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Workshop 2 report: Effective institutional design, regulatory frameworks and contract strategies

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ABSTRACT

This paper describes the progress of world-wide research on institutional design, both on the level of the regulatory regime as well as on the level of the governance of the relation between authority and operator of public transport services. Tendering has found its way into regulatory frameworks and has become a mainstay of governance. A first conclusion is that tendering has become mature, with consequences for existing and new implementations, with refined and contextual lessons coming from research. A second conclusion shows that governance design should intelligently balance including power and control oriented elements with empathic and cooperation oriented elements. A first framework for the analysis of this balance is provided in this paper.

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1. Introduction

This workshop examined the interface between authority and operator, their respective roles and responsibilities and the governance tools used to develop a fruitful interaction. The workshop looked at both regulatory regimes and the governance of the relation between authority and operator, from public operators, through licensing, direct award, yardstick competition, competitive tendering, open markets and mixed models. It continued and developed the themes emerging from Workshop 5 in Thredbo 13 in Oxford, UK. These might be summarized as follows:

- Specifying concessions that are attractive to potential bidders.
- Providing adequate data to all bidders.
- Retaining risks that the operator cannot control.
- Ensuring that bidders can acquire the assets they need, if necessary by leasing them to the operator themselves.

The following countries were represented in the Workshop, which had 30 participants and 18 papers:

- Australia, Brazil, Chili, Ecuador, Finland, Germany, Japan, Mexico, Netherlands, New Zealand, Norway, Russia, Singapore, Sweden, Switzerland, United Kingdom, and many more.

In Section 2 below we review the contribution of the papers presented at the workshop, before discussing policy recommendations and areas for future research.

2. Overview of the papers presented

In total 18 papers were presented and discussed, in four blocks of closely related papers:

1. Cases of country and modal experiences, mostly with transitions to a new regulatory or governance model.
2. Formal evaluations of efficiency, productivity and welfare when changing governance for rail and bus services.
3. Specific aspects and evaluations of governance, risks, transactions costs and governance failures leading to legal action.
4. Comparative governance analysis and evaluative frameworks.

The key results from these papers are summarised below.

2.1. Cases of country and modal experiences, transitions

Based on experience from contract re-negotiations of Transantiago (in 2012 and 2013) **Erazuriz and Hutt** address the

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question of how to achieve the right balance between public and private sector participation. A key finding is that the decision on public versus private involvement depends on both the income level of a country (its stage of development) and also political factors. For example, in richer countries funding exists to provide services; thus political factors determine how much public and how much private (for example, the UK chooses a higher proportion of private sector participation than Germany). On the other hand emerging countries might see increased use of private sector companies, where the need for funds to invest in public transport offers good investment opportunities for the private sector.

San Goh, Swee and Low describe the move towards greater state ownership of assets and risk in Singapore's rail and bus sectors. It was noted that the two main drivers of these changes have been the desire to improve services whilst maintaining financial sustainability for operators and at the same time by taking ownership of assets (and reducing entry barriers) increase contestability (which in time would be expected to lead to improved efficiency). Another key factor is that the Public Transport Authority looked carefully at the reforms undertaken in other countries before designing its policy approach. It is perhaps too soon to tell what the impacts of these reforms will be however.

Anttila used a mix of survey based research (with PTAs, companies and bus manufacturers) and quantitative research on the impact of competitive tendering to study the regulatory reform of Finnish bus services in 2013/14. It was found that in urban areas, most interest was in middle-sized tenders, with smaller and larger tenders only generating around 2 bids per tender. In rural areas there was competition only for small tenders (1–2 buses). Apart from one totally new company, in general interest only came from local bidders. This was explained by the fact that there were too many tenders being let at once and also because of lack of familiarity with the new tendering approach. In general operators preferred gross cost contracts and having a range of different sizes of tender packages was also helpful in stimulating competition.

