

Public Policy versus Competition

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Abstract

New Zealand introduced competition for urban passenger transport services on 1 July 1991. The planning, funding, and administration authorities — regional councils — have applied public policy initiatives within the competitive process. This paper examines the experience of the Wellington Regional Council. It identifies the policy initiatives (preference for electric modes, quality requirements, preference for existing operators) and examines how these initiatives have influenced competition. It concludes that strong public policy initiatives are necessary to achieve strategic transport outcomes and they do not, necessarily, negate competitive expectations.

Introduction

The planning, administration, operation, and funding of public passenger transport in New Zealand was reformed on 1 July 1991. This reform process and the financial and operational changes that have already occurred have been documented by other authors and presented to conferences and seminars around the world. However, to fully understand the viewpoint expressed in this paper, it will be necessary to provide a partial description of the New Zealand public transport planning and administrative structure. Indeed, further administrative reforms were introduced on 1 July 1992, the consequences of which are only now being digested. These reforms may not be so widely known.

The Administrative Structure

There are three tiers of government in New Zealand, National, Regional, and Territorial. Regional and Territorial governments have separate and distinct tasks. There are also unitary authorities that have both regional and territorial responsibilities. Territorial government is not beholden to Regional government. For public transport, the following tasks are undertaken by each government agency -

National	setting of safety standards licensing funding from national sources legislation national policy directions
Regional	service planning registration of individual services contracting policies on service levels, fares, and standards local funding sources infrastructure funding
Territorial	traffic management public transport infrastructure provision

The Policy Overview

National government has provided a set of transport policy objectives. These are set out in a document entitled "Transport Directions 1991-1996."¹ The key policies of relevance to public transport are:

- Public transport policies will be developed to ensure that both private and public urban transport system planning is integrated for maximum efficiency to include all aspects of the transport system including roads, parking, and public transport. The aim will be to ensure that in major cities, public transport can operate with the greatest efficiency possible.
- Wherever possible, policies will be developed to ensure that the costs of environmental externalities created by the transport system - such as air, water, and noise pollution - are incorporated in the cost structures of the appropriate operating sector. In this way, operators will make decisions on patterns of operation that reflect the best interests of the whole community.
- Policies will be developed to encourage local authorities to favor public transport through disincentives on the use of private vehicles in circumstances where urban roads are becoming clogged with traffic.
- Wherever possible, transport users who are identified as needing some assistance to gain access to transport systems should be directly helped with targeted financial assistance.

Legislation introduced in 1992 requires Regional Councils to prepare and promote regional land transport strategies² that will be implemented on a day-by-day basis by themselves and territorial authorities through an annual program of specific projects. Regional Councils also have to have a Regional Passenger Transport Plan that provides policy details on fares, ticketing, service levels, and routes. Some of the strategies and specific policies that are contained in these documents are:

- The main urban passenger rail lines should continue to be used.
- No extra peak hour road capacity to be added.
- Electric modes of public transport should be favored.
- All day parking to be discouraged in main urban centers.
- All public transport vehicles should comply with pre-defined quality standards.
- Existing operators on a route should be given preference over new operators.

Public Transport Service Delivery

Public transport services are provided by bus and rail companies. Territorial authorities may own bus companies, however, most authorities have sold their interests in such companies. NZ Rail Ltd, owned by the government, is also soon to be sold into private ownership. Providers of public transport services either operate commercial services where the revenue income covers the operating cost or tender for non-commercial services that Regional Councils ask to be provided. The administrative system used by regional councils in the tendering process is laid down by the governments transport funding agency, Transit New Zealand. These procedures are called the TNZ Competitive Pricing Procedures.³ They are designed to encourage and promote competition.

Public Policy Versus Competition

It is not the intention of this paper to justify the specific public transport policies applying in the Wellington Region. These policies are the result of a structural analysis of options and the direct involvement of public opinion. They express the regional communities vision of their future. What the paper will attempt to do is to describe the application of these policies within the competitive environment established by TNZ's CPP's and hopefully demonstrate that their implementation has not unduly influenced the efficiency and effectiveness of that competitive environment but has, indeed, ensured the deliverance of the communities desires in the most cost effective way.

