

RUNNING BUSES

WHO KNOWS BEST WHAT PASSENGERS WANT?

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Adam Smith
I N S T I T U T E

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Published in 2003 by ASI(Research) Ltd, 23 Great Smith Street London SW1

Printed in England by Imediaprint Ltd

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ISBN 1-902737-43-1

Executive summary

The bus and coach industry in Britain today is under pressure for greater intervention by local government (including the Passenger Transport Authorities in the great conurbations). It is a reasonably profitable industry, effective at its best in marketing management, though with some failings, not least when compared with the retail companies.

Few informed observers today seek to return to the state of affairs that existed before the regulatory reform and privatisation that followed from the Transport Act of 1985. However, much of the current debate on transport is being led by public authorities who find re-regulation appealing, and who want to see the close political control and heavy public subsidy in London extended to the rest of the country.

At the international level too, the European Commission has produced a Draft Regulation which, under the proposed European Constitution, would override British legislation and give powers to ‘competent authorities’ to intervene “to pursue legitimate public service objectives within a framework of regulated competition”. This reflects the pattern to be found in most continental countries, where bus services are provided in accordance with the requirements of officialdom, leaving entrepreneurs little freedom to grow the market.

As a result of the one-sided nature of the debate, there is a growing pressure for bus operations to be provided within a form of franchise. But it is a form of franchise that is far removed from the familiar High-Street (‘ethical’) franchises that we all see very commonly in the retail and catering trades.

For example, statutory powers already exist for voluntary ‘Quality Partnerships’ between operators and authorities, and beyond that for the imposition of ‘Quality Contracts’ that would inevitably move the situation closer to the European model.

But a move in this direction would decidedly *not* provide the bus services that customers are seeking. The commercial freedom of bus and coach operators must be upheld, since they are far better placed to understand and satisfy local demand, and to grow the market, than any form of government or quasi-government authority. The industry is profitable, and since privatisation it has become increasingly market-led, with the leading companies noted for considerable achievements in promoting customer satisfaction. It is high time that public awareness of these issues was bolstered, and that there should be a genuine public debate, rather than a slow slide into a system which will not actually deliver what the public want.

1 Buses in Britain

The industry today

The road passenger transport industry is very diverse. There are bus services, and trams (which are now known as Light Rail); there are coach services linking the principal towns and cities and serving the airports; and there is what may be called ‘the coaching trade’, offering vehicles for hire, education and works contract services, and a range of excursions to various attractions. (Many of the smaller coaching firms also provide local bus services, some under local-government contract, but few of the larger bus companies enter the coaching trade). In this paper we shall be concerned with the provision of public transport by regular bus and coach services.

Ownership of the industry is almost entirely in the private sector, and the 18 companies owned by unitary authorities¹ are required to operate commercially. There are nine ownership groups,² of which seven are public limited companies, most of which have other interests, such as railway franchises, or overseas investments. Some of these, and in particular those which have remained private companies, are among the most progressive and customer-oriented businesses in the industry. Alongside these there many small firms providing bus services, with or without coaching interests as well. The long-distance services in England and Wales are largely the preserve of National Express and Scottish Citylink Coaches, each of which contract with smaller firms on a semi-franchise system for the actual provision of their services.

The Transport Act 1985 returned the industry to a contestable market, subject of course to safety regulation. Bus and coach firms must hold an Operator’s Licence,³ under which they have to register their services with the regional Traffic Commissioners, and to notify them of closures and major alterations, but there is no control of charging. Long-distance services have been subject to no such measures since 1980; and private hire was never controlled. Local authorities of various kinds have powers to provide ‘socially necessary’ bus services, usually by a process of tender, but they are constrained by limited available finance. The exception to this is the situation in London, where bus services since 1984 have been provided according to the specifications of what is now Transport for London (TfL), in a form of franchise that is far removed from the kind that is common in the High Street retail and catering trades, and

¹ Namely Blackburn, Blackpool, Bournemouth, Cardiff, Chester, Eastbourne, Halton, Ipswich, Islwyn, Lothian, Newport, Nottingham, Plymouth, Preston, Reading, Rossendale, Thamesdown (Swindon) and Warrington.

