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## COMPETITION IN PUBLIC SHORT-DISTANCE AND REGIONAL PASSENGER TRANSPORT

In Austria, more than 1.5 billion passengers annually are transported by public enterprises operating at short and regional distance, about half of them by VOR, the association of public transport providers in eastern Austria. Public short-distance and regional passenger transport cost some EUR 1.9 billion in 1999, of which two thirds (EUR 1.3 billion) were financed from the federal budget. After efforts at rearrangement and regionalisation in 2000, the state and local governments have been given greater responsibility for organising and financing public passenger transport although the federal government is underwriting a financing guarantee for EUR 800 million for each of the next ten years. International examples have shown that competitive tendering can produce cost cuts, improve services and deliver a reduction in subsidies. Nevertheless, the structural and legal prerequisites to introduce such a model for public passenger transport are not yet in place in Austria.

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In a report by the European Commission in December 2001, the market performance of network industries providing services of general interest was first assessed since their liberalisation (*European Commission, 2001*). The report looks at telecoms, mail services, public overland passenger transport, electricity utilities, natural gas utilities and air transport. It concentrates on services of general economic interest ("universal services") and does not attempt to give any comprehensive evaluation of the effects of market opening in general. A key conclusion of the report is that liberalisation does not negatively impact on consumer prices and the provision of universal services in these sectors. Problems do occur in connection with the service quality, especially with regard to public short-distance and regional passenger transport. A qualitative rating based on a survey of European consumers found that public transport services ranked lowest in customer satisfaction among all sectors investigated (Table 1).

Canzler – Knie (1998) have identified three crisis situations for public passenger transport: a crisis of supply, a crisis of demand and an institutional crisis.

- The demand crisis is reflected in the low esteem suffered by public passenger transport systems, especially when compared to private motorised traffic, in spite of the efforts made to improve the situation in recent years.
- The supply crisis is the consequence of suburbanisation and the development of decentralised geographical structures. It also comes in the wake of a new sovereignty over time and the pluralisation of lifestyles, which are changing traffic habits and thus have a grave impact on the performance capacity of public passenger transport systems. The supply crisis is further aggravated by the fact that public systems are organised primarily along community social policy lines, i.e., directed at people of low mobility from socially weaker strata. Such instrumentalisation weakens profitability and gives rise to cost coverage problems for all public transport systems.
- The institutional crisis is the result of monopolies and extensive political intervention by the municipal owners of public transport services, which have contributed to the dearth of flexibility and lack of innovation.

The manifest crisis suffered by public passenger transport systems in Austria is best illuminated by the fact that they have constantly lost market share against private motorised traffic.

In many countries, public transport is a heavily state-regulated system. The state interferes not only with the type and scope of the services to be rendered but also with mar-

ket access, and prices are not determined through free competition. Enterprises act on the basis of licences and are rarely faced with direct competition. The extensive scope of state intervention is defended chiefly by arguing the existence of natural monopolies and external effects. But upon a closer look we find that the conditions of a natural monopoly apply to public transport only to a very limited extent. When it comes to exclusive bus or rail transport (at least in the more densely settled areas), it is difficult to assume declining average cost on the relevant (local/regional) market. What's more, investment in rolling stock is not associated with sunk costs, which means that the market remains open to attack<sup>1</sup>. Even if conditions of a natural monopoly were to exist, potential competitors would act as a disciplinary tool. The situation is different when companies also operate a rail network: investment into the rail infrastructure requires high capital inputs, and duplicating the networks, in contrast to telecoms, rarely makes economic sense. Fair competition will thus occur only when infrastructure and operation are separated, at least on the organisational side.

Public transport systems generate a number of positive external effects (for car drivers, employers, land owners, etc.) and they help keep private motorised traffic and its negative external effects (air pollution, noise, congestion) within bounds. So far, no successful comprehensive approach has been identified to internalise external effects in traffic through the shifting of relative prices and incentives to reduce pollution. State intervention usually concentrates on making public short-distance transport more attractive than private motorised traffic through specific, direct intervention (subsidies). This is seen to be justified and necessary not just from an ecological aspect but also for reasons of urban and regional development. Customer satisfaction is given a critical role in intermodal competition (competition between types of transport). The decision of whether to undertake a journey and by what means depends much more on the duration of the journey than on its cost, because of the low price elasticity of subsidised public transport tariffs and the mostly cost-free use of roads. Demand for public transport will thus respond strongly to any change in its quality and supply compared to that of private motorised traffic.

This insight contrasts with the fact that the financial margin of the government is currently rather limited. Aid and transfer payments will soon reach the limits of public finances, and cross-subsidies for public transport from utilities are increasingly impeded by the liberalisation of the supplier markets, and in particular the energy markets. The situation is further aggravated by the rise in social, health and education costs, and in the rising pension costs for the staff of local governments. As a result, municipal passenger transport systems are increasingly experiencing bottlenecks in their financing.

In the face of such a situation, the introduction of intramodal competition, i.e., competition between transport enterprises within the public transport system, is fraught with emotions. Its advocates expect costs to decline and the quality to improve, whereas its opponents fear that quality will deteriorate, supply will dry up, enterprises will be jeopardised in their very existence and rents will be lost. Both sides can refer to international empirical evidence. Thus, experience in the Scandinavian countries, which restructured their public transport services long ago, confirms that competition can generate cost cuts, a greater customer focus and better quality assurance management, all at the same time. In contrast, liberalisation in the UK made for an – occasionally critical – decline in quality both for railway and, in part, bus transport services. It should also be considered that wage and productivity levels differ between public and private operators and that this difference is at places substantial. Concerns on the part of employees at public operators that liberalisation might trigger cost competition that affects the workers, thus are not quite without foundation. In an open-competition situation, the higher wage level, as compared to private operators, and the well-established social standards of municipally owned operators cannot be maintained, as has been shown by recent developments in Germany.