The Public Policy Intervention Issues

Some commentators would suggest that any form of public policy intervention in a competitive market will by definition distort that market and hence be sub-optimal. However, it can also be argued that if a specific outcome is desire by a community, that outcome cannot be guaranteed by competition alone. In the Wellington Region and no doubt elsewhere, there are a number of key community outcomes that have a unique character, and it is these that the rest of the paper will focus on as case studies of intervention versus competition. These issues are:

- (a) Community preference for electric modes of passenger transport.
- (b) Desire for vehicle qualities greater than the minimum set nationally for safety reasons.
- (c) A bias towards existing operators.

Though the community desires these interventions they are generally aligned to the achievement of overall national and regional objectives — in particular, an improvement in air and noise pollution and the promotion of public transport use over private vehicle use. The pure economists approach would be to tackle these issues through pricing so as to modify behavior. Vehicles emitting air or noise pollution would be asked to pay for the privilege. They might also suggest that quality public transport services would attract patronage off services of lesser quality and, hence, public policy intervention was unnecessary. Regional government has no powers to tax polluters, and the quality of transport services has declined to unacceptable levels since competition began.

Case Studies

Electric modes

There are three electric modes of public transport in Wellington: trolley buses, electric urban rail, and a cable car. The trolley bus network provides partial coverage of Wellington City and, in particular, is available in the central business district along several of the main commuter routes. The urban electric rail system has three commuter lines that provide fast links between the major population centers of the region and the Wellington CBD. The cable car is a vehicular counterweight system that connects the Wellington CBD to one hill top suburb.

The approaches adopted by the Regional Council to ensure the ongoing operation of all these three electric modes have similarities but also unique features. The overall standard approach will first be described and then the unique features will be presented.

The cost of providing a public transport mode has three basic components: the fixed assets, the variable

assets, and the operation costs. For a traditional bus service, the fixed assets could be the roadway; the variable assets, the number of buses used on the service; and the operational costs, drivers wages and other costs. The fixed asset is owned by the local authority, the variable asset might be owned by a bus leasing company, and the operational element provided by a facilities management company. The approach to providing this bus service at least cost might involve financial arrangements between these parties and the Regional Council through competitive pricing or negotiation. Applying this concept to the three electric modes, there are three different outcomes.

(a) Trolley Bus Services

In Wellington City trolley bus services operate alongside diesel bus services, as the trolley overhead wiring network does not fully cover every suburb of the city. The trolley buses are owned by Stagecoach Wellington, a private company. Stagecoach are also the main diesel bus operator. Generally speaking, direct competition on price between diesel and trolley buses would result in diesel only services, as the overall operating costs of trolley buses is consistently greater than diesel. Analysis of the costs of both types of service indicated that a close approximation of the difference in costs was the cost of provision and maintenance of the overhead wiring system (5).

To ensure that trolley bus services had a fighting chance to survive in the competitive environment was, therefore, to remove the cost of the overhead wiring system from the balance sheet of the owner of the trolley buses. The overhead wiring system became an asset of a company established by Wellington City Council. (It should be noted that the Regional Council is legislatively barred from owning any public transport asset). This provided an added bonus. It was inconceivable that another trolley bus company would emerge. But if one did, rather than having to provide their own overhead wiring and hence creating a duplicate system with probably unsurmountable engineering problems whenever the two systems crossed, there would be one wiring system available to any trolley bus operator. The only complication would relate to the distribution of the cost of electric power. Only one company currently operates trolley buses, though enquiries have been made by others.

