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Public Transport Procurement in Britain

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Abstract

Britain is one of the countries with the most experience of alternative ways of procuring public transport services. From a situation where most public transport services were provided by publicly owned companies, it has moved to a situation where most are private. Long distance bus services, most local bus services outside London and a small number of rail services are left to commercial operators to provide without regulation on a purely commercial basis. Most rail services, bus services in London and subsidised bus services elsewhere are competitively tendered by central or local government. In the bus industry, both forms of competition have substantially reduced costs, but competitive tendering of services planned by local authorities has been the more successful in boosting patronage. On the other hand, on the rail system, whilst competitive tendering has again gone hand in hand with a large rise in usage, it has also been accompanied by a large rise in costs. Some possible reasons for this difference are considered, but it does appear that caution should be exercised when transferring lessons from one mode to the other.

1. Introduction

Public transport has often been viewed as a natural monopoly, subject to economies of scale and with strong public interest arguments for public intervention, because transport is seen as a social necessity for everyone, and because by attracting passengers from using the private car it reduced externalities of congestion and pollution. Thus, it has often been provided by a public sector monopoly. Where competition has been introduced, building on the work of Demsetz (1968), it is frequently considered that competition for the market (or ex ante competition) is a more appropriate means of introducing competition in public transport than competition in the market (or "on-road / on-track" competition). Under this model, the government can specify what it wants to provide and then invite the market to bid for the exclusive right to provide these services on a given route or routes. In this way, it is thought that efficient production can be ensured, whilst leaving the public sector to specify service levels and fares.

Competitive tendering has been introduced for public transport in many countries, with the result generally of significant cost savings (Hensher and Wallis, 2005), although variable with circumstances (such as whether the incumbent was publicly or privately owned). What has been observed, however, is that usually competitive tendering after the initial round does not produce more cost savings, and indeed often some of those from the first round are lost. Competitive tendering has been less used for rail than for bus but a number of countries have done so and again the result has generally been to reduce costs (Nash et al 2019).

By contrast, competition in the market is relatively scarce, partly because public transport is generally subsidised so profitable opportunities are rare. Where it does exist, it is generally for long distance bus, and in a few cases rail services. It appears that competition in the market typically leads to improved services and lower fares in these long distance markets.

Britain is a particularly interesting case study in that both forms of competition exist in both bus (including local bus) and rail services. Britain is the country in Europe which has gone furthest in moving away from the public sector monopoly model of public transport procurement, having completely deregulated and largely privatised the provision of bus services under the 1985 Transport Act, and completely privatised rail passenger services under the Railways Act of 1993 (rail infrastructure was also privatised but reverted to public ownership following the failure of Railtrack). Moreover, Britain has made use of a combination of competition for the market (by means of competitive tendering) and competition in the market (with competing companies offering services on the same route). Bus services outside London were deregulated on the basis of competition in the market, except where subsidy was needed. Bus services in London and rail services were privatised largely on the basis of competition for the market, with local or central government respectively still tightly specifying the services to be provided. Thus, British experience should be a good test of which form of competition works best.

We consider in turn the experiences of the bus and rail sectors before seeking to reach conclusions.

2. Bus deregulation

Already in 1980, the British government had deregulated long distance bus services, permitting any operator to run whatever services they wished and to charge whatever fares they wished (White and Robbins, 2012). Prior to this such services had been regulated to limit competition both between rival bus companies and with rail. They were mainly provided by the National Express subsidiary of the state owned National Bus Company.

Immediately upon deregulation, a consortium of private coach operators (British Coachways) opened rival services on the key inter city routes, operating mainly from stops on the streets close to main railway stations and charging much lower fares than National Express. National Express retaliated, turning many of their services into limited stop motorway services at much lower fares than they had previously charged. In the following battle for passengers, National Express emerged the winner, and British Coachways soon ceased operating. It was argued that National Express had strong advantages from its position as the known operator and its ownership of a network of coach stations. In the meantime, the monopoly rail operator, British Rail, also retaliated with new cheap off peak fares including a little later advance purchase tickets. By 1985, long distance bus patronage had increased by 67% since deregulation, but then fell back although remaining above pre deregulation levels.

Following privatisation, National Express remained the dominant operator despite the opening up of the coach stations to rival operators. Much later, Stagecoach entered the market with its Megabus

network of services based on the low cost airline model, with sales on the internet using yield management methods, and again operating from curbside stops mainly outside railway stations. But neither they nor First, with similar services, achieved a major market share. Overall coach services seemed to reach something of an equilibrium with lower fares and faster services than pre deregulation, but with some smaller towns losing out by diversion of services to motorways. They gained a strong market share in trips to airports, where they offered through services, and in the student and elderly persons markets. But their impact on the position of rail services was limited, partly because congestion both in cities and on the motorway network itself made bus journey times slow and unreliable.

