Only Great Britain has chosen for a regime that is almost entirely based on competitive tendering in the rail sector. After its introduction passenger numbers gradually rose to an all-time maximum and from a burden to the public purse the sum of all franchises can now be provided with almost no subsidy. Despite this, the McNulty study published in 2011 by the British government and Rail Regulator found the network as a whole (i.e. including the infrastructure) to be inefficient with costs 30% in excess of its peers, with misalignment of incentives between players as a main cause after the vertical separation introduced in the 1990s. Alliancing between infrastructure management and train operations was suggested (and is currently tried) as a way to solve part of these problems; tendering of vertically integrated franchises was suggested but not tried yet (see also the article by Prof. Nash in this Observer).

No other country has chosen to introduce a similar regime. Those that have introduced competitive tendering in their railway sector have done so on regional routes (often branch lines) or local services on the main network, and did this in rather small contracts compared to the British practice. This is best exemplified by Sweden, Germany and the Netherlands. Efficiency gains of around 20% are often reported, as are innovations: new rolling stock, higher frequencies, more attractive services, better integration with local and regional public transport services, etcetera.

Thorough studies reviewing these practices remain scarce, and in depth European comparisons close to nonexistent. Nevertheless, the measures included in the 4th Railway Package suggested by the EC ask for tendering all PSO services, together with open access on commercially viable services. This is backed by an impact assessment report, the quality of which has been criticized. The Impact Assessment Unit of the European Parliament even writes (May 2013): “Assumed impacts of the different options are well illustrated and described, but the reasoning as to why these impacts occur as a result of a specific policy does not appear to be based on facts, academic literature or existing evidence.” So is this policy dogmatic and unfounded? Several remarks should be made to inform the debate.

Competitive tendering outside the UK often came with decentralising services from national to regional tiers of government who took this opportunity to force new operators to provide service characteristics that incumbent state monopolists often were reluctant to provide, or could not fund without added public money. Note that in many cases regional authorities even chose to bear themselves the revenue risk of those services. Many observed innovations are therefore the direct result of shifts towards more voluntaristic regional rail policies focussing on expansion, improvement and better integration with local public transport as input to – and not as outcome of – competitive tendering.

The competitive nature of tendering did indeed lead to efficiency improvements in productive terms: higher staff and rolling stock productivity, new maintenance practices, etc., even though this was to some extent the result of the possibility (or even obligation) given to winning operators to adopt simplified working practices (such as using no conductor in the Dutch case). However, note also the cost increases observed in Great-Britain.

As passenger transport services are characterised by strong consumer side network effects, splitting large networks into smaller tendered parts will therefore require coordination. Balancing contract size, operator freedom and central planning will therefore be a challenging task when continuing on the tendering path. The danger is that the desired-for entrepreneurial freedom of the operator gets – paradoxically – replaced by a large share of central planning.

Finally, the growing discussion and growing body of evidence showing that vertical separation might increase costs due to incentive misalignments (McNulty study), in particular under high-density traffic (EVES-Rail study) is also important. While the EC takes the position...
that vertical separation is necessary to guarantee fair competition and that competition is necessary to guarantee customer focus and market innovation. Practice shows that tendering can be large and growing even in the absence of full vertical separation (Germany). Therefore, a growingly relevant question is whether over the longer run vertical separation could be a costly obstacle to sector-wide optimisation. Shake-ups and management reforms of old railways were long overdue but the resulting performance improvements – often attributed to vertical separation – may well have been realised under different institutional configurations. Inspiration from the long-term system-wide (train/infrastructure) optimisation commonly realised by the Japanese private and vertically integrated railways could usefully be taken here and one desirable step in that direction would be to implement cases of vertically integrated franchises to see how that model could combine benefits from competition with those from vertical integration.

**Competition – a goal in itself or a strategy for efficiency?**

It was generally well received that the discussion on the 4th Railway Package has moved from a rather ideological approach to a more constructive approach. In the current discussion, at least at this 9th Florence Rail Forum, there is a clear focus on the cost of the rail system. One of the central statements was that competition or any governance approach in itself does not have a purpose if it leads to an increase of the overall cost of the rail system. One very concrete example that was given refers to the provision of separating IT systems between operator and infrastructure manager where there may be less costly alternatives to the current approach: instead of forcing rail companies to invest several hundred millions for the set-up of new IT systems the same goal can be achieved with an audit and corresponding penalties in cases of noncompliance.