The crucial issue with regard to the modal split (i.e., the distribution of the transport volume among transport modes) thus is: how will the introduction of competition affect supply and quality of services, and what will be the consequences for public financing? If competition has no negative effects on the supply of public transport services and at the same time reduces the aid required, then market opening should be permitted, not just

<sup>1</sup> A potential competitor could take over from established transport enterprises individual routes or the entire network. Since buses and rail vehicles are not restricted to any single route, investment in rolling stock is not lost upon leaving the market. Sunk costs certainly have to be expected, in the form of advertising expenditure or the cost of acquiring a reputation for reliability; but such costs will occur in most markets when a market is entered, so that they are not a special feature of close-range passenger transport.

for economic considerations but also and especially for ecological and social reasons. The funds thus saved could be used to improve and extend public transport services and add to their attractiveness vis-à-vis private motorised traffic.

Table 1: Rate of satisfaction of EU citizens with the quality and price of general-interest services

Evaluation by EU-15 average

		Marks
		0 . . . maximal dissatisfaction, 10 . . . maximal satisfaction
Electricity utilities	General	7.13
	Prices	5.40
Fixed-line telephony	General	6.38
	Prices	5.17
Mobile telephony	General	7.10
	Prices	5.67
Airlines	General	7.00
	Prices	5.80
International railways	General	5.90
	Prices	5.00
Urban transport	General	5.63
	Prices	5.30

Source: OPTEM (2001).

In 1991, the European Council adopted a regulation according to which the traditional universal public service obligations for urban, suburban and regional passenger transport services (operation, transport and tariffs) were to be replaced by public service contracts. Ex-post refunding of economic disadvantages arising from the public service obligations were to be substituted for ex-ante agreements between the responsible authorities and transport services which specify the services to be rendered and their financial compensation<sup>2</sup>. In its articles 92 to 94, the EC Treaty specifies in its rules on competition the conditions under which subsidies are incompatible with the Common Market: subsidies must not bias competition nor result in any impairment of trade between member states. Yet the Regulation excludes some transport services from the ban of subsidies<sup>3</sup>, for as long as they do not discriminate nor bias competition, i.e., for as long as all enterprises on the market have access to the subsidies. Subject to these conditions, the European Parliament explicitly legalised some types of aid in the transport sphere (*European Parliament, 1997*):

- payment of publicly mandated obligations, provided that such funds are granted to all comers in service-related rather than enterprise-related terms (e.g., school transport, disabled transport, cross-tariff losses in transport associations and other association-related disadvantages);
- aid to rehabilitate public enterprises (except that such aid must be limited in time and must be based on a rehabilitation concept that provides for transforming monopolies into enterprises that have a long-term prospect of competitiveness);
- compensation for the free use of infrastructure (the government may cover part or all of the cost of the infrastructure on condition that such subsidy is transparent and non-discriminatory).

With this, the future conditions of operating a public passenger transport service were put in concrete terms, yet it was not specified that such public transport service was to be exposed to competition. Already in its green paper on "The Citizen's Network" (1995), the EU Commission states that public passenger transport must take precedence over individual mass transport for environmental and socio-political reasons as well as on economic grounds, but that this market needs to be liberalised as well. It took until July 2000 for the Commission to give more weight to competition in public passenger transport. In a draft regulation to open the market for public passenger transport, provision

<sup>2</sup> Council Regulation (EEC) No. 1893/91 of 20 June 1991 amending Regulation (EEC) No. 1191/69 on action by member states concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway (OJ L 169, 29 June 1991, p. 1).

<sup>3</sup> State aid to transport companies is permitted in order to ensure sufficient transport services or in order to offer special tariffs to specific groups of users or on specific transport routes, taking into account social, environmental and zoning factors.

## The EU framework

was made to tender service licences for contract periods of not more than five years. Underlying this was the idea of "controlled competition" which provides for exclusions in terms of geography and time and which was to be the basis for improving efficiency and quality of public passenger transport. However, the European Parliament, in its first reading in November 2001, rejected the obligatory tendering procedure and raised the maximum permissible contract period to eight years for busses and 15 years for the rail. With this, it was left to the member states and their local authorities to decide on whether to consider the tendering option or continue to make use of existing structures for public passenger transport services.

Internationally, passenger transport services are increasingly awarded on a competitive basis. Two models are used: one is tendering (competition for the market), and the second is market liberalisation (competition in the market). The tendering model requires that planning and operation of public transport services be completely separated at the institutional and organisational levels. Planning and co-ordination are a public responsibility, i.e., are handled by a public or private body given proper competencies, whereas actual operation is the sphere of transport enterprises chosen by tendering. In order to ensure central co-ordination, the market is closed again after a tender since unplanned market entries will make central planning impossible. Market liberalisation, on the other hand, ultimately means that access to the market is completely opened. In both the profitable and the public service obligation sectors this applies primarily to economic barriers to market access, whereas eligibility criteria and safety provisions must still be met. In contrast to the tender model, enterprises are required not just to provide services, but must also plan and co-ordinate the supply.

