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An assessment of the Competition Commission report and subsequent outcomes

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ABSTRACT

Following the Office of Fair Trading's review of the British deregulated bus market as a whole in 2009, the issues raised were referred to the Competition Commission. Its final report was published in December 2011. Subsequently, the House of Commons Transport Committee carried out an enquiry into the Commission's report, and reactions to it by the operating industry, user groups, and other bodies, which was published in September 2012. A number of major issues have been raised, including the extent to which price competition may be effective, the appropriate rate of return on capital that would be expected within the industry (and appropriate actions where this is excessive in practice), and industry structure. The importance of competition *per se*, as distinct from attributes of direct concern to users (such as reliability, frequency, and fares) has also been debated. This paper reviews the issues raised, and outcomes to date, in the light of further evidence on the industry's performance. It is demonstrated similar rates of return could be attained through very different operating strategies, which in turn have very different implications for changes in consumer surplus. The alternative uses made of such profits (for example through reinvestment) may also have markedly different impacts effects on users. Rather than focussing on the dangers of excessive rates of return on capital, the outcomes for service users should be the main issue.

1. Developments in Britain prior to the recent competition debate

In previous papers at a number of 'Thredbo' conferences – beginning with the first in 1989 – I have outlined developments in the deregulated coach and bus sectors in Britain. Many other writers on this subject have indicated a range of views on probable outcomes and those observed. This introductory section highlights the main changes.

1.1. The express coach case

The deregulation of long-distance coach services under the Transport Act of 1980 took place from October of that year. The quality of statistics is unfortunately very poor, but some broad conclusions can be drawn. Following removal of previous quantity controls (route and timetable licensing, also direct capacity controls), and those on price, which had protected both the railways and incumbent coach operators, rapid growth took place. The major operator, National Express (NE), increased ridership by about 50% between 1980 and 1986, in addition to which growth was attained by new entrant operators, albeit probably relatively small. Fares fell sharply, especially on the major trunk routes. In addition to coach users, rail users may also have benefitted through fare reductions made in response. However, the major competition was between National Express and British Rail, both then in state ownership, rather than within the coach market itself. Difficulties in obtaining access to terminal facilities used by incumbent operators were undoubtedly a factor in the limited impact of new entrants in the early 1980s. Initial impacts are described and analysed by Robbins and White (1986), Cross and Kilvington (1986), and Thompson and Whitfield (1995).

From this initial peak, some reductions took place in NE ridership, as a result of substantial real fares increases, especially following privatisation in the form of a management–employee buyout in 1988. The outcome was broadly consistent with a short-run price elasticity of about −1.0, i.e. total revenue remained largely unchanged in real terms. Little new entrant competition was generated in response to this and a reversal of pricing policy appears to have been associated as much with a change in management following incorporation of NE as a plc in the early 1990s. Following real price reductions, the decline in ridership was

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reversed, and long-term growth resumed. NE absorbed many of the competing independents, and only on one major corridor (Somerset–London) has all-year-round independent competition been sustained since the early days of deregulation. Increased emphasis was placed by NE on direct services to airports (notably Heathrow) where coach has a competitive advantage over rail, and is not in the 'inferior mode' position found in respect of trunk routes to city centres. Substantial competition re-emerged for NE from Megabus (a subsidiary of Stagecoach) from 2003, adopting a yield management/internet booking pricing system. These subsequent developments to 2010 are summarised in White and Robbins (2012). NE's long-distance coach traffic has remained broadly stable in recent years, and consistently profitable despite growing competition from Megabus.

In brief, two broader conclusions may be drawn from the express case:

1. Contrary to some economic theory, impacts of small independents were limited. Although direct economies of a scale in service operation may be limited, network and marketing advantages undoubtedly exist. The only substantial competition in recent years has come from another large company.
2. While direct 'on the road' competition may be *a* factor in pricing, it is not necessarily the *only* one, and awareness by management of the negative impacts of successive real price increases could also explain behaviour, especially in a market sector with a high short-run price elasticity such as express coach.

1.2. The first phase of local bus deregulation

It is convenient to divide the impacts of local bus deregulation into two phases:

(a) From its inception in October 1986, following the Transport Act of 1985, to the year 1999/2000 inclusive, encompassing the initial phase of competition, and dramatic reduction in unit cost per bus-km, but with a sharp drop in ridership outside London.
(b) From 2000/1 inclusive, in which real costs per bus-km have risen (although still below 1985/86 levels), and the aggregate rate of ridership decline has diminished.