Perceiving the deregulation of coach services as a success, the government adopted a similar policy towards local buses outside London. From 1986, commercial operators were permitted to operate whatever services they wished at whatever fares they chose. Local authorities could only subsidise services where they believed that there were gaps in terms of route coverage or times of day, and then they had to go out to competitive tender to fill the gaps. The government owned National Bus Company was split up into many small companies and sold to the private sector, whilst the limited ability in the new legal framework for local authorities to direct or subsidise their own companies encouraged many to do the same.

The immediate effect of the changes was major changes to service, and instability as operators tried different approaches to services in the new environment, and as competition came and went (Nash, 1993). But some 80% of routes were able to operate without subsidy. There was some intense on street competition with rivals matching each other's schedules and racing to reach the next stop first. But such competition was rarely sustained; usually one or other operator left the market. In some cases, low frequency services with full sized buses were replaced by high frequency services with small vehicles – but again this was short-lived. There was also much use of anti-competitive practices such as running free buses in front of their services to bankrupt rivals, but this was tackled by tightening competition laws.

Within London, a different approach was adopted. The government argued that because of recent changes in London with the abolition of the Greater London Council and the transfer of responsibility for buses to a new body, Transport for London, more time was needed before full on street competition could be introduced (although many commentators also thought that there was nervousness at the outcome of allowing unlimited competition in the dense bus market and severe congestion of central London). Instead, the network was divided into routes or small groups of routes and let by competitive tender on gross cost contracts to the newly privatised bus companies. Therefore, whilst the rest of Britain had mainly competition in the market, London had competition for the market.

Table 1 shows developments in the first 10 years after deregulation in October 1986. Both forms of competition brought about a similar, dramatic reduction in costs. In part this is exaggerated, since some responsibilities for bus stations and information remained with the local authorities and they had to plan and manage competitive tendering for subsidised services. In London the public authorities retained responsibility for all timetabling and the setting of fares. In addition, there was a trend to smaller vehicles. But much of the decrease was a result of genuine improvements in productivity, plus a reduction in wages and conditions of workers in the industry (Heseltine and Silcock, 1990).

In both London and the rest of Britain, there was a substantial increase in services and in real fares. In London this was a result of planned decisions by the public authority, whilst in the rest of Britain it was a result of competition in the market. Thus, it appears that competition mainly took the form of

intensification of services rather than competition on fares. It was argued that this was because, unlike in long distance markets, behaviour in the local bus industry was largely for passengers to catch the first service that came rather than to wait for a bus with lower fares. Thus, frequency was more important than fares as a way of boosting market share. The net effect was a big reduction in subsidies under both forms of competition, but a modest increase in traffic in London whilst traffic continued to fall elsewhere.

Table 1 Local bus industry trends 1985/6 to 1996/7

(real terms)

	London	Rest of GB
Cost per bus km	-45%	-46%`
Bus km run	25%	26%
Fares	38%	27%
Passengers (m)	8%	-31%
Subsidy*	-£378m	-£666m

Source: Transport Statistics Great Britain

* 2014/5 prices

The difference between the results of the two forms of competition may have been partly to do with the socio economics of the areas concerned. London enjoyed a buoyant economy and a low increase in car ownership. Moreover, Transport for London introduced travelcards which essentially meant bus travel was free for the holders of rail season tickets and also free fares for elderly and disabled passengers. However, a modelling exercise by Fairhurst and Edwards (1996) concluded that the trend in bus demand in London is explicable in terms of their model, whilst demand in the rest of the country was below expected. They argued that the problem was a lack of integrated planning (bunching of services; operator specific tickets which tied passengers to the buses of a specific operator, reducing effective frequency, lack of connections between services and the lack of system wide marketing).

Table 2 shows trends in passenger numbers and bus miles run from deregulation to the present. In London, there has been a massive rise in bus patronage since 1995/6, helped by a big increase in subsidies used to greatly expand bus frequencies, and by the introduction of road pricing in Central London. Elsewhere, the decline in bus patronage has greatly slowed down but the decline in bus miles run has resumed. By now subsidies were rising again here, partly because of the introduction of free fares for the elderly and disabled, which was extended to the rest of Britain outside London in 2005 for the local authority area in which the passenger lived and in 2008 for the country they lived in as a whole). A report on the industry by the Competition Commission (2011) found that few

routes had actual on the road competition whilst in many local authorities a single operator existed or was dominant, reducing competition for contracted routes as well as competition in the market.