Pioneers of market opening were the UK, Sweden, Denmark and France. In the UK, liberalisation outside London has reduced the public bill by about 40 percent since 1986. Yet this reduction was combined with a substantial deterioration of quality which in turn contributed to a loss of 22 percent in passenger numbers (*Austrian Court of Audit*, 2000). The tendering of London's bus services, on the other hand, cut costs and improved services: Having increased by 79 percent in real terms between 1970 and 1985, the cost per vehicle kilometre fell by 51 percent between 1985 and 2000. As by product, the service, as measured by vehicle kilometres, could be improved by 32 percent. Prior to the introduction of tendering, fares covered only 60 percent of the operating and capital costs; by 2000-01 that rate was 98 percent, even though fares had risen only slightly more than the consumer price index (+17.2 percent as against +14.9 percent; *Transport for London*, 2001).

In Sweden, all licences granted prior to 1989 were cancelled by law and services awarded by tender. The Swedish model is designed to ensure satisfactory, safe and environmentally compatible transport for the citizens and the economy at the lowest possible cost for the national economy. The contracts with enterprises have a term of three to seven years. Since 1996, the country has already tendered 75 percent of all urban, suburban and regional passenger transport services. Since the start of tendering, the supply has grown by 15 percent, annual costs have plunged and cost coverage improved from 30 percent to almost 50 percent. In the major towns, awarding by tender is already implemented on a full scale. In Stockholm, the reform was launched in the early 1990s (*Nordstrand – Kraft*, 2000). Gradual tendering drove down the cost per vehicle kilometre by 20 percent between 1991 and 1999, while improving transport performance by 15 percent and generally increasing quality. Since the early 1990s, the benefit accruing to public households has made up some € 115 million or 25 percent of original expenditure.

The development was similar in Denmark, where tendering is not obligatory but has become standard procedure. The reform of the bus system in Copenhagen was initiated in 1989 and completed in 1995. Two thirds of the bus services were tendered, some of them several times. Still, the public enterprises Combus (state-owned) and Bus Danmark (owned by the communities of the capital region) have remained market leaders, whereas private bidders obtained a market share of about 40 percent. Tendering reduced the cost per vehicle kilometre by 24 percent between 1989 and 1999, while transport performance rose by 14 percent. The savings achieved over a decade made up some € 300 million (*Cox – Duthion*, 2001).

In France, regionalisation started in the late 1960s, when local authorities took over responsibility for public transport and a local transport tax (*versement transport*) was introduced to put in place the requisite financial foundations. Since 1993, all contracts for

### International experience in competition applied to public transport

*International experience in tendering transport services is showing mostly positive effects on the quality at declining costs. In all European countries which have been organising tenders over the past years, the amount in public subsidies required has been reduced, at times remarkably. Thus, the UK, Denmark and Sweden achieved cost savings of 15 to 40 percent across longer time periods. Much of the relief effect on the budget can be obtained already with the first tender.*

public transport services have been tendered by the local authorities. Fares are set by the authorities. There is a tendency to fix annual subsidies and expenditures for the duration of a given contract, and to provide additional incentives to transport enterprises by way of bonus or penalty payments. Occasionally, a contract may include the stipulation that the new provider employ all the staff of its predecessor (Cox – Duthion, 2001).

In Germany, responsibility for public short-distance transport was transferred to the federal states and local governments, which are increasingly opting for competition. Munich has been tendering bus routes since 1996. Altogether 24 new and existing routes of 10,000 to 300,000 vehicle kilometres were awarded in this manner between 1996 and 1999 (Haller, 2000). Some of the batches were intentionally reduced in order to enable smaller-sized operators to enter the market. On average, six operators filed bids on each tender, two thirds of them new players in the market. Of the awards, 80 percent were to new bidders. According to a cost/benefit analysis based on 14 routes, some 10 to 40 percent of the costs could be cut. Even though 107 percent of the original performance were tendered in a defined quality, costs were reduced by a total of 26 percent.

Switzerland similarly started on its own reforms of regional passenger transport in 1996, concentrating on regionalisation (i.e., transferring competencies to the cantons) and introducing the purchasing principle. The cantons can tender operation of individual (bus or rail) routes. Since 1997, public contributions to the Swiss National Railways SBB are shrinking even though regional transport services are constantly extended. From 1993 to 1999, subsidies to SBB were reduced by 23 percent, from SFR 725 million to SFR 558 million (LITRA, 2000).

Table 2: Performance indices for cities which have controlled competition in bus transport

	Observation period <sup>1</sup>	Tendering intensity <sup>2</sup> In percent	Total expenditure, real	Service level (vehicle kilometres) Percentage change over the observation period	Real unit costs <sup>3</sup>	Productivity <sup>4</sup> Average year-to-year percentage change	
London	1985 to 1999	100	- 34.9	+ 32.2	- 50.8	+103.1	+ 4.8
Copenhagen	1989 to 1999	100	- 13.5	+ 14.4	- 24.4	+ 32.2	+ 2.8
Stockholm	1991 to 1999	100	- 7.1	+ 16.1	- 20.0	+ 25.0	+ 2.8
Munich	1996 to 1999	11	- 26.0	+ 7.0	-	+ 44.6	+ 9.8
Las Vegas	1992 to 1993	100	+128.5	+242.6	- 33.3	+ 49.9	+ 49.9
San Diego	1979 to 2000	43	+ 2.7	+ 46.6	- 29.9	+ 42.7	+ 1.7
Denver	1988 to 1999	22	+ 12.9	+ 31.8	- 14.3	+ 16.7	+ 16.7

Source: Cox – Duthion (2001). – <sup>1</sup> Since the start of tendering. – <sup>2</sup> 1999 or 2000. – <sup>3</sup> Deflated expenditure per vehicle kilometre. – <sup>4</sup> Vehicle kilometre per real unit of expenditure.