The Regional Council contracts with the City Council for the provision of the overhead wiring system. The City Council competitively tenders the maintenance of the system. The Regional Council tenders bus services in Wellington. Operators tender trolley runs or diesel runs and the lowest tender is accepted. Removal of the overhead wiring costs from the operator of trolley buses also enabled that operator to commercially register some of his trolley services. These commercial services are protected by the Regional Council from other commercial competition on environmental grounds.

The trolley overhead wires are maintained in an "as good as" state. No funding is provided for depreciation. Additions to the system are funded as one-off costs and then maintained to the same high standard. The company that owns the asset is not a company that makes a financial return on the asset. This way the Regional Council is paying the minimum possible to fund trolley bus services.

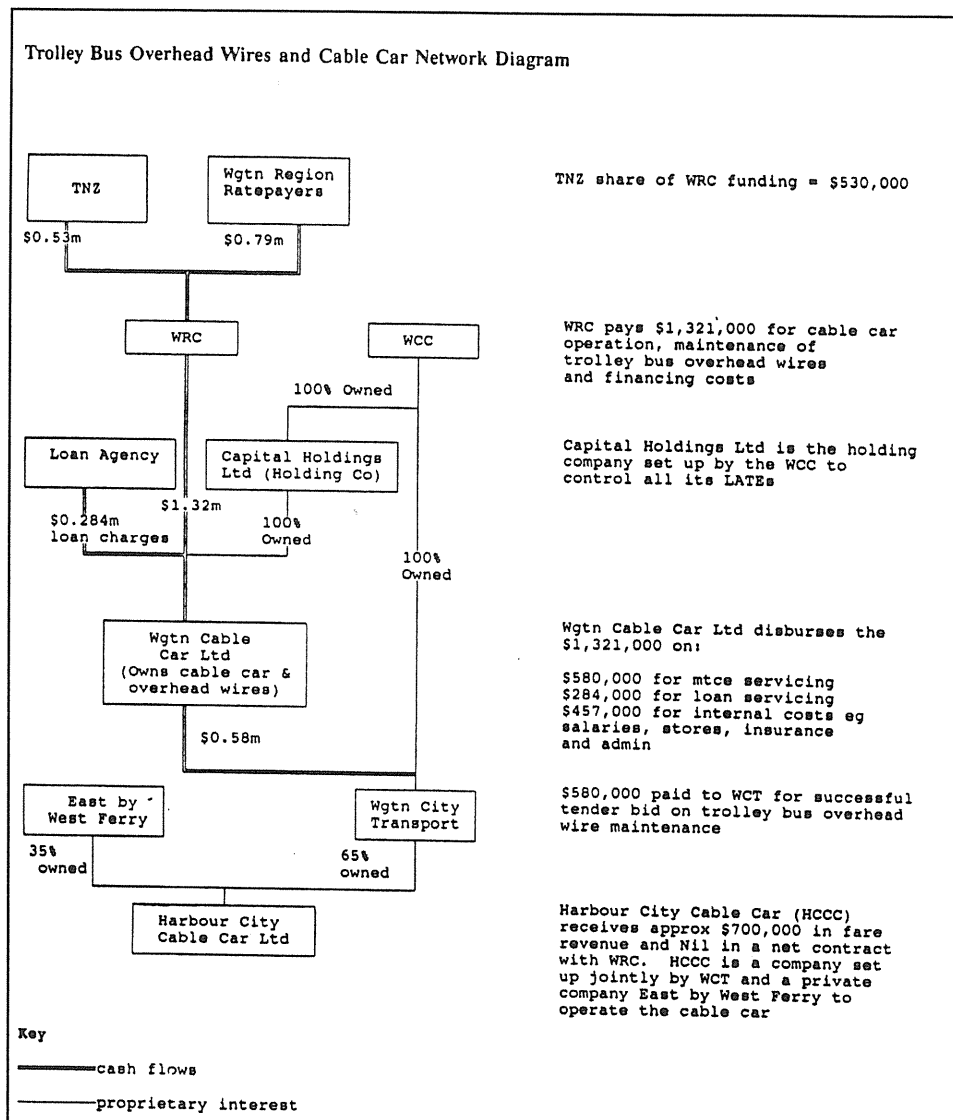
(b) Cable car

The Regional Council determined that the unique character of the "one and only one" cable car must be retained and refused to tender point to point services on the cable car route, because it was unlikely that the cable car would be the lower tender. Having decided that the cable car service would continue, a similar process to the trolley bus case was undertaken.