² They are Arriva PLC, Blazefield Holdings Ltd., Firstgroup PLC, The Go-ahead Group PLC, National Express Group PLC, Southern Vectis PLC, Stagecoach Group PLC, Traction Group Ltd., and Wellglade Ltd. Some smaller companies have recently been floated on the Alternative Investment Market.

³ The ‘O-Licence’ sets safety standards and specifies the number of vehicles permitted to the operator. It also requires the employment of a manager who holds a valid Certificate of Professional Competence. It complies with the requirement of the European Commission.

under which the company managers have virtually no freedom for any marketing decisions.⁴

As early as 1916 the fledgling bus industry started to develop a series of mutual boundary agreements between the major companies, and the regional pattern reappeared after the privatisation of the industry under the Transport Act 1985. Mergers between the major operational groups are now unlikely to be accepted by the Competition Commission, and early examples of anti-competitive behaviour have not generally been repeated.

The regional Traffic Commissioners have powers to ensure safety, and may restrict the number of vehicles permitted by the Operator's Licence, or suspend the licence and put the firm out of business. Penalties for late running have been imposed increasingly on bus companies, with no attention being paid to the many occasions when lateness has been due to traffic congestion which is beyond the operator's control.

We have thus an industry which is reasonably profitable and mostly market-driven, though dependent upon subsidy in London and over much of the countryside. (The extent to which subsidised rural bus services carry a great deal of fresh air is, as we shall see, a severe criticism of current government policy there). But the public image of the industry is not high. The marketing management displayed by many if not most of the operational bus companies, large or small, compares badly with the retail and catering industries, though there are, of course, some notable exceptions.⁵ And the middle classes began to desert the buses as car ownership grew from the 1950s. Yet buses and coaches carry five billion passengers each year, compared with two billion carried by rail (train journeys are generally over longer distances than trips by bus).

The political image of the industry is another matter, as we shall see in Section 4, with increasing pressure for its return to public control. Light Rapid Transit has been claimed to be the way to attract passengers back from their cars, but the systems constructed so far in Britain, at heavy public cost, have not been notably successful. They currently account for less than one percent of the total distance travelled by bus and rail.

The outcome of reform

The Transport Act of 1985 was a deliberate attempt to free the bus and coach industry from burdensome controls, bureaucratic management, and over-dependency on local authority subsidies and other political interference. The Act of 1980 had freed the express coach sector from route licensing, and had removed price control from all bus and coach services, although the largely state-owned companies made little use of this freedom. The 1985 Act is often seen

⁴ For a more extensive analysis of the London system see *Don't Stop The Bus* by John Hibbs, ASI, 1999.

⁵ Recent examples include Trent Barton's *Rainbow 5* route into Nottingham, re-launched for the fourth time and achieving an eight percent growth in passenger numbers over the previous year; Cardiff Bus, which carried an extra 1.5 million passengers in 2002/2003, an increase of more than six percent over the previous year, following a four year investment programme; and Stagecoach South Midlands has seen a 40 percent growth on one of its services after introducing new low-floor buses and doubling the frequency.

as providing for ‘deregulation and privatisation’, but it is better described as intending economic and regulatory reform, since in some ways the regulatory structure became more intrusive. Nevertheless, the benefits that have flowed from the liberalisation of the bus industry (outside London) since then have been considerable. Bus services in many places run much closer to people’s homes than they used to, and urban services have greater frequency, while many new routes have been served, that had been neglected under the old regime. Public subsidy has been greatly reduced, and while fares have risen, many smaller firms offer lower prices, which must be welcome for passengers with lower incomes.

It is true that in some places, poor marketing has led to public confusion as to where and when the buses run, while some local authorities have made it difficult for operators to display their publicity. Terminal facilities and shelters are generally the responsibility of local government, and only with the development of quality partnerships (see Section 4) has there been any serious co-operation between councils and bus companies on such facilities. (Privatisation seems initially to have led many highway authorities to withdraw from their responsibilities).

