

Summary:

# Targeted Competitive Tendering of Passenger Transport Services

This report gives an overview of experiences with competitive tendering of passenger transport in local public transport, in the railway sector and in regional aviation.

Two main questions are addressed: What are the effects and experiences with various forms of competitive tendering in Europe, and what is the relevance of such experiences for the design of competitive tendering in Norway?

Answering these questions, we take as point of departure that various forms of competitive tendering imply different forms of division of roles and responsibilities between public authorities and operators, in terms of planning and control in public transport. Hence, the analytical point of departure in this project is the established distinction between strategic, tactical and operational level:

The strategic level relates to the formulation of general aims and in the denomination in broad terms of the means that can be used to attain these goals. The tactical level involves decision-making on the use of means to reach the general aims, and on how to use them in the most efficient way, through the design of routes, fare etc. The operational level has to do with the actual operation and production of services.

These distinctions have implications for the understanding of different forms of competitive tendering. First and foremost it is necessary to distinguish between the introduction of free competition and competitive tendering. Free competition implies free entrance to the market for every actor who finds it commercially interesting, hence a limited role for public authorities, and this only on the strategic level – related to licensing etc. Competitive tendering, on the other hand, refers to competition for the production of goods and services for public authorities. The responsibility for strategic decisions is left to the authorities, whereas the

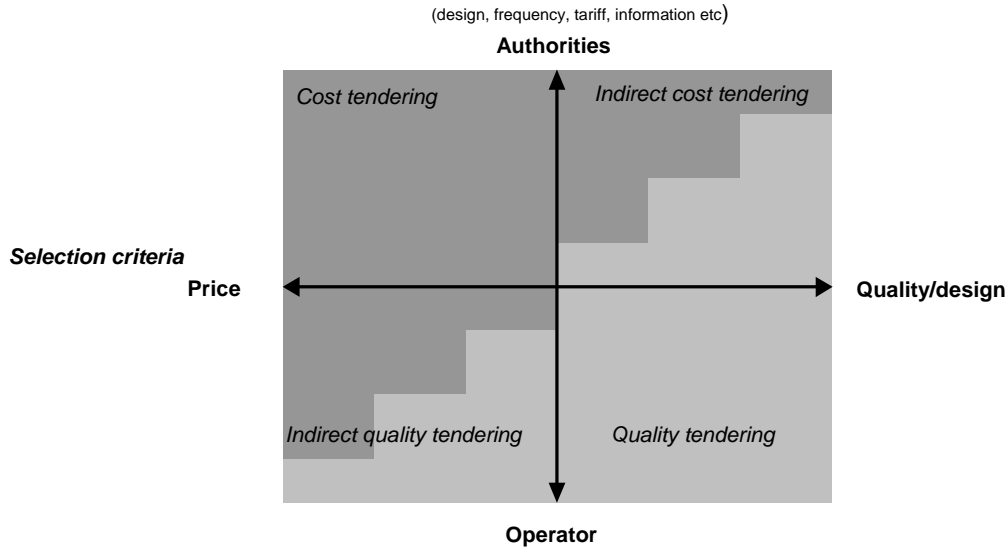
responsibility for decisions on the tactical level can be divided between public authorities and operators in several ways. The responsibility for decisions on the operational level, however, is always with the operator/company.

Competitive tendering can be organised and designed in various ways: On the basis of factors relating to the tendering procedures, four main forms of competitive tendering may be identified (see figure 1):

In the upper left corner of the figure, the service-design is pre-defined by the authorities and the operating costs remain the sole criterion for the choice of operator (“cost tendering”). The opposite extremity of the cost tendering model is found in the lower right corner of the figure, named as *quality tendering*. Quality tendering means that the service design and proposed quality is totally or partially decisive in the choice of operator. The operator is furthermore given greater opportunities to develop the content of the service provision within a given geographical area.

Both cost tendering and quality tendering models have their mixture forms, defined as indirectly quality tendering in the lower left side of the figure and indirectly cost tendering in the upper right side. *Indirect quality tendering* has its basis in the cost tendering regime, as price remain the decisive selection criterion. It indirectly promotes focus on quality matters, however, as the operators are allowed freedom of design and awarded net cost contracts with supply side incentives. Similarly, *indirect cost tendering* promotes focus on operating costs, as the operators service design freedom is very limited and practically non-existent, even though the quality criteria are decisive for the choice of operator.

