



Introduction

Bernhard Wieland ^{1*}

¹ *Institute for Transport and Economics
Faculty of Transportation Sciences "Friedrich List"
Dresden Technical University*

Competitive Tendering is currently viewed by many as a *panacea* for the economic problems of public transportation services. Competitive tendering is believed to reduce costs, increase productivity, decrease subsidies, induce better quality, stimulate innovation, and to further the modal share of public transport. The European Commission advocates competitive tendering as a means to stimulate competition in public transport and as an important additional step towards the goal of an internal European market for transportation services.

The present special issue of European Transport assembles five articles which review the experience of those European countries that have the greatest experience with competitive tendering so far, namely the UK, Sweden, Norway, and Italy. To these European countries the overseas perspective of Australia has been added, because the failure of the public tender in Melbourne has received widespread interest among experts.

Basically the papers show that no easy answers and – what is even more important – no *standard* answers emerge. Competitive tendering will not deliver economic gains *per se*. Context and history matter. Moreover, there are some serious inherent pitfalls in competitive tendering that have to be avoided. Finally, it is not clear, in how far competitive tendering can replace regulation (as contended in Demsetz classical article of 1968) or whether there must still be constant monitoring of the winning bidder. It is also unclear whether improved regulatory mechanisms could achieve the same efficiency results as competitive tendering, but perhaps at less transaction cost.

Concerning the role of context Boitani/Cambini point out the importance of the political framework conditions. The two authors present new original data from which they conclude that the Italian experience with the tendering of bus services has been disappointing so far. The number of participants in the tendering processes has been very low in most cases and the incumbent won the tender almost everywhere. There has been no convergence of cost levels (as should be expected with a well known production technology like in bus transport) and the cost savings that have been achieved have been

* Corresponding author: Bernhard Wieland (Bernhard.Wieland@mailbox.tu-dresden.de)

small. The authors conclude that for the development of cost levels past cost levels seem to be more decisive rather than competitive tendering.

The authors emphasize the importance of the “political economy context” for the tendering procedure to be successful. Legal and political uncertainties create disincentives for potential market entrants to participate. Such uncertainties may arise when there is suspicion of favoritism on the part of the tendering authorities, for instance, when their own transport enterprises are involved or when tenders seem to be tailor-made for the incumbents.

Regulations are another key element of the political context. In Italy there exist social clauses which stipulate that the winner of an auction has to re-employ the staff of the former incumbent. Considering that labor costs amount to approximately 2/3 of total operating cost this is a very important factor for the efficiency gains that can be achieved via a tender.

Boitani and Cambini believe that public tendering can only be successful when the following three preconditions can be met: (1) there must be credible commitment on the part of the franchisor to let franchisees go bankrupt, (2) the authorities must be able to guarantee fair tenders, possibly by an independent agency, and (3) there must be free choice of the factors of production. The authors argue that if these requirements are not achievable in the policy process other mechanisms like subsidy capping or yardstick competition will be preferable.

The importance of history and the political context is also apparent from the paper on Norwegian bus services tendering by Bekken et al. The authors show that in Norway the efficiency gains that have been achieved by competitive tendering are primarily a function of previous contractual arrangements. The authors carry out an econometric analysis to study the effect of competitive tendering on costs, subsidies, and vehicle kilometers. The cost savings amount to approximately 10 %, which is less than in other countries, even other Scandinavian countries like Denmark and Sweden. The paper explains these low efficiency gains by the fact, that in Norway private involvement has already been substantial previous to the opening up of this market to competitive tendering. In Norway a great share of bus services has traditionally been provided through negotiated net cost contracts with private firms. Public operation was limited to major cities. As a result cost savings in Norway were already in the order of 6-20% before competitive tendering was introduced. This raises the question, of course, what gave the private firms the incentives to achieve these gains, given that they had a *de facto* monopoly position. Bekken et al. attribute this to the fact that these firms were operating under the constant threat of competitive tendering.

Bekken et al. report that the Norwegian counties have preferred to cash in the efficiency gains of competitive tendering in the form of reduced subsidies rather than in the form of increased service quality, apparently without great loss in patronage. A further interesting result achieved in the paper is that counties with a mixed regime (partly tendering, partly negotiated contracts) have fared less well in terms of cost reduction and output than counties which exclusively have kept to negotiated contracts or exclusively moved to competitive tendering. The authors conjecture that this can be explained by the fact that the threat of competitive tendering breaks the trust relationship established with the operating firm and the purchaser. As the prolongation of the existing contract becomes less likely firm behave more according to the actual length of the contract. The horizon of investments will be shortened and risk aversion increases.