The same Wellington City asset owning company became the owner of the cable car, the tracks, the tunnels, the winding machinery, and the stations. This company is called the Wellington Cable Car

Company Ltd, even though it also owns the trolley overhead wiring. This company, again, is responsible for tendering out the maintenance of the facility. The difference between the cable car and the overhead wires is that the company also tenders the operation of the assets. In this case, it is possible to have a negative tender with the tenderer paying the cable car company for the privilege of maintaining and operating because the revenue from the operation belongs to them. The current cable car operator won the tender for a nil price. The company is called the Harbour Capital Cable Car Company. It is 25 percent owned by a harbor ferry company and 75 percent owned by the City bus company.

Figure 1



The main bus company in Wellington is, as has been stated before, now owned by Stagecoach. Prior to privatization, it was wholly owned by Wellington City Council. The relationship between the Regional Council, the City Council, the bus operator, the company owning the assets, and the companies maintaining and operating the assets particularly so intrigued the Transit New Zealand auditors that they felt it necessary to describe the linkage in detail in their audit report on the Regional Councils ... handling of the public transport tendering process.⁴ (See Figure 1.)

(c) The Urban Rail Service

NZ Rail Ltd that provide urban rail services also operate inter-city passenger services, carry freight and provide a passenger and freight sea link between the country's two islands. NZ Rail Ltd is owned by the NZ Government. It has recently been put up for private sale.

In the first year of the deregulated competitive system, it had been intended that rail services should be subject to direct unfettered competition. Arguments put forward by the Regional Council and Rail that this would inevitably lead to the demise of urban rail was finally accepted by Transit New Zealand and in the first year NZ Rail were provided with an infrastructure payment (similar in concept to the trolley bus overhead wire costs being separated out) that enabled a substantial number of urban rail services to be registered commercially. The remaining services, mainly weekend and evening, were then tendered. NZ Rail won all they tendered for, which suggested that the infrastructure payment was larger than necessary to provide a true competitive environment.

This current year Transit New Zealand has deemed that because the Regional Council, for strategic reasons, wants to continue with urban rail services and only one provider of such services currently exists, then the Council can negotiate for these services but must impose competitive pricing principles wherever possible in that negotiation.

The Regional Council had reached the point whereby it intended to have three separate contracts for urban rail. The first contract would be for the fixed assets (track, stations, etc.) and, because of the 30 to 50 year life of these assets, expected to negotiate a contract of up to 10 years. The second contract would be for the variable assets (rolling stock) and the third for the management, maintenance, and operation of those assets. This process would expose NZ Rail to the competitive environment. Circumstances, however, overtook the negotiation process. The decision to sell NZ Rail Ltd changed the rules, and, as a consequence, these three contracts have not proceeded.

Vehicle Quality

The competitive pricing procedures used in New Zealand allow the tendering authority to pre-specify non-mandatory factors that if provided by a tendering will be accounted for in the tender evaluation by not awarding the contract to the lowest tenderer if the public benefit of the non-mandatory additions is greater than the cost difference between tenders. This ability has led some tendering authorities, for example, to give a cost premium for a whole range of non-mandatory attributes. A problem with this process is pre-determining the public benefit of these attributes, as they have to be described as a percentage of the tender price. If the tendering authority places a high value on the attribute then they will be provided, but the tendering authority will be paying more than is necessary for them. If the tendering authority places a low value on them, then they are unlikely to be provided. It appears impossible to hit the precise neutral spot on the scale.

