting together the terms of reference, the announcement of the tender, the (pre) qualification of bidders, evaluation of proposals, contract negotiation and award, contract management and monitoring and evaluation of the contract.
- Monitoring and enforcement of contracts – The PTA will monitor and enforce the contracts on public transport services. For this and other tasks, a comprehensive traffic database should be established and maintained.

For the enhancement of the Public Transport Authority some key requirements have to be fulfilled;

- The position of the PTA should be non-political, well defined and in due time fully independent from both the authorities and the transport sector.
- Financial resources should be sufficient and ensure continuity.
- To stress independency and guarantee continuity, a multi-year service contract between the authorities and the PTA should define the tasks and responsibilities of the latter.
- Management and staffing need to be professional, competent and sufficient, and the authority should have all legal, economic and financial expertise by its own.

In the second step the performance of the public sector should be monitored through benchmarking with peers in the market. Large operators could be split up into smaller business-based units of which the performance could be compared among each other. These units will be prepared to operate in a more competitive environment. Thus management contracts for public/private partnerships will be stimulated to develop the professionalism of management. By splitting up the large operators, one is able to get rid of a lot of bureaucracy and inefficiency, giving the viable parts a chance for the future. Besides one prevents that the level playing field is hampered by protected, dominant market players.

Furthermore, to create a comprehensive and well-integrated public transport system one has to develop;

- A Unified Timetable, in which both the public and private operators may offer their services.
- A Revenue Allocation System, based on the production and passengers transported.
- A Uniform Tariff System, that also enables the use of an integrated ticket system.

In the third step controlled competition should be introduced for the entire public transport market. Tendering will be organised for a market with medium-sized business based companies, mostly private, but all acting independently from the authority.

Conclusion

In conclusion, the key recommendations for the development of public services in Central Europe are;

- Transferring risks of the provision of public services now will guarantee tomorrow's resources.
- With a differentiated transition path acceptability of reform will increase.
- A Public Transport Authority is crucial to establish a level playing field and find the balance between efficiency improvement and network integration.