There are different opinions on the effect of market elements in the rail system as also divergent experiences were made in different countries. It was pointed out that stakeholders need to accept that competition is the chosen strategy to achieve efficiency in the EU – even though it is not excluded that efficiency can be achieved by other means as well. It was clear that there are many instances that question any direct relation between open markets and cost savings. Yet the focus of European Rail policy lies on addressing the inconsistencies yet sticking to making use of competition as an instrument to achieve efficiency.

**Liberalization of national passenger markets – which way forward for competitive lines and PSO?**

In the discussion about the effects of competition - both on open access lines and for contracts in PSOs in competitive tendering procedures - many references were made to the British example and what conclusions to draw from it. Britain was described as “15 years ahead” with reforms the EU is currently advocating. In this regard the McNulty report was often referenced. One suggestion was that there has to be a different view on railway governance as a whole. Given the high costs of the system in Britain today, what is needed is better coordination. Access charges alone are not sufficient as an instrument for coordination. Also the coordination that can be achieved through non-binding mechanisms does not extend beyond issues that involve the allocation of funds. It was concluded by some that, in order to achieve such coordination, integration between operator and infrastructure manager was needed – in spite of this being in contradiction to the principle of vertical separation.

It became clear that the relationship between competition, on the one hand, and overall network coordination, on the other, is especially acute in densely used networks and in smaller countries. As regards the question of whether Member States shall be allowed to contract entire networks or whether a certain minimum amount of contracts shall be
mandatory, the Commission acknowledges the risk of fragmentation in smaller networks. A compromise could be to allow a differentiation depending on the size of the network.

Tendering of PSOs
An important aspect of the discussion was the role of markets in PSOs. While there is general agreement on introducing competitive tendering, different views were expressed on the how and why. For instance, direct award should be limited to exceptional situations, and on this point the Parliament’s amendments were considered as too permissive. However, another opinion expressed was that the competence to decide whether or not to impose a PSO has to remain with the local transport authority: even in cases of commercially attractive lines a city or a region should have the possibility to offer more or better services than the market would provide on its own. It became clear that there was some opposition to the new definition of Public Transport Authorities (PTAs), which some consider as too narrow. A possible outcome may be that the current definition will not be changed. There was a general agreement on the question whether mandatory tendering would bring down costs. Many cases spoke in favor of the assumption that the process of tendering would reduce costs and thus the burden for the tax payer. Yet also several caveats to this assumption were presented. Competition may sometimes come at a price that is higher than the actual cost savings achieved by it. While in many ways unique, the British case illustrates this problem as in spite of a relatively smoothly working system of tendering overall system costs are too high.

Level playing field and legacy costs
It was stressed by some operators that fair conditions were needed not just for new entrants but also for incumbent operators. It was pointed out that incumbent operators, unlike new entrants, are burdened with significant legacy costs. It was pointed out that with their current debt resulting from retirement schemes and employee friendly work time arrangements, several operators are not able to compete with companies that do not face such costs. There were different views and different experiences on that issue. In some countries such as GB the winner of a competitive tender takes over the operating company including its staff, so the age of staff and pensions cost are not an issue in the competition. However, it was also stressed that in other cases tenders were frequently won by the companies with the youngest workforce as they could offer the lowest wage costs. To date there are no uniform rules on the obligations of a new operators vis-à-vis their predecessors. The availability of rolling stock was mentioned as one of the biggest remaining issues.

Competitive pressure is however an important driver for change and can facilitate a process of making the railway companies more efficient. However, it was recalled that railways are very different from other industries. Because of its nature, the principle of “creative destruction” where new and agile companies replace old incumbent inefficient ones, does not apply to railways: size and age can be a good thing in railways also from an efficiency perspective. This is why it is necessary to help the change process of the incumbent operators before introducing competition.

Public Transport Plans and Network Statements
Some concerns were raised over the level of detail and prescriptiveness required of Public Transport Plans and Network Statements. Yet from the Commission side it is clear that the plans serve as a means to address the crucial issue of gradually defining common rules for the imposition of PSOs.

Also, the importance of introducing more reliability of financing was stressed from several sides. The Network Statement should clarify what kind of major disruptions will impact the network over the upcoming five years. Such information is needed by all operators to make business decisions. Many believed that the way this is managed in Great Britain is exemplary.