The Wellington Region has argued that if the community value certain attributes then they should be provided at the lowest cost possible. Also the New Zealand experience with tendering of rural school bus services has shown that vehicle standards have declined rapidly because of low tender prices. (The nation's school children are now transported in vehicles that are of a standard less than the vehicles used to transport valuable live stock or even tins of beans). Other experiences of competitive tendering in the public transport industry have seen vehicle standards decline and vehicle builders go out of business.

A set of vehicle quality standards has been devised that promotes a vehicle profile for any bus company and incorporates a full range of vehicle attributes including age, floor height, door width, grab rails, bell-pushes, and so on.⁵ These vehicle standards are being applied progressively over a five year period so as not to deter any operator from adhering to them. All the region's operators fulfil the first year requirements but some will need to make investments in future years. Clearly, all operators will need to maintain a quality fleet to remain within the standards once the full implications of those standards are implemented in the fifth year. (A copy of the standards is attached).

The Regional Council believes that this approach to Vehicle Quality provides the best and cheapest solution to maintaining standards. Firstly, public transport users behavior is known to be directly influenced by vehicle quality, hence the need to ensure good quality.⁶ Lowest price tendering creates a poor quality environment. It is difficult to measure the public good associated with quality. But if quality standards are mandatory, the competitive process will deliver those standards at the lowest price.

The vehicle quality standards produced by the Council evolved from a series of meetings with all operators and a group of users. Other regions and operators are now considering implementing similar standards.

Existing Operator Bias

The competitive process with lowest price wins can produce situations where the existing provider, often of long standing, is undercut by a competitor and loses the business. This is of course the expected outcome at some point and, hence, the desirable outcome if competitive pricing is to produce cost efficiencies. The more desirable outcome would be for the existing operator to retain the business but at the lowest price. This way, the user of the service is not disrupted and maintains faith in the service because of the security of continuity, and the funder achieves a reduction in costs.

The process in the Wellington Region has been that an existing operator losing business on price will respond by commercially registering the service. After a time, they will de-register their commercial service and hope to bid successfully at the next tender round. They hope to drive away the competition during this process so that eventually they are the only or the lowest bidder. Income lost during the period of commercial registration is recouped later through higher tender prices resulting from reduced competition.

A more logical approach from the tendering authority is to recognize that a competent existing operator carries with them a measure of public good will. This good will has a cost that should be seen as a public good and allowed for as a tender evaluation factor. A competent existing operator's loss of a tender results in the loss of the goodwill, which rebounds as a community cost, directly or indirectly. Measuring the value of the good will element is of course difficult. Obviously it is greater than a few dollars and very similar tender prices can be judged accordingly. The Wellington Region has yet to determine how far it is prepared to pay over the lowest price to retain that good will but is working on it.

Conclusion

Urban passenger transport is a shaper of urban communities. Urban passenger transport, its availability, its quality and its price has a part to play in determining the quality of life. Politicians have the ability to express community values through their visions of tomorrow's urban form, and their transport policies are an important part of these visions. Implementation of political requirements through a completely free market is unobtainable. Strict regulation, however, inevitably results in cost escalation. Achieving political aspirations through a competitive process is possible as long as a clear statement of the political vision is available and competitive principles are applied to ensuring the provision of that vision. The Wellington experience of this approach endorses that view. Public transport services have been retained at their same level or more, with the same quality features, at the same fare levels for the last two years at a 25 percent reduction in price.

End Notes

1. Transport Directions - New Zealand Ministry of Transport.
2. Beyond 2000 Proposed Transport Policy - Wellington Regional Council. and Draft Regional Land Transport Strategy - Wellington Regional Council.
3. Cost of Trolley Bus Services - Steer Davies and Gleave (NZ) Ltd.
4. Audit Report Public Passenger Transport Wellington Regional Council - Transit New Zealand.
5. Vehicle Quality Standards For Urban Services - Wellington Regional Council.
6. The Effect of Quality Improvements in Public Transport - Steer Davies and Gleave (NZ) Ltd.