This distinction between cost and quality tendering regimes may be further nuanced by introducing issues related to the contractual period:



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**Diversification of design powers**

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Figure S.1: Main forms of competitive tendering based on selection criteria and design freedom for the operator

Table S.1: Cost tendering according to contractual clauses

Revenue risk	Incentives beyond risk diversification	
	No	Yes
Authorities	1. Gross cost tendering	2. Extended gross cost tendering
Operator	3. Net cost tendering	4. Extended net cost tendering/indirect quality tendering

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Gross cost tendering implies that the operator leaves the fare revenue to the public authorities, i.e. that the operator only has risks related to costs. Public authorities have the responsibility for all planning, marketing and information during the contract period. Extended gross cost tendering implies that although public authorities still use gross cost contracts, these include relatively large economic incentives as bonus for quality and /or passenger improvements. Net cost tendering implies that the operator carries the revenue risk, keeping the fare revenue, whereas extended net cost tendering implies that the contract also has incentives for further improvements in quality or patronage. The latter one is often called indirect quality tendering.

The main purpose of this project is to explore the effects of the various forms of competition. In doing

so, we have distinguished between various types of efficiency.

Production efficiency (cost efficiency) implies that a given output is produced at the lowest possible costs, and such decisions are primarily related to the operational level.

Market efficiency implies the best possible level of service within a given level of public expenditure/ subsidisation. Measures to achieve market efficiency are related to the design of routes, frequency etc and hence to decisions on a tactical level.

General economic efficiency refers to the level of service of public transport which contributes to the realisation of general strategic goals, by the use of such measures as correct level of subsidy, but also measures related to other areas of transport policy such as parking policy and public road policies .

**Method and selection of data**

The data source in the project is qualitative, i.e. it is based on the summary of country/sector descriptions based on public reports and research reports. Only characteristics of regimes until mid 2004 are included in the material.

The sector studies of local public transport and rail transport are all based on data from four countries; Great Britain, the Netherlands, Sweden and Denmark. The description of experiences in domestic aviation is mainly based on information about several rounds of

competitive tendering in Norway, whereas the characteristics of the Norwegian regime is explored by contrasting it with other European countries.

**Brief summary of main conclusions**

The use of cost tendering in local public transport, rail passenger transport and air traffic in Europe is summarised in table S.2 below.

*Table S.2: Cost tendering in use in European person transport*

	Additional incentives not included	Additional incentives included
Authorities with revenue risks	<i>Gross cost tendering.</i> Bus in Copenhagen, Denmark Bus in London Regional rail person transport in Sweden	<i>Extended gross cost tendering</i> Bus in Halland, Sweden
Operator with revenue risks	<i>Net cost tendering.</i> Bus in Helsingborg, Sweden Inter-regional rail person transport in Sweden (the economically non viable ones) Rail passenger transport in Central and Western Jutland, Denmark Regional aviation in Norway	<i>Extended net cost tendering</i> Bus in Telemark, Norway Rail person transport in the UK <sup>1</sup>

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One of the major general conclusions that can be drawn across sectors and countries is that competitive tendering is associated with increased cost efficiency – at least in the short and medium term. There are, however, differences in cost reductions, as well as long term challenges for maintaining cost reductions. As to the observed effects on market efficiency, there is strong variation. This variation is related to whether public authorities use the gains of the reduced costs to improve the level of service of public transport, as well as to how this “surplus” is used, e.g. whether incentives for improved market efficiency are imposed on operators. As to general economic efficiency, there is a general lack of systematic research and documentation.

Choice of tendering regimes seems to develop in particular historical stages, especially in local public transport. The first stage is the introduction of gross-

cost contracts, aiming at and actually leading to cost and public expenditure reductions. At later stages, initiatives are taken to develop extended gross cost tendering in order to give operators increased degrees of freedom and incentives to improve the quality of services. It seems that effects of different tendering regimes are more closely linked to the design freedom of operators than to the choice between gross cost and net cost regimes per se. The development of increased degrees of freedom for operators is often combined with new modes of management and control, often designed as partnerships.

In general, no form of competitive tendering can be seen to be better than the others in all cases or in relation to all types of effects. There are different challenges related to different forms of competitive tendering. For instance, whereas a main challenge concerning gross cost contracts is the involvement of operators, the main challenge concerning net cost contracts is the involvement of the public authorities. The different traditions across sectors and countries concerning the division of roles and responsibilities also have consequences for the relevance of international experiences for the choice of forms of competitive tendering in Norway.

<sup>1</sup> It is our interpretation that the contracts used in franchise agreements in rail person transport in Britain has more in common with extended net cost tendering than the other categories in our framework ( (see description of Great Britain in documentary report 787a/2005).