From past and current experience it can be said that tendering produces better results than either market liberalisation or state provision of public transport. Complete market opening may produce lower prices but it frequently means deteriorating service quality, so that public transport loses market share to private motorised passenger traffic. Tendering, on the other hand, generates much more demand for public transport than a closed market (Figure 1).

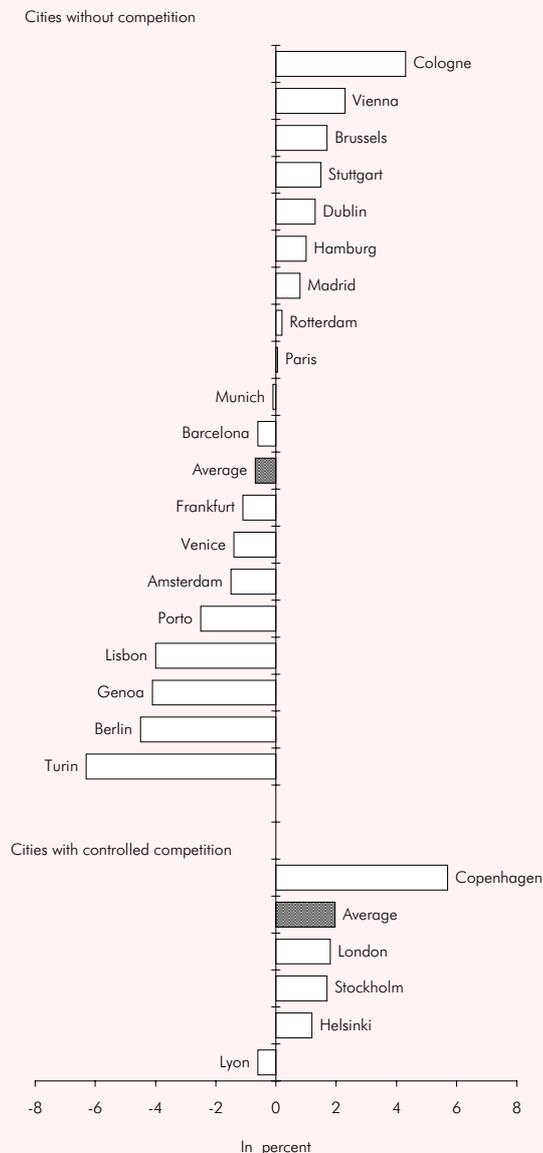
The latest study by Cox – Duthion (2001) furthermore demonstrates that urban bus enterprises operating on deregulated markets on average offer at lower costs than enterprises operating in more strictly controlled markets. Compared to the situation prior to market opening, all cities studied that were characterised by controlled competition showed clear productivity gains (Table 2). What's more, where controlled competition prevailed, the volume of subsidies required plummeted (Table 2).

Even though international experience with the use of competition in public transport has been generally good so far, it is nevertheless necessary to point out some of its dangers – mainly the quality issue and the market concentration processes.

**Problems of  
(tendering) competition  
in public transport**

Figure 1: Utilisation of buses and urban rail systems in major EU cities

Average year-to-year percentage changes in the 1990s



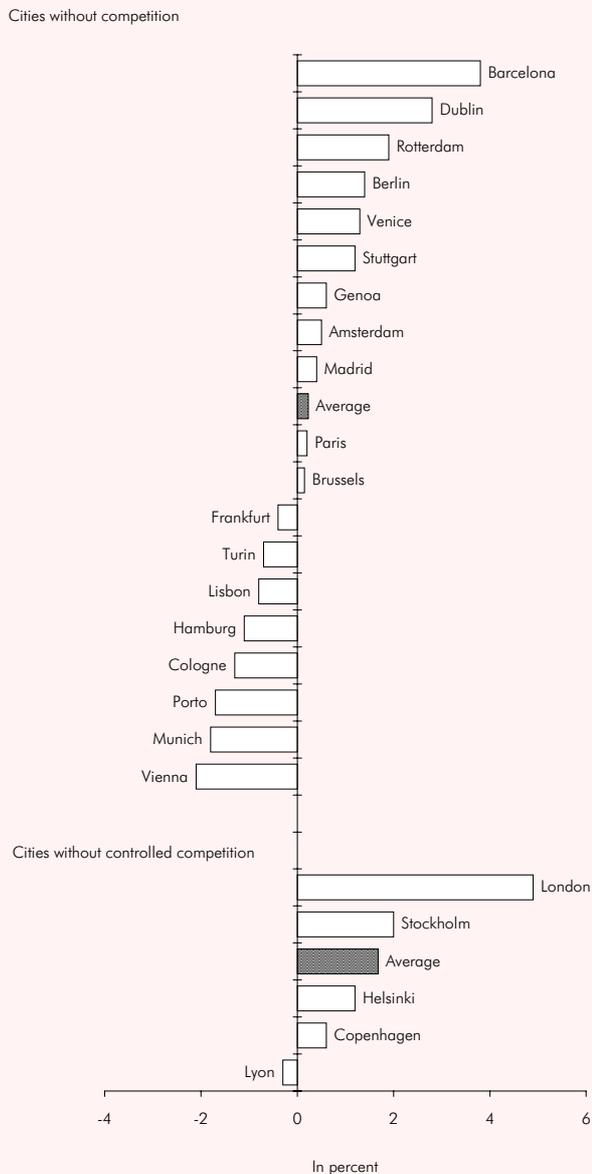
Source: EU Commission, Energy and Transport General Directorate, 4<sup>th</sup> Framework – Transport RTD – PETS (Pricing European Transport Services) project.