The bus industry before 1985 was marked by a general policy of managed decline, while statutory control of charging had encouraged managers to compare average revenue with average cost, which led to continuous withdrawal of mileage, much of which had in fact contributed to net revenue; while the use of price as part of marketing management was not allowed. Most companies today aim to grow their market, seeking to provide the mix of price and quality that maximises customer satisfaction. Only London operators are denied the freedom to pursue this policy objective themselves.

Box 1: Inclusion, intervention, and inefficiency

The present government has raised the issue of how far people in certain communities are prevented from seeking the satisfactions available to the better-off. To begin with they were said to suffer from social *exclusion*, but, perhaps because this might be seen as condescending, the term has been revised so as to seek greater social *inclusion*.

The issue is not new (see Box 3), but its implications for public transport are seen by some to justify intervention in the market, whether by regulation or subsidy. However, the impact of such policies on allocative efficiency must be open to question.

The extent of competition in the market is limited, and varies from place to place. The major groups, as we have seen, are headed by public limited companies with interests in rail as well as road transport, and in a number of cases with overseas interests of the same kind. Some of them also operate light rapid transit systems as agents for the local authorities that have invested in them. We have already seen that further territorial mergers are unlikely, but the extent to which the PLCs delegate management successfully to their subsidiaries varies. An early period of management and employee buyouts ended as the new shareholders took their profits and sold out, but there are examples of smaller firms going for growth and challenging

the local ‘established operator’. Smaller entrepreneurs and family businesses trade at the margins, ensuring that larger companies cannot neglect the market, and many offer lower fares to passengers in the poorer parts of the cities – a market response that helps deliver the ‘social inclusion’ agenda (see Box 1) without the need for political intervention.

There have also been examples among the larger businesses of moves towards market segmentation, with fares that differ according to the choice of vehicle and prices directed at students. It seems most unlikely that public ownership or control would permit such departures from standard charging.

The government’s ten-year transport plan, intended to achieve the shift in favour of public transport outlined in the 1999 transport White Paper, introduced the key and too often meaningless term *integration* once more onto the public agenda. In its second annual assessment of the success (or otherwise) of the ten-year plan the Commission for Integrated Transport calls for the public transport industry to support the Secretary of State for Transport, Alistair Darling, as he moves to a more anti-car position, including his advocacy of nationwide road-use pricing (see Section 5). In all this the question of “Who knows best what the consumer wants?” remains mired in a marsh of political contradictions. For example, we certainly need greater evidence of the costs and benefits of giving on-street advantages to buses, a policy that provokes furious objections from motorists and shopkeepers.

2 The European model

The new EC Regulation

Three years ago the Commission of the European Communities (EC) published a draft proposal for a Regulation of the European Parliament and of the Council “on action by Member States concerning public service requirements and the award of public service contracts in passenger transport by rail, road and inland waterway”.⁶ Article 1 makes its objective plain when it says “The Regulation introduces and confirms the principle that competent authorities should normally pursue legitimate public service objectives within a framework of regulated competition”. Article 4 then says “In applying this Regulation, competent authorities shall ensure adequate passenger transport services that are of high quality and availability, by concluding public service contracts . . . or by laying down minimum criteria for public transport operation . . .” Surely no-one should expect anything less of Brussels, but why just for public transport? Why not for service in supermarkets, or for motor repair and maintenance?

Box 2: A straightjacket of regulation and control

Article 43, Clause 2 states that “In assessing the adequacy of public passenger services, defining selection and award criteria, and awarding public service contracts, competent authorities shall take into account at least the following criteria:

- consumer protection factors including the accessibility of services in terms of their frequency, speed, punctuality, reliability, the extent of the network and the service information that is provided;
- the level of tariffs for different groups of users and the transparency of tariffs;
- integration between different transport services, including integration of information, ticketing, timetables, consumer rights and the use of interchanges;
- accessibility for people with reduced mobility;
- environmental factors, including local, national and international standards for the emission of air pollutants, noise and global warming gases;
- the balanced development of regions;
- transport needs of people living in less densely populated areas;
- passenger health and safety;
- the qualifications of staff; and
- how complaints are handled, disputes between passengers and operators are resolved and redress is made for service shortfalls”.