Outside London and Northern Ireland, operators were required to register those services they considered 'commercial' (i.e. covering all costs from user revenues, including the then fuel duty rebate and any compensation received for concessionary fares). About 80% of total bus-km run outside London has operated in this form since.[1] The remaining 20% share was taken by services contracted to local authorities, where commercial operation was not registered. In addition to obvious cases such as low-density rural routes, this also covered a substantial part of the day and week on routes otherwise registered as 'commercial' (for example evenings and Sundays). Hence, one might find two separate operators on the same route, both commercial and contracted, dependent on time period. It should be noted that the fuel duty rebate has been replaced in recent years by the Bus Service Operator Grant (BSOG), which to a large extent fulfils a similar role, but incorporates incentive payments for using low-carbon buses, adoption of smartcard ticketing systems, etc. It also takes different forms in Scotland and Wales.

The perceived threat of competition 'on the road', and direct competition in the case of bids for contracted services, helped to stimulate a very sharp reduction in real total cost per bus-km for the industry as a whole (including London). This had reached about 45% by 1999/2000 (on a base of 1985/86, i.e. the last full year before deregulation), explained by increased labour productivity (notably through reductions in administrative and engineering staff), some reductions in wages and working conditions, higher vehicle utilisation, and use of smaller vehicles (Heseltine & Silcock, 1990).

However, this was not translated into a corresponding reduction in costs per passenger trip in the deregulated regions, since average loads fell by a similar percentage to unit cost per bus-km. While ridership might have been expected to grow as a result of higher bus-km operated (and certainly did so in some cases such as high-frequency minibus conversion), the aggregate impact was affected by an unstable network structure, and offset by substantial real fares increases. Some of these were due to removal of high support levels in the former metropolitan counties, but also occurred in other areas – there was no aggregate effect of price competition in reducing price levels. Rising car ownership and other external factors would also have affected ridership in any case. The result was very poor average loads. The National Travel Survey (NTS) can be used to estimate changes in bus trip rates by car availability – in non-car owning households trip rate per person remained about the same (i.e. real fare and service level changes offset one another), but for those with cars available the bus trip rate fell even below that found in 1985/86 (White, 1997, Table 1).

The outcomes of direct competition on service quality, fares levels and ridership were highly variable and have been debated by many authors (see, for example: Gomez-Ibanez & Meyer, 1997; Preston, 2003). Evans (1990) and Van der Veer (2002) indicate that much competition may have taken the form of increased frequency, rather than lower fares, partly as a tactic by incumbent operators to deter entry to newcomers.

Following an intensive phase of 'on the road' competition in the late 1980s, this diminished rapidly, and in many areas is now non-existent (the main exception being Oxford). Periodic competition occurs in some areas, but is not necessarily sustained.

The reductions in unit costs, and increases in fares, enabled substantial reductions to be made in the net level of financial support received by the industry. This was most marked in London, where the drop in costs while retaining ridership enabled net support (after BSOG and concessionary fare compensation) to be virtually eliminated in 1999/2000.

1.3. The second phase of local bus deregulation

Taking 2000/01 as the base, a different overall pattern emerges. A lower rate of overall ridership decline in the industry as a whole has been observed. This was assisted by very strong growth in London offsetting decline elsewhere, and also by the extension of concessionary travel for older and disabled users. From 2001 a nationwide minimum standard of a half fare was imposed, in place of a wide range of local authority policies applying previously. Subsequently, a far more generous scheme was introduced, of free travel after the morning peak period, initially by the devolved administrations in Scotland and Wales, and then subsequently in England from 2006. This clearly stimulated ridership growth, especially in areas which had offered less generous concessions previously (notably England outwith London and the Metropolitan areas), although this effect has probably reached its full extent, and decline has resumed in recent years, notably in Wales and Scotland. Within England, London's continued growth has offset aggregate decline elsewhere such that aggregate industry ridership still rose (DfT, 2014).

[1] See DfT statistics table BUS0205b. The percentages in 2012/13 (for 'Great Britain excluding London') are 79.6% commercial and 20.4% local authority supported.