In the UK, complete market opening outside London resulted in a flood of acquisitions and mergers. At present, the four main operators make up more than 60 percent of market sales (Andersen, 2000). Similarly, in Denmark and Sweden the number of operators shrunk substantially in the course of tendering. The number of Danish bus operators was halved in ten years, from 400 to 200. Sweden is dominated by three major companies (Swebus, Linjebus, Busslink) which cover more than 50 percent of overall public bus transports. After several years of liberalisation, only very minor operators can survive against their big competitors, while the number of medium-sized companies is virtually negligible. Seen from a tendering point of view, this constitutes a problem since an adequate number of bidders is required in order to obtain satisfactory results. Consequently, some countries have already made efforts to counter the trend towards oligopolies and monopolies through the type of tendering used (e.g., splitting awards into smaller batches). Such a procedure, however, has problems of its own, since insufficiently large batches may lead to substantial losses in terms of economies of scale and economies of scope. It will therefore be necessary to extend the role of merger controls

also to the liberalised public transport, in order to ensure effective competition between transport operators.

Figure 2: Coverage of operational expenses by fares, major EU cities

Average year-to-year percentage changes in the 1990s



Source: EU Commission, Energy and Transport General Directorate, 4<sup>th</sup> Framework – Transport RTD – PETS (Pricing European Transport Services) project.

Whether or not a public transport system is attractive compared to private motorised transport will largely depend on the quality of the service. Quality in this connection comprises all aspects of travelling comfort, personal and operational safety, system access and environmental impacts (*European Commission, 1996, p. 14*). Encompassing the range of quality dimensions in the design of a tender may thus generate weighty practical problems.

Presently, two different tendering philosophies are facing each other in Europe (VCO, 2001): In the Scandinavian countries, the quotations to be filed are defined down to the minutest detail. With performance and quality requirements exactly stipulated, competition concentrates on price. In France, on the other hand, enterprises are requested not only to state prices, but, even more importantly, to furnish concepts. Here, the focus of

competition is on quality. Both approaches have their pros and cons. The French model is more encouraging to innovation, but requires higher planning and supervisory costs.

Yet both types of tenders are faced with the problem of how agreements with the licensed operator can be enforced (Borrmann, 1999). The tendering authority needs to be able to check the performance quality actually offered, so that it can provide evidence and impose a penalty in the event of an infringement of quality requirements. Such a task may at times be difficult, as has been demonstrated by some private railway lines in the UK. When the public transport system in Stockholm was first liberalised it similarly encountered problems chiefly in terms of quality and lack of customer focus. The gross expenditure contracts<sup>4</sup> offered until 1998 held no incentives for enterprises to commit themselves to improving quality and customer frequency. The new tendering model no longer insists on the cheapest bid, but includes (soft) quality factors in the evaluation. Such a procedure, albeit translating into higher regulation costs, is applied ever more frequently, also in other countries, in order to solve the quality problem (Nordstrand – Kraft, 2000).

In Austria, local public passenger transport is handled by a great number of public and private enterprises. The larger towns and cities have organised their own municipal transport utilities. Numerous private bus providers and a few private railways supply local services, as do the Austrian Federal Railways ÖBB (mostly by metropolitan railways). At a regional level, transport services are supplied within the scope of so-called Verkehrsverbünde, transport associations which are responsible for conceptual planning and controlling co-operation between the transport enterprises involved and the territorial authorities that provide the financing. Presently, twelve associations have been established, which cover all of the territory of Austria<sup>5</sup>.

Altogether the Austrian system transported some 1.5 billion passengers in 1998, of which fully 990 million transports were by urban systems. The largest share is contributed by streetcars in Vienna (including underground lines), Graz, Linz, Innsbruck and Gmunden, which handled 46.2 percent. Regular and regional buses operated by ÖBB, the Postal Service, municipal enterprises and private operators transported 37.8 percent of the passengers. ÖBB railways took 10.2 percent, the 18 private railway operators managed 1.1 percent of passengers. Trolley busses in Salzburg, Innsbruck, Linz and the Mürz valley supplied 4.6 percent.

Verkehrsbund Ost-Region (VOR), the largest transport association which includes Vienna as well as parts of Lower Austria and Burgenland, transports some 764 million passengers per year, more than half of all the passengers handled by Austrian public transport systems. By far the largest share is made up by the Vienna system, which covers 704 million passengers or almost 47 percent of all transports (passengers) performed by the public short-distance and regional passenger transport system in Austria.