The paper by Stanley fits rather well to the main result by Bekken et al. In Melbourne too, large efficiency gains had been achieved before the city decided to put out its public rail services to tender. As a result it could have been predicted by the bidders and the franchisors alike that the potential for further gains was low. The opposite occurred however and rather optimistic bids were made and accepted by the authorities.

In August 1999 Melbourne split its rail services into four parts, two heavy and two light rail (tram) operations which were to be put out to tender. (There was also one regional passenger service which was tendered too) The idea behind this construction was to allow yard-stick competition between different transportation firms. National Express Group (NEX), the British Bus Operator, won the franchise to operate one of the two metropolitan train services and one of the two metropolitan tram services. The other metropolitan train service was awarded to Connex and the other tram service to Yarra Trams. The contract length was set at 12 years for the tram services and at 15 years for the train services. Already in early 2002, after only three years of operation, all franchisees reported financial problems. The government responded with substantial short term funding. Nevertheless, a few months later National Express stopped operations. After interim arrangements with the two remaining companies in the market Connex finally took over the whole train network and Yarra Trams the entire tram network in 2004. The contract lengths were shortened from 15 to 5 years.

Stanley attributes the failure of the Melbourne tender to several factors. Among these are overoptimism of the bidders, as mentioned above. The bidders were influenced in their expectations by the substantial growth rates in the British transport sector and did not realize that in Melbourne further cost cutting would be difficult. But Stanley also mentions other problems like the poor performance of the existing ticketing system and unsatisfactory security around rail stations. Stanley conjectures, however, that these factors are only part of the explanation. In his view the real causes lie deeper and point to a major problem in competitive tendering in general. Invoking ideas from the so called Capture Theory of the Positive Theory of Economic Regulation Stanley claims that the bidders were quite conscious of the fact that their bids were unrealistic. Their market entry was aimed at “getting a foot in the door” and “creating facts” for the regulatory authorities who would find it politically difficult to let the bidders go bankrupt. Instead of incurring the political troubles connected with service disruptions the authorities would rather grant fare increases to the troubled companies. This hypothesis raises the objection, of course, why reputation effects do not counteract such strategic behaviour. Moreover, as Stanley himself recognizes, competent regulators should immediately recognize unrealistic bids and see through the strategic intentions of the bidders.¹ Stanley claims, however, that in the Melbourne case due to a mixture of ignorance and ideological preconception the responsible decision-makers were not able to assess the bids in a realistic fashion. He concludes his paper by spelling out key-elements of what he terms a “trusting partnership” between the State and private operators in transport service planning and delivery.

The two remaining papers in this special issue of *European Transport* deal with Sweden and Great Britain, respectively, the two countries that have certainly accumulated the greatest experience in competition in public transport services so far.

Alexandersson and Hulten give an overview over the experience in the UK, the Netherlands, Germany and Sweden. Their focus is on railway services. Since the

¹ A very good discussion of these problems of strategic behaviour can be found in Kain 2006

Transport Policy Act in 1988 the Swedish railway sector has a vertically separated structure, where investments and maintenance of railway infrastructure are the responsibility of Banverket, a public enterprise. At the level of train operation the former state railway operator SJ competes with new entrants, like Connex, Citypendeln and Tagkompaniet. The County Public Transport Authorities (CPTAs) act as responsible agencies for regional services and are compensated by the state for deficit making services.

New entry was slow in Sweden at first. From 1989 to 1995 there was only one single competitor to SJ, BK Tag. The break-through did not occur before 2000. Alexandersson and Hulten attribute the break-through to the increased transparency that had gradually improved after more and more functions like allocation of track access rights (slots) and train traffic control had been moved from SJ to Banverket, the network operator. This created safety for investors and new entrants, like Connex, Citypendeln and Tagkompaniet which are now strong competitors of SJ.