Table 2. Local bus industry passenger journeys and bus miles run, 1985/6 to 2015/6

	Passenger Journeys		Bus miles run	
	London	Rest of GB	London	Rest of GB
1985/6	1152	4483	170	1120
1995/6	1193	3296	219	1412
2005/6	1881	2818	286	1343
2015/6	2293	2723	303	1225

Source: Transport Statistics Great Britain

Another factor which helped bus patronage outside London was a change in the attitude of local authorities. Initially, in the new environment, local authorities showed little interest in bus services; why should they help private bus operators make profits for private shareholders? But as bus traffic fell and congestion worsened, a more enlightened approach began to take hold, in which it was seen that encouraging better bus services could help local authorities achieve their transport objectives. Thus by around 2000, there was a rise of voluntary quality partnerships, whereby local authorities promised to introduce better facilities in terms of bus priorities, waiting areas and information, whilst operators promised to invest in better vehicles. Such voluntary arrangements were problematic inasmuch as they were unenforceable, and there were claims of both sides failing to keep their promises; bus operators could easily move new vehicles away, whilst local authorities could reverse policies, perhaps after a change of political control. Moreover, there was nothing to stop bus operators who were not party to the voluntary arrangement taking advantage of the facilities the local authority provided whilst doing nothing in return themselves. Thus, there has been a move towards legally binding quality partnerships with the ability to exclude nonparticipants from use of the facilities. But some local authorities, particularly in big cities, wanted to go further and adopt the London approach in full. There is now legislation making this possible in certain circumstances (White, 2018) although no local authority has yet implemented it the issue of what happens to the staff of existing operators and how their transfer to the new franchised operators is managed remains problematic). Moreover, many of the authorities in question foresaw an approach more akin to that in France and Spain, where management of whole networks was contracted out, rather than that of competitive tendering for small groups of routes, as in London.

3. Rail Privatisation

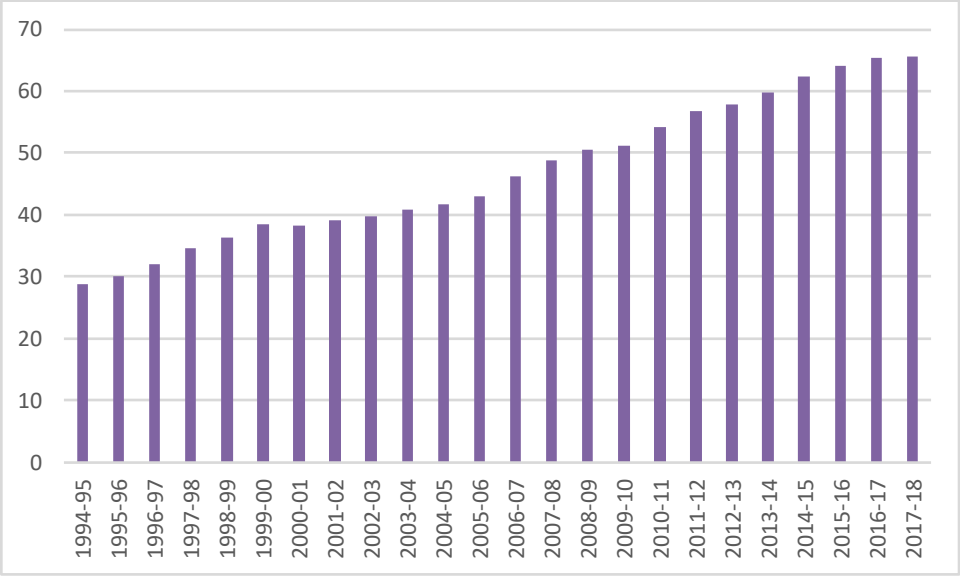
When the government came to privatise the rail industry under the 1993 Railways Act, there was also a long debate about how best to do it. In the event, the conclusion was to rely, initially at least, on competition for the market for passenger services, with infrastructure separated from operations, and passenger train operations divided into 25 franchises let by competitive tendering.