Transport services rendered by the public short-distance and regional passenger transport system are financed from public funds and fare revenues. The cost-cover percentage achieved by the sale of tickets varies between regions and depends on a number of factors. ÖBB records 30 to 40 percent in cost coverage (Draxler, 1995), whereas the Vienna lines manage 50 percent (Mayr, 1995)<sup>6</sup>. At a total cost of public transport in Austria of € 1.93 billion in 1999, this translated as € 1.3 billion charged to the public households (VCÖ, 2001). Cost coverage from fare revenues and from the state-financed transport of pupils and students thus makes up just 33 percent in terms of the entire public passenger transport system. The largest chunk of public funds is derived from the federal government (€ 836 million), whereas local governments contribute € 429 million and state governments pay € 49 million.

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## Public short-distance and regional passenger transport in Austria

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### Structure and financing

<sup>4</sup> According to such gross expenditure contracts, the operator is paid for the service rendered. Net expenditure contracts, on the other hand, provide for the operator to retain the revenues from operations (and a contractually agreed subsidy) in return for carrying the risk associated with transport. In both cases, premium payments and the threat of penalties may act as incentives to comply with quality standards.

<sup>5</sup> The first such association was Verkehrsbund Ost-Region (VOR) launched on 3 June 1984; the latest is Verkehrsbund Steiermark, started on 1 March 1997. Lower Austria is covered by four associations.

<sup>6</sup> This relatively high rate for Vienna is, however, achieved by the fact that the Vienna lines pay very low fees to use the underground infrastructure. If the cost for the infrastructure were included, the rate of cost coverage would be significantly lower.

Table 3: Enterprises and transport modes of Austrian public short-distance and regional passenger transport systems

1998	In million	Persons transported	Percentage shares
<i>Enterprises</i>			
Vienna lines	704.2		46.8
ÖBB – railways	154.1		10.2
Post – buses	150.0		10.0
ÖBB – buses	93.6		6.2
GVB Grazer Verkehrsbetriebe	92.6		6.2
ESG Verkehrsbetriebe Linz	84.0		5.6
RegionalBus (VOR)	49.7		3.3
Innsbrucker Verkehrsbetriebe	45.4		3.0
Private railways	17.0		1.1
Other commercial and bus operators	113.0		7.5
<b>Total</b>	<b>1,503.6</b>		<b>100.0</b>
<i>Transport modes</i>			
Streetcar, underground	694.6		46.2
Regular buses	569.1		37.8
Railways	171.1		11.4
Trolley bus lines	68.8		4.6
<b>Total</b>	<b>1,503.6</b>		<b>100.0</b>

Source: Railway statistics (1998-99), annual reports published by transport associations and operators.

Table 4: Public financing of public short-distance and regional passenger transport in Austria

1998	Million €
<i>Federal expenditure</i>	
Public-benefit services by ÖBB	819.3
Federal contribution to the underground	457.8
Investment subsidies for private railways	109.0
Transport associations	30.9
Payments within the scope of the revenue sharing act	47.8
Free transport of pupils, students and apprentices	146.2
Subsidies for the transport of pupils, students and apprentices	279.4
	3.4
<b>Expenditure by states and local governments</b>	<b>478.0</b>
<b>Total payments from public sources</b>	<b>1,297.3</b>

Source: Stubenböck (1999), VCÖ (2001).

Faced with the situation that public passenger transport found itself in the late 1990s, and with the requirements posed by the EU, it had become necessary to reform both the structure and the financing of the system. Up till then, the system had been financed without any legal underpinnings and on a voluntary basis, and not all the transfer payments were transparent (financing types abound, including cross-subsidies). What was lacking – and was demanded by the EU – was clear-cut and economically sensible division between those that commission services and those that provide them (Draxler, 1995). As a result, incentives to improve the modal split were inadequate and the use of finances was inefficient, while the financial margin available to public households was indubitably contracting (Austrian Court of Audit, 2000).

Consequently, a set of comprehensive reforms was introduced, which comprised an amendment of the Act governing regular bus and coach services (KfIG 1999), of the Act governing public short-distance and regional passenger transport (ÖPNRV-G 1999) and the Act regulating the rail transport market (1 January 2000)<sup>7</sup>. The keystone to the re-

<sup>7</sup> Federal Act governing public short-distance and regional passenger transport (ÖPNRV-G), Federal Law Gazette I No. 204/1999; Federal Act governing motorised passenger transport on regular lines (KfIG), Federal Law Gazette I No. 203/1999.

form is the ÖPNRV-G, which has the express purpose of securing and improving public passenger transport in the long term by the proper and sensible use of funds and with due regard to competitive elements. This objective is to be achieved by restructuring the transport associations in legal and organisational terms, assigning new tasks and responsibilities to them, and by introducing the buyer principle for transport services rendered not for profit but on a public service obligation basis.

At its core, the reform distinguishes between transport associations (i.e., transport enterprises co-operating with each other) and organisations uniting transport associations under their umbrella (Verkehrsverbundorganisationsgesellschaften, VOG). Within the frame of associations, enterprises can be assigned responsibilities such as transport planning on an entrepreneurial basis, management of timetables, enterprise-specific marketing and sales activities, ensuring transparency of services and their financial foundations in the transport association, and transparency in the appropriation of funds expended by the buyers.

Transport planning continues to be in the sphere of the territorial authorities. They are supported by the VOGs which must be created for each of the territories of the transport associations, independently of co-operation between transport enterprises. The VOGs are also charged with identifying a frame for standard fares, co-ordinating the purchase of transport services, monitoring observance of quality criteria and of compliance with service contracts, carrying out association-specific marketing and sales activities and supplying association-specific customer information. In addition, they may also act as arbitration and clearing boards for settling and allocating profits between transport enterprises and, if necessary, for settling intra-enterprise fare revenues and other revenues on behalf of the transport companies.

