



4th RP: Tendering of PSOs: What are the remaining challenges?

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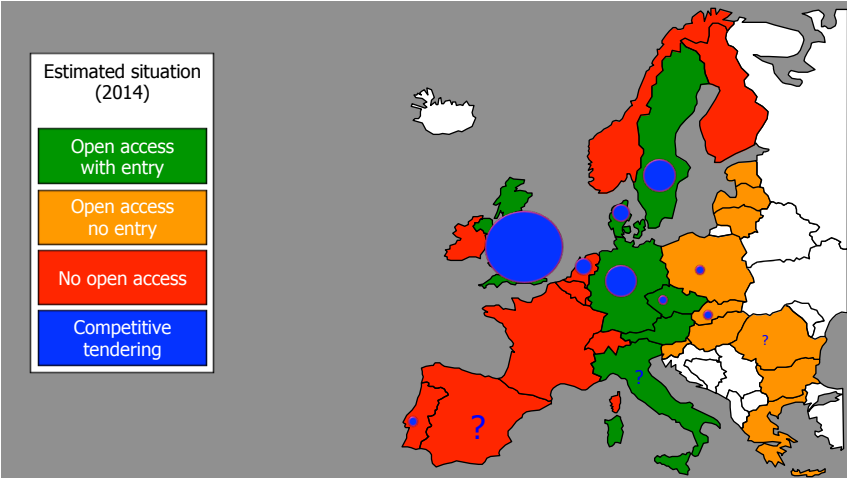
9th European Rail Forum European Univ. Inst., Florence School of Regulation, 12 Dec. 2014

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Competition in rail passenger market

Estimated situation (2014)

- Open access with entry
- Open access no entry
- No open access
- Competitive tendering



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Key lessons from British experience: Nature of contract

- Short franchises (7+3 years)
 - Have significant problems
 - Too much emphasis on avoiding financial risks versus innovation to reduce costs and improve services
 - e.g. working practices (lack of one person operation)
 - e.g. new rolling stock (lack of emphasis on lighter, more track friendly designs)
 - Work best with
 - The franchising authority taking charge of
 - marketing and pricing, and
 - procurement of assets (including rolling stock)
 - Gross cost contracts, which focus attention on cost control
 - Particularly appropriate for urban and regional operations
 - e.g. London Overground
- Long franchises (15 years plus)
 - Better with more commercial freedom for operator
 - More appropriate for longer distance services
 - (e.g. Chiltern)

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Key lessons from British experience: Geographical scope

- Most successful franchises are medium sized ones
 - Limited economies of scale
 - (C2C, Chiltern etc: 6-10m train km per year rather than 40m)
 - But strong economies of density, so avoid overlaps
 - Economies of density less pronounced for more diverse franchises
 - But may be benefits of integrated service planning
 - e.g. First Great Western
 - (unless this is undertaken by franchising authority)
 - See (online)
 - Wheat, P.E. and Smith, A.S.J. (2014), "Do the usual results of railway economies of scale and density hold in the case of heterogeneity in outputs: A hedonic cost function approach", Journal of Transport Economics and Policy.

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European evidence on rail tendering: Summary

- Great Britain (see also slides prof. Nash)
 - High costs (by int. standards) (McNulty, 2011)
 - Need for more integrated approach, vertical alliances (McNulty, 2011)
- Sweden
 - Jensen & Steling (2006): competition reduces costs, separation increases costs
 - Increased supply, and tendering (see also Alexandersson (2010): "The accidental deregulation")
- Netherlands
 - No good data, no academic publications
 - Regional lines: better regional integration (buses!) and growth by regional transport policy, efficiency gains by tendering (but simplified operations)
- Germany
 - Link & Merkert (2011): more service, better quality, lower costs; regulatory problems irt non-separation
 - Yet: one of the largest share of tendered services in Europe
- International comparisons (EVES-Rail: van de Velde, et al., 2012)
 - Competition: No measurable impact on market share or costs
 - Vertical separation raises costs for densely used railways

Research challenges: Shortcomings in most studies

- **Data quality** remains very problematic!
- Insufficient attention paid to **separating effect** of
 - Vertical **separation** (true, half, adequate,...)
 - Type and extent of **contracting** (gross-cost, net-cost,...)
 - Type and extent of **competition** (competitive tendering, open access)
 - Managerial and **governance** reforms (even without competition)
 - **Economic** effects (financial crisis, growth)
 - **Demographic** effects (urbanisation, growth, decline)

Tendering PSOs: Why?

- For more **efficiency**?
 - 20% (or more) improvement compared to prior inefficient situation
 - However: lessons from GB (high total costs)
- For more **innovation**?
 - New rolling stock: often imposed by TA
 - New service patterns: often imposed/created by TA
 - Better integration with local services: often imposed/created by TA
 - Marketing/pricing: often gross-cost and integrated fares by TA
- So is it more a question of **power**, rather than a question of competition?
- Or is it **dogmatism**?
 - On impact assessment 4RP:
 - *"Assumed impacts of the different options are well illustrated and described, but the reasoning as to why these impacts occur as a result of a specific policy does not appear to be based on facts, academic literature or existing evidence."*
(Impact Assessment Unit, European Parliament, May 2013)

Tendering PSOs: What?

- **Splitting** the main network?
 - EC's formula (3) or EP amendments (1-2-3-4) or ???
 - Beware of consequences!
 - Paradox: More contracts → more competition & need for more state coordination (otherwise worse product) → more central planning
 - Communicating vessels: contract size ↔ market innovation
 - (Note: depends on geography and demography, and on available capacity)
- **Alternatives**
 - Arrange such as to tender only regional lines? (SE, DE, IT)
 - **Open Access** on main routes ... to avoid tendering and complex contracting?
 - Paradox: Loosing opportunity to contract main operator! (e.g. if in NL)
 - 1370 lacking on "rules of the game" as alternative regulatory instrument
 - How fair is this?
 - Embeddedness in regional economy, real-estate development and synergy
 - Example: Impressive Japanese examples, also Hong-Kong
 - Tendering for **vertically integrated concessions**? (as a weak version of Japanese synergy)

Tendering PSOs: **How?**

- Ensure **knowledge of transport authority** (tendering, contracting, monitoring)
 - One tendering authority (GB) versus several (D, NL, S)
 - Benefit of competition/learning between authorities?
- Ensure **level playing field**
 - Access to rolling stock (financing!) ← concessions tend to get bigger!
 - Access to other facilities (but how far should this go?)
 - Dominance of state railways (not only as incumbents)
- Ensure proper **coordination for system-wide efficiency** (4RP?)
 - Network effects (Note: this is not about cross-subsidisation!) (1370?)
 - Service coordination (timetabling, etc)
 - Ticketing, seasonal passes, rebates, etc.
 - Passenger information, etc.
 - Incentives for efficiency of infrastructure management (50% of costs!)
 - Interface management with infrastructure manager (and others)
 - Avoid bias to capital expenditures
 - Avoid bureaucracy, slow responses and incentive misalignment
 - Beware: Penny-wise, Pound-foolish?
 - Who takes care of long-term developments? State? "Ministry of railways"?