The reason for this was less that this appeared to be the more successful approach in the bus sector, than that it was desired to make the infrastructure manager a purely commercial organisation with subsidies channelled entirely into services, and this would mean – initially at least – that high track access charges would cause few services to be profitable. To make entry easier, rolling stock was placed in the hands of separate leasing companies. Franchises were let under net cost contracts subject to minimum service levels and with some fares regulated. Moreover, whilst in the bus industry contracts were usually for a single route or corridor, which represented an expansion or contraction of an existing company, in the rail industry contracts were for an entire geographical area, and involved taking over an existing company with its staff and assets. Contract length was normally 7 years but 15 in some cases where major investment was involved. Competition in the market was limited, to protect franchisees, although in some cases franchise overlaps led to competition in the market (often between commuter operators and intercity, with the commuter operator offering lower quality but lower fares). Although entry conditions for open access operators were subsequently eased, it remains the case that entry must not be primarily abstractive (i.e. it must generate significant new rail business; Nash and Smith, 2011). Thus open access entry has been very limited, with only two companies currently operating, both on the East Coast Main Line. It has provided high levels of passenger satisfaction at lower fares, and there is some evidence of reduced costs compared with franchisees, but at the expense of absorbing limited infrastructure capacity and abstracting some revenue from the franchisee and thus helping to make franchising on this route more problematic.

The winners of franchises largely fall into two groups – the privatised bus companies (First, Stagecoach, Go-ahead and Arriva) and foreign state owned rail operators (subsidiaries of German, Dutch, French and Italian Railways and MTR Hong Kong). Arriva actually falls into both categories, having been bought by Deutsche Bahn.

Fig 1 shows the dramatic rise in rail traffic that has followed the reform. However, studies have suggested important external factors (in particular a slowing of the growth in car ownership together with rising road congestion and fuel prices) as an important cause of this (Wardman, 2006). Nevertheless, improved services and reduced fares were also important factors (Preston and Robbins, 2013) particularly in the early years when fares regulation required an annual reduction of 1% in regulated real fares; later this policy was reversed to allow 1% p.a. increases.

Fig 1 Rail passenger traffic in Britain (billion passenger-km)



Source: Transport Statistics Great Britain

Less satisfactory was the experience on the cost side (Smith and Nash, 2014). Table 3 shows major increases in the cost of infrastructure and even some increase in the cost per train km of train operations. This is in marked contrast to the major cost reductions in the bus industry and in rail tendering elsewhere in Europe.

In regard to rail infrastructure, the fatal accident at Hatfield in October 2000 was blamed on a broken rail and led to a major increase in spending on track maintenance and renewal (the Regulator had already recognised that there was an issue in terms of the resources the infrastructure company was spending on this, but his action was too late to prevent this accident). The McNulty report (2011) also blames some of the cost increase on vertical separation itself, in that the train operating company had too little incentive to help the infrastructure company to control costs (for instance by cooperating in granting long possessions for work on the track).

Reasons why, in the context of competitive tendering, train operating costs went up rather than down are less clear. Certainly, a major factor was rising wages for skilled labour, particularly drivers. Unlike in the bus industry, train drivers typically require a year's training and in the context of relatively short franchises it was more profitable for train operating companies to raise wages to recruit from their rivals than to train new drivers themselves. It also appears that the relatively short franchise contracts discouraged challenging traditional working practices when this might lead to industrial disputes. For instance, the former nationalised operator - British Rail – had started introducing one- person operation of passenger trains in 1992, but there was little progress on this by the privatised operators until forced to do so as part of franchise conditions in some recent franchises. Other possible reasons for these trends in costs were that British franchises were too large for efficiency (Wheat and Smith, 2015) and that – unlike in the bus industry – British rail franchises took the form of bidding to take control of an existing company with its existing staff, wages and conditions, so there was no scope for new entrants into the franchising business to bring in their own, staff, wages and conditions.

Table 3. Passenger railway costs in £ per train km (2014/5 prices)

	1996/7	2005/6	2011/2

Total	21.9	29.3	27.5
- Infrastructure	10.0	15.6	15.1
- Operations.	11.9	13.6	12.5

See Smith and Nash (2014)

Following the bankruptcy of Railtrack, the infrastructure was placed in the hands of a not for profit company without shareholders and with its debts guaranteed by the government; in 2014 this was declared to be a fully publicly owned company. In a reversal of previous policy, this was grant aided directly by the government and by 2014-5 all net subsidies were channelled through the infrastructure company rather than the train operators, with premia paid by profitable franchises outweighing subsidies paid by unprofitable ones (Table 4).