The VOGs thus are charged both with regulatory functions (quality assurance, ensuring contract compliance, determining the common fares), and with co-ordinating, mediating and consulting functions (co-ordination of services; handling of transport service contracts, purchasing and tendering for the territorial authorities; preparation of proposals for short-distance and regional transport planning). However, the VOGs are not the ultimate unit of responsibility within the meaning of EU law, with the exception of demand-oriented transport services in the regular bus and coach field (§ 10 (2) of the Revenue Sharing Act FAG).

The authorities actually responsible for adequate public transport coverage are the territorial authorities. They have the exclusive right to purchase, but they can impose planning and implementation responsibilities on the VOGs. The regular bus and coach services are the responsibility of the state and local government, whereas the federal government is in charge of the basic rail transport services. Contracts on rail passenger transport services which reach beyond the basic services<sup>8</sup> are in the sphere of the state and local governments, which are also responsible for planning demand-oriented transport services (reducing, extending or shifting transport services).

With these regulations, the ÖPNRV-G responded to the demand to regionalise purchasing and financing as a prerequisite for the efficient use of funds.

In its regionalisation approach, the ÖPNRV-G thus combined responsibilities for services and expenditures in a single unit in the form of the territorial authorities. As of this Act, the federal government is financing the basic rail services, but is not obligated to refinance and index those funds which are made available for basic coverage by the states based on contracts signed prior to the entry into force of the ÖPNRV-G. The federal government will provide a guarantee of € 800 million per year annually for ten years (up to 2010), as a financing contribution to short-distance transport. If and when the state and local governments want to increase services, the federal government will in its turn contribute up to € 62.5 million annually, provided that the buyers cover up to 50 percent of the costs. In addition, the communities have been granted the right to levy an earmarked "short-distance transport charge" from transport generators (e.g., shopping centres).

*The structural reform initiated in 1999 has been a first step towards more efficient use of funds in the Austrian public transport system. As a key element of this reform, procurement and financing of transport services have been shifted to the regional level. In transferring responsibility for services and expenditure to territorial authorities, cost consciousness is to be improved and the supply of transport services better adjusted to demand.*

<sup>8</sup> Section 7 of the ÖPNRV-G defines as "basic services" the services ordered or rendered in the timetable year of 1999-2000.

## Potential for competition

*Even in the wake of structural reform there is still little potential for competition in short-distance and regional passenger transport in Austria. The organisational framework specified in the ÖPNRV-G leads to conflicts of interest in the territorial authorities due to their double function of purchaser and owner. Such a situation precludes any fair and non-discriminatory tendering. Moreover, the definition of profitability of public enterprises, which is very wide at present, screens large parts of the transport services from competitive tendering.*

As provided by EU regulations, both the ÖPNRV-G and the KfIG distinguish between profitable public transport (pursued to ensure continued existence or viability) and transport on a public-benefit basis (serving the commonweal, i.e., pursued to improve social and economic conditions and not to maximise profits). Regular transport on a profitable (market-initiated) basis is financed by fare revenues and statutory compensation payments which do not bias competition. The distinction between profitable and public-benefit transport is essential for assessing the competitive potential of public short-distance and regional passenger transport. Once a transport service is recognised as being of public benefit, it may be tendered, whereas no such procedure is currently envisaged for profitable transport services. As a result, enterprises see an incentive to declare their transport services as being of the profitable public enterprise type, in order to evade a possible future need of tendering.

Under the ÖPNRV-G, public-benefit services are defined as services which cannot fully cover their costs from fare revenues and which need for their continued existence additional financing from territorial authorities or third parties (ÖPNRV-G, § 3 (3)). Profitable transport services, on the other hand, are services which fully and exclusively cover their costs from fare revenues. These include fare compensation payments within the scope of a transport association (financing contributions by the territorial authorities or third parties to compensate for losses from special fares for special users), or compensation for fares granted on the basis of other contracts (e.g., compensation for free travelling by pupils or students under the Family Burden Equalisation Act FLAG; ÖPNRV-G, § 3 (2)).

The issue here is to identify those transport services which fall under the public benefit label, considering that almost all payments granted by the government are deemed to be fare revenues and are thus seen as constituting the status of profitability. What is problematic is not so much the assignment to fare revenues but the resulting definition of profitability. This definition does not take into account that transport enterprises may have different efficiencies and may thus render identical services at different costs (Puwien, 2000). With no competitive pressure present, there is thus no incentive whatsoever for enterprises of profitability status to improve their efficiency. The tendering option applies only when a transport enterprise is unable to operate "profitably" in spite of payments and compensations received from the government or third parties and thus would withdraw from the market. In actual practice, tendering will be reduced to additional transport services which an existing licensee is not (or no longer) willing to offer. In all other cases, competition is de facto excluded by this definition.