In his first paper **Veeneman** surveyed PTAs in the Netherlands. In an effort to gather the key lessons of an already mature tendering market, he asked what key changes they had made to their approach when moving from one round of tenders to the next. It was found that there had been a trend towards fewer, larger contracts and importantly to combining rail and bus services in one tender in some cases. It was also noted that the bidding process tends to focus on existing services – and once the winning bidder is announced the winner then discusses with the PTA how to develop future services. It was also noted that changes in technology (e.g. dial a ride, car and ride share) meant that PTAs were reluctant to commit to long franchises. A model of developing the contract to reflect the degree of maturity was highlighted; where a gross contract is optimal initially to ensure delivery, with a subsequent move to net cost or other incentive contracts (over time these would also need to evolve to resolve their weaknesses). [note I could not find your paper in the pack so this is just based on my notes].

Finally in this section, **Preston** took a look back at passenger rail franchising policy in Britain since its inception in the 1990s. He concludes that rail services may be less amenable to contracting out, due to instability in service requirements (rail passenger numbers have more than doubled since the mid-1990s), high sunk costs and technological issues relating to rolling stock, train control and electrification. There have been substantive issues in letting franchises and then enforcing delivery, particularly for inter-city services. He also notes that the Competition and Markets Authority (CMA) is advocating open-access competition at least for inter-city services; partly because of the failures of rail franchising in Britain.

2.2. Formal evaluations of efficiency, productivity and welfare when changing governance: rail

Smith, Benedetto and Nash explored the extent to which regulatory reforms in railways in Europe had impacted on costs (via the expected mechanisms of regulation of the infrastructure manager and enabling stronger competition). They extracted the regulatory reform aspects of the IBM Rail Liberalisation Index to generate a rail regulation index that was included in a cost function model. They find that strong economic regulation, combined with vertical separation, tends to reduce costs (whereas strong regulation in a more integrated environment is less effective in terms of cost reduction). They also note that strong regulation can overcome some of the negative consequences of vertical separation at high traffic density levels noted by **Mizutani, Smith, Nash, & Uranishi (2015)**.

Mizutani studied the impact of yardstick regulation on rail operator productivity in Japan. Overall their paper finds that yardstick regulation (applied only to large railways but not smaller ones) does not appear to have led to improved productivity performance or average cost reduction. However the authors do find some differences in TFP trends for different activities (train services versus track activities within the vertically integrated companies). A key factor affecting Japanese railways and some markets in particular has been falling passenger-km over the period of the study.

Finally in this sub-section, **Dementiev** develops a model to determine the optimal corporate structure of a partnership between a public body and a private (monopoly) operator. A number of such partnerships emerged in Russian railways in recent years. Based on the theoretical model the paper finds that social welfare can be improved by local authorities delegating fare setting and subsidy decisions to partnerships with a particular corporate structure. It was found that the potential proceeds from selling the publicly-owned stake in the partnership could create a useful dynamic that leads to more business-oriented decisions.

2.3. Formal evaluations of efficiency, productivity and welfare when changing governance: bus

Sakai studies the impact of different contractual approaches for Japan's publicly-owned bus sector. It was noted that the sector was under considerable pressure resulting in operating deficits. The reforms have involved the contracting out of a sub-set of the service operations to private firms (though only operators in that region are allowed to bid). The impact of these reforms are studied econometrically based on a translog cost function. It was found that the policy had led to lower costs (with the reduction being higher where there is a higher proportion of contracting).

In a study of Swedish public transport **Vigren** compares the efficiency of 21 PTAs in 2013 (282 contracts). Costs increased substantially during the previous decade; thus the paper explores the impact of different contractual approaches on cost efficiency and what factors affect efficiency using a stochastic frontier model. Where direct awards are used cost efficiency is found to be lower although on a weighted average basis there was little evidence of much variation between the PTAs in efficiency performance. Interestingly high density operations were associated with low efficiency; which the author postulates might be due to the need to provide for peak services. Measures to even out the peak through pricing might be advantageous from a cost efficiency perspective.

Finally in this sub-section, **Svendson, Hervik and Odeck** consider how the organisation of tendering (internal or external) impacts on technical efficiency. The study uses Data Envelopment Analysis (DEA) and second stage regression modelling to reach its

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