Table 4. British rail industry finances 2014-5 (£ billion in current prices)

Income	Passenger revenue	9.6
	Government funding	3.5
	Other	0.4
	Total	**13.5**
Costs	Train operating companies	7.4
	Network Rail (Of which, financing cost)	6.2 1.4
	Total	**13.6**

Source: ORR

A number of solutions to the problem of rising costs have been proposed. These include decentralisation within Network Rail, longer franchises where the franchisee is responsible for service development, procuring rolling stock and influencing infrastructure investment (the Chiltern 20 year franchise being the model) and short gross cost franchises where the franchising authority is responsible for asset procurement, marketing, influencing working practices etc (the London Overground 7 year franchise being the model). Alliances with Network Rail have also been seen as crucial, the 'deepest' of these being the alliance with South West Trains involving complete sharing of revenue and cost risk. An alternative is the suggestion of a greater role for competition in the market through extending open access (Competition and Markets Authority, 2016). In the meantime, further problems have arisen. On the most profitable route, the East Coast, three successive private franchisees have overbid in terms of the premia they have agreed to pay, and had to withdraw during the life of the franchise. In the case of Network Rail, not only have costs risen but also major infrastructure projects have run late and over budget. Partly as a result of this, major timetable changes have been undertaken with too little notice, and have been found to be unworkable. For these reasons, the government has set up a 'root and branch' examination of the structure of the rail industry (the Williams Review). It has made clear that further major changes are coming in the approach to franchising, as well as to improve integration of franchisees and the infrastructure manager.

4. Conclusions

Britain has had extensive experience both of competition in the market and competition for the market in the public transport sector. In the bus sector both approaches led to major reductions in costs, but it appears that the better integration of services resulting from competition for the market achieved better overall results in terms of passenger numbers in the local bus market. However, it should be born in mind that the evidence for this statement comes from the results in London,

where bus transport has the strongest market position, and similar results might not be achieved elsewhere, particularly in smaller cities and towns.

However, in the rail sector, whilst competition for the market has gone hand in hand with a major increase in traffic, it has also been accompanied by a major increase in costs. This is largely but not exclusively in the area of infrastructure costs. It is an interesting question why the experience of the two modes should be so different. Some of these factors may relate to fundamental differences between the modes such as in asset life. Longer asset lives in rail make franchising more difficult (a problem not wholly overcome by the leasing of rolling stock, since the relatively short franchises meant that train operators could only sign leasing agreements much shorter than the lives of the assets unless – as happened in some cases - the franchising authority underwrote them). The long training period for train drivers (unlike the short training of bus drivers) appears to be a further factor. In neither mode has lack of bidders been a worry. It is still the case that on average bus contracts have 3.2 bids, whilst rail franchises have typically had five or more. However, there are concerns that, following the exit from the industry of National Express, now Virgin and Stagecoach will cease to bid, whilst First Group has announced that following its successful bid on the West Coast Main Line, it will not be bidding for further franchises in the foreseeable future. Also, Arriva is for sale, which may affect its future bidding strategy. This leaves just Go-ahead and SERCO as true private sector companies bidding for franchises, so competition for future franchise bids may be heavily dependent on foreign government railways.

Other explanations for the rail cost increases relate to the policies followed. For instance, the decision to go for relatively large rail franchises (and to increase their mean size by mergers over time) may be partly explained by a larger minimum efficient size for rail companies over bus and the need to integrate services over a wider area. However, this decision appears to be a contributory factor in the relative success of competition for the market in the two sectors.

It should also be noted that in the bus sector, competition in the market appears to have been largely successful for long distance services despite the limited amount of competition actually to emerge. This may be partly because integration is a less important issue for such services and price competition more effective since passengers are more willing to book in advance on line and less likely to travel on a 'turn up and go' basis. Thus competition in the market may be effective for intercity rail services (in practice these are often the only services that are profitable on rail and therefore the only ones for which competition in the market is an option), although perhaps integration, particularly in the form of connections with regional services, matters more for rail than bus, where lower economies of density mean that through services can be offered to a much greater number of locations.

In short, caution is needed in transferring conclusions between modes and market segments. But in short competition for the market seems to have worked better than competition in the market in the local bus sector in Britain, whilst competition in the market has worked well for long distance bus. In the passenger rail industry only competition for the market has been tried on a large scale; it has been successful in terms of attracting increased patronage (although partly as a result of external forces) but problematic in control of costs.

Finally, a comment should be made on the relationship between operators and infrastructure managers. Even in the bus sector, it appears that the best results have been achieved where the infrastructure manager and bus operators have worked together to create attractive services by means of bus priorities, and enhanced information and waiting areas. But in the rail sector this

relationship appears more crucial both in terms of providing attractive services and in terms of controlling costs.

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