What's more, there are further reasons why potential competition is limited by the current legal situation. According to the comments to ÖPNRV-G, the VOGs are intended to act as bodies neutral vis-à-vis competitors and enterprises and independently of the collaboration between transport enterprises. Yet at the same time they have been assigned responsibilities which throw up serious problems in terms of competition:

- The VOGs are to carry out tenders on behalf of territorial authorities (Section 18 (1) 9). The award is decided by the territorial authorities, which, however, usually double as the owners of transport enterprises – a situation that may obviously cause conflicts of interest due to their double functions as buyers and owners. With this, a crucial prerequisite for unbiased competition is absent. For the same reason, it is problematic from a competitive point of view when local governments are represented as shareholders in the VOGs<sup>9</sup>.
- More evidence for the lack of independence characterising these bodies is the assignment of special tasks. The VOGs may undertake to carry out, against a fee, tasks which initially were supposed to be handled by the transport enterprises themselves (Section 18 (1) 6). Furthermore it is questionable whether the exercise of association-specific marketing and sales activities (Section 18 (1) 4) is a task that can properly be undertaken by an independent regulation body.

Some problems also arise from co-operative ventures between transport enterprises as provided for in Section 16 of the ÖPNRV-G. These might be abused to ensure co-ordinated behaviour of the enterprises involved and to set up barriers against market entry. Whether the design given to the associations will enable non-discriminatory award of transport services under such conditions remains open.

<sup>9</sup> Section 17 (2) 1. The subsequent item 2 provides that the VOGs may alternatively be established as companies in which neither the territorial authorities in their capacity of buyers of transport enterprises nor transport enterprises are represented as shareholders. Yet it cannot be expected that local governments will voluntarily abstain from exercising this influence.

Considering the above, there are definitely extremely narrow limits to the potential for competition in the Austrian short-distance and regional passenger transport at present. Even if a narrower definition of profitability were to increase tendering, organisational provisions and the assignment of tasks might stand against ensuring fair competition. The question thus is whether the competitive potential was kept low intentionally because of doubts that competition would work in public transport or whether other reasons applied.

Internationally, competitive tendering has proved to produce quite satisfactory results, with – at parts – significant potentials to reduce costs (see above). This is not astonishing from an economic theory point of view. Rendering public transport services is not necessarily disconnected from cost-coverage for reasons of market failure, but because their provision is tied to ecological, social, regional policy and urban planning goals. Offering public transport services solely on the basis of rentability would considerably reduce its scope from the level existing today. But if we want to offer an extensive and attractive supply at the best possible costs, then it is necessary to eliminate the structural disincentives of the current system. Provided that the infrastructure is supplied or financed by the body commissioning the service, little or no sunk costs will arise from rendering transport services, and functioning competition between operators may release potentials to reduce costs (Borrmann, 1995). The remaining scope of market failure (quality, information and co-ordination problems) may be accounted for by the fact that the market is not fully opened but that competition is "controlled" by tendering. Provided that there is a sufficient number of serious bidders, the competitive dynamism thus initiated will reduce costs.

Nevertheless, the European Commission was unable to gain ground for its proposal to introduce obligatory tendering for public-benefit transport services. Based on the subsidiarity principle, the European Parliament voted for national exemptions from the competitive principle. This outcome, however, was due less to serious doubt of whether competitive tendering would work and more to the successful lobbying of well-organised economic groups (Elsenbast, 2001). Since most municipal transport enterprises will be unable to avoid losses in the medium term if competition is introduced, their lobbies have a marked incentive to reason for competitive restrictions by using commonweal arguments. Particularly in municipal economy sectors which are highly sensitive when it comes to securing supply, and with regard to which the citizens have little experience of alternative supply regimes, this line of argument should continue to be successful. It can thus be assumed that politicians, among other groups, may at times fail to properly assess the opportunity costs of such decisions.

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### *Competition in Public Short-distance and Regional Passenger Transport – Summary*

Of all the network-bound sectors of the economy, it is public short-distance and regional passenger transport which gets the worst ratings in the view of European consumers. Satisfaction is markedly better with regard to markets that have already been liberalised, such as telecoms, electricity utilities and air traffic. For Austrian public short-distance and regional passenger transport, customer satisfaction is still relatively high compared to international levels. And taking the modal split as a basis, public carriers still carry considerable weight (when seen against international rates), transporting, as they do, more than 40 percent of passengers in the Vienna area. Nevertheless, over the past years public short-distance and regional passenger transport has lost substantial ground to private motorised traffic. In spite of heavy subsidising, especially of the rail, shifts to public passenger transport, an objective that is desirable in both traffic and environmental terms, have been minor at best.

The attractiveness of public short-distance and regional passenger transport depends not just on its funding but also on the incentives in connection with its structure and financing. At present, public short-distance and regional passenger transport costs some € 2 billion per year. Of this sum, two thirds are financed from public funds, much of it from the federal government, which has provided a financing guarantee of € 800 million p.a. for another decade. The restructuring and regionalisation effort started in 1999 will certainly improve cost awareness, but it still provides no sufficient basis to ensure the efficient use of funds in public short-distance and regional passenger transport. In addition to regionalising order processes and awarding greater financial responsibility to the ordering agencies, an important step to improve financial efficiency is tendering. Numerous international models have established that efficient tendering can substantially reduce the level of subsidies while maintaining the quality of service in public short-distance and regional passenger transport. The funds thus saved could be used to add to the service and improve the attractiveness of public passenger transport vis-à-vis private traffic.

However, the statutory prerequisites to ensure effective tendering have not yet been introduced in Austria. The definition of profitability of public enterprises, which is very wide at present, screens large parts of the transport services from competitive tendering, and within the boundaries of profitability there are few incentives to improve cost efficiency. A further impediment to fair and non-discriminatory competitive tendering is raised by the organisational framework specified in the Act governing public short-distance and regional passenger transport.