⁶ COM(2000) 7 PROVISIONAL, 2000/0212 (COD)

Clearly the key word here is *adequate*, and Article 43, Clause 2 sets out what the Commission expects (see Box 2). If managers have got to spend so much time satisfying the ‘competent authority’, they are going to have little time to get on with their job. The paperwork alone that must arise from administering these criteria could only divert managers’ attention from the objectives of a company seeking to find and satisfy customers, while the cost burden on the ‘competent authority’ would fall on taxation, national or local. Article 6 requires competitive tendering for the award of contracts; but what market-driven manager of the high level of competence to be found in the British transport industry today would want to work within a straitjacket such as this? And the clauses that follow contain still more bureaucratic detail, for page after page. The cost of all this, in the time required of both managerial and local authority staff, would be huge; while the impact on fares (short of heavy subsidy such as may be acceptable in other European countries) must be a matter for serious concern.

Box 3: Marketing or control: how best to help those who need it?

British local authorities have for many years arranged for pensioners and others to be offered lower prices for travel by bus. The cost is reimbursed to the operator, after making allowance for the growth of travel that is induced. The generosity of these schemes has varied from place to place, but they require expensive regulatory control, especially in London.

This is in marked contrast to the long-standing practice of railway management, where marketing is directed to certain classes of customer by providing ‘railcards’ which give reduced fares to senior citizens and also to family groups and to students, in order to attract increased demand, and no public subsidy is required.

The implications for pricing, which we have seen to be one area of serious weakness under the former UK regulatory system, are worrying too. Pricing decisions are central to marketing management; a manager who cannot set the price of the product, and adapt it to different circumstances, has lost control of a fundamental part of business decision-making. Any price control imposed by a ‘competent authority’ must damage the marketing efficiency of the industry, and can lead only to a waste of resources. Yet price control is tempting for politicians, who see it as a way to buy votes. The problem is well illustrated by the controversy concerning reduced fares (even ‘fares-free’ travel) for pensioners and the disabled (see Box 3).

The true nature of the Commission proposal appears in Article 6, Clause 3, which says “Contracts shall be limited in time. They shall last no longer than five years (except in special circumstances)”. What this implies is something very similar to the franchises which govern the UK train operating companies (TOCs) in their relationship with the Strategic Rail Authority (SRA), and to the system of bus regulation in London – which as we shall see is very different from the ‘High Street’ (or ‘ethical’) franchises that are to be found in the retail and catering trades. There is growing pressure for the introduction of London-style franchise over the remainder of the country (see Section 4), and no doubt the proposed EC Regulation

would be welcomed by the ‘competent authorities’ concerned. Regulations are usually directly applicable in all member states without the need for further action.

What does it all mean?

Constitutionally, as a ‘legal instrument’, it should be noted that the proposal is for a *Regulation* rather than a Directive. Its effect is limited almost entirely to the way public authorities conduct themselves, leaving little power in the hands of central government.

If the government concludes that the existing powers of the appropriate local authorities and Passenger Transport Executives are sufficient to apply the Regulation, there would still remain the matter of price control, which could only be applied by the enforcement of Quality Contracts, a form of franchise, which were provided for by the Transport Act 2000.

Essentially the scheme is a basis for franchise, which we shall analyse in Section 4. It appears to incorporate the various forms of public control over commercial bus companies that are found in other European countries (see Section 3). It would fit well into the view of bus services that pervades in local government, and especially in the Passenger Transport Authorities (see Box 4). And it will be applicable to the United Kingdom with no further argument, as well as being legitimised in the proposed European Constitution.

Box 4: Officials, not markets: the Passenger Transport Authorities

The Transport Act 1968 set up Passenger Transport Authorities in four conurbations, each with a Passenger Transport Executive to operate bus services; which had powers of compulsory purchase; and to which the municipal transport fleets were transferred. They were made up of members appointed by the local authorities in their areas, with additional direct appointments made by central government. (The original proposal had been for them to be ‘co-ordinating authorities’, with no operating powers).

The Metropolitan Counties created in 1972 were also designated as Passenger Transport Authorities, increasing their number to six (Greater Glasgow, now Strathclyde, was given similar powers), but the appointed members disappeared.