Alexandersson and Hulten report that competitive tendering of railway services in Sweden has led to subsidy reductions in the order of 20% in the first round and an additional 28% in the second round of tendering by CPTAs. There has also been an increase of 32% in patronage - on short distances even of 70%! This means stronger growth than for all other modes and can probably not be attributed to tendering alone. Alexandersson and Hulten mention better integration with bus-services by the CPTAs as a major success factor.

Compared to these successes of public tendering in Sweden there are some negative aspects too. The average number of bidders has been rather low. It amounted to 1-2 bidders for net cost contracts (which are mainly used for the regional services tendered by the CPTAs) and 2-3 bidders for gross cost contracts (which are mainly used for interregional services tendered by the state). There were also several cases of non-fulfilment of contracts due to too optimistic bids, the best known case being the problems with Stockholm's commuter services in 2000.

Great Britain has certainly been the country that has gained the most publicity for its far reaching experiments with competition in public transport. Concerning the railways most observers agree that after some initial reductions in the subsidies to the TOCS, subsidies now are almost back to the initial level before the reform. Alexandersson and Hulten even speak of a "cost explosion" in Great Britain's railroad sector, not only with respect to train operations (the level of the TOCS) but also with respect to infrastructure and rolling stock. Many of the TOCS seem to be in serious financial trouble. The big success of the British rail reform undoubtedly lies in the substantial increase in patronage that has occurred.

Britain has employed both competition in the market (open access) and competition for the market. Indeed this distinction was coined in Great Britain already in the middle of the 19th century by Chadwick, long before 1968 when Demsetz published his classic article "Why Regulate Utilities?" on which the modern philosophy of public tendering is based. (It is very little known, by the way, that the concept of competition for the market was developed even earlier than Chadwick by the German railway politician Hansemann in 1831) The paper by White contends that the intensity of competition is stronger in tendered services than in services which are characterized by "on the road or on the track" competition" White attributes this to the many potential alternative providers which are waiting in the wings to replace an unsatisfactory incumbent. With the large experience gained in the tendering of bus and rail services in Britain there is a

large supply of potential and knowledgeable market entrants with ensuing competitive pressure on incumbents. In contrast, it may be far more difficult to replace an incumbent by “on the road-competition” who may have developed a monopoly position over long years of operation.

In his general conclusions White also casts an aside on the Melbourne case mentioned above. White conjectures that the failure may be due to an inherent deficiency of using net cost contracts. In his view net cost contracts run the danger of doubling the “winners curse” problem of auctions. This is because overoptimism can not only occur with respect to costs but with respect to revenues too. It may therefore be advisable to use gross cost contracts rather than net cost contracts. As British examples he cites the two Virgin rail franchises which too were based on very optimistic forecasts of large ridership and revenue growth. He admits, however, that in growing markets, the effect of doubling the winners’ curse may be less important. In growing markets bidders may be able to spread the risk over larger networks rather than single routes. But even in this case there may be a point for gross contracts. Gross contracts may help to increase the number of bidders because there is less risk to be taken by the bidders. Thus more small enterprises may be encouraged to participate in the tender. White also shows that price competition in long distance markets has been more effective than in local markets.

In conclusion it seems safe to say that uncritical optimism with respect to tendering of public transport services has given way to a more realistic assessment. It has become clear that “one size fits all” solutions are no longer appropriate. Success or failure in this area depend very much on history and on political circumstances which require careful and thorough *ex ante* analysis. The role of experience and learning by both authorities and bidders can hardly be underestimated. In addition, many theoretical issues still seem to be underresearched. This applies in particular to the strategic aspects of the bidding process and concerns perhaps more the institutional and political economy aspects of the matter than, for example, deficits in pure auction theory (see also Kain, 2006).

On the empirical side I can possibly do no better than to cite the last sentences in the Alexandersson/Hulten paper:

“We see at least two major possibilities for future empirical research. Firstly, a comparative European study directed towards measuring the effects of competitive tendering and testing the relative contribution of different factors, such as network size, number of bidders, contract length, how many times the services have been tendered, type of contract (net or gross cost), upstream competitive markets or vertical monopoly, and so on. Secondly, research projects including both statistical and qualitative data, comparing railway systems using competitive tendering to railway systems using either negotiated contracts or a monopoly regime. Such a study could shed some light on the relative merits of the different regimes after nearly two decades of experimentation with railway deregulation in Europe.”

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