Since then the Authorities have become increasingly political, with Labour majorities existing in each example today. They have sought to develop Light Rapid Transit, although such heavy investment has proved far from successful financially.

3 In Europe today

Attitudes to efficiency

What might be called a ‘cultural fault line’ exists between the UK and continental Europe. It contrasts the thought of Locke with that of Descartes, and is reflected in the difference between the Common Law and the French-style Civil Code. With regard to road transport, the Common Law approach regards regulation as necessary for public safety, but leaves the initiative to provide services up to the market, whereas the Civil Code approach provides the argument for franchise.⁷ The Regulation proposed by the Economic Commission for the EU seeks to extend this ‘Cartesian’ approach to the United Kingdom.

While the European model allows for the existence of profit-seeking bus companies, there is an underlying assumption, derived from the civil code, that they are to be allowed to exploit what is properly to be regarded as a function of the state, or the municipality. (As we shall see in Section 4, this thought is implicit in the pressure for franchise that is appearing from the Passenger Transport Authorities). But there is a deeper significance implicit in the European model, in that it would seem to ignore the concept of competition leading to economic efficiency (and specifically allocative efficiency), in a contestable market. And when we examine the model further, there is the inescapable assumption that the state – or the ‘competent authority’ – is assumed to know best what it is that customers want from the provision of services. This in turn leads to the practice of setting prices by decree, instead of leaving them to respond to market demand, leading in turn to the need for subsidy and yet further political intervention.

Subsidy in itself distorts the efficiency of an industry, but the problem goes further. The commercial organisation that provides the services required by a ‘competent authority’ becomes more or less a creature of that authority. Where the terms of the contract provide for the authority to cover all the operator’s costs (a so-called *gross contract*), it becomes impossible to measure the economic outcome of the expenditure, and the provision of services becomes a political rather than a marketing activity. Where, as in some European countries, the system is defended in terms of social inclusion (see Box 1), the political objectives may well make such measurement even more unattainable.

Freedom of enterprise

When we examine the place of the entrepreneur in the bus industry in European countries we find little to compare with the situation in the United Kingdom, itself today under threat. ‘Gross bus contracts’ are common, and the significance of the EC Proposed Regulation

⁷ For a fuller analysis, see *Regulation – An international study of bus and coach licensing*; John Hibbs, Transport Publishing Projects, 1985.

becomes apparent in the widespread practice of calling for tenders. Though there are variations, the Civil Code approach prevails, as the following examples show.

- In **Denmark**, bus services in Copenhagen are all tendered on gross contracts, and the terms of contract are highly prescriptive, as they are in London. There are Passenger Transport Authorities for each county, and services are mostly tendered on gross contract.
- Services in **Sweden** are largely tendered, and contracts are performance related. However, problems have arisen where contract prices have been set that conflict with national levels of inflation.
- **Norway** is moving to tenders, with a move to sell public undertakings to private enterprise.
- Policy in **The Netherlands** is moving to regional responsibility, intended to be completed by 2007, with combined road and rail contracts designed to improve connections. Privatisation of public undertakings is not popular in the cities.
- **Belgium** has a closed system, with public agencies permitted to offer concessions to smaller firms.
- The situation in **Germany** is complex. There are contracts offered to private firms, but the financial aspect may not be sustainable; while there is no Federal policy, the privatisation of the public utilities – gas, electricity and water – has ended the practice of cross-subsidising public transport from their profits. Some tendering exists, but there are serious financial problems.
- **Austria** largely follows German practice.
- **France** is committed to tendering, with proposals for ‘network management’ by tender. There is more risk for the operators than elsewhere, and there is a move away from gross tendering which would lead to more risk-bearing by the operator.
- In **Italy** the regions are responsible, and services are all tendered.
- **Portugal** retains a route-licensing system, not unlike that which was ended in the United Kingdom by the 1985 Transport Act. There are many small firms outside the cities.
- The situation in **Spain** is not dissimilar, with consortiums of private firms found in certain cities.

Among these countries there are various systems for the renewal of contracts by tender, and these may lead to problems where the incumbent operator’s tender is not accepted. Where the terms of the contract are changed – for example, if a higher standard of vehicle is required – there may be serious problems for the incumbent, whose assets may lose value without the prospect of compensation.

Summary: private provision, public control

Throughout Europe, there is an underlying assumption that the shape of transport services should be specified by the political authorities, but that private enterprise can actually deliver those services more cheaply. Thus a municipal bus undertaking may be offered for sale on the argument that the purchaser will be more ‘efficient’ than the public authority, though the monopoly will still exist. However, such private monopolies are in no sense entrepreneurs,

and owe their existence to the power of the political authorities, rather any understanding of what users really want, or ability to deliver it.

Also, the extent to which operating costs are financed by subsidies and grants is a significant factor in some of the countries we have been examining. Within the United Kingdom, subsidy is largely provided by way of reduced fares for pensioners and others, and for the provision of ‘socially necessary services’, so that the commercial companies remain free from top-down control of their business. In other European countries there is a greater tendency for the companies to be subject to bureaucratic decisions as to what services they provide, where and when, and at what price.

Sources of revenue by country (late 1990s)

Country	Subsidies/ Grants	Fares etc
Austria	30%	70%
United Kingdom	32%	68%
Belgium	32%	68%
Spain	33%	67%
Germany	38%	62%
Netherlands	40%	60%
Italy	40%	60%
France	52%	48%
Denmark	52%	48%
Sweden	55%	45%
Greece	55%	45%

Source: *Facts 2003*, Confederation of Passenger Transport

The cultural fault line is nowhere clearer than here, with the belief that the provision of services is the responsibility of the state, rather than the assumption that the entrepreneur is best able to identify and satisfy demand. In the UK today the entrepreneur has this freedom (except in London), with the local authority having a residual responsibility for situations where demand is not sufficient. While it is true that UK local authorities have an increasingly poor reputation for providing such services by tender, and while the major bus operators are not equally effective in satisfying demand, the benefits of the British system in terms of public finance and the economy present clear arguments against the Civil Code approach.

4 The fashion for franchise

Quality Partnerships

The return of a Labour majority to the House of Commons in 1997 gave rise to expectations that the railways would be re-nationalised and the bus companies re-regulated, if not actually re-nationalised as well. Today the railways, with the exception of the Freight Operating Companies, are well on the way to renewed state control; but until recently the bus companies have largely been left to pursue normal commercial objectives (subject always to safety control). Yet pressure from local government, and especially from some of the Passenger Transport Authorities (see Box 4) led to provisions in the Transport Act 2000 that were designed to increase the powers of local authorities to direct bus operation, along the lines provided for in the EC Proposed Regulation (see Section 2). What they imply is, in a word, *franchise*, comparable to that which exists in London bus services and in passenger train operation.

The practice of franchise in these examples is radically different when compared with that which is to be found on the High Street. Retail shops and fast food outlets will display a well-known name while still owned and managed by individual traders. There will be a franchise agreement permitting the franchisee to make use of the title and reputation of the franchisor, while required to maintain standards of quality and service set by the agreement, which may be terminated if this is not achieved: there will be an agreed payment to the franchisor for the benefits thus obtained. The actual premises will be owned or leased by the franchisee, though the lease may be arranged by the franchisor. This arrangement is commonly known as an ‘ethical franchise’ because it rests upon good faith between the two parties and the existence of a voluntary contract.

In contrast, the Transport Act 2000 provides for a two-step process leading to a very different kind of franchise. Here, a ‘competent authority’ is empowered to enter into a ‘Quality Partnership’ with one or more bus operators within its borders, the aim being to improve the quality of service to passengers by way of mutually agreed investments. Where Passenger Transport Authorities are concerned it will be the Metropolitan Council or Councils that will be involved (as the competent highways authorities), and it is usual for the police to take part where enforcement issues arise. Elsewhere, in England it will be the County Council or a Unitary Authority that will be the local-government partner, while in Scotland and Wales it will be a Unitary Authority.

Quality Partnerships may be for a single route or for an area. In a typical Partnership the PTE or the local authority will provide bus shelters with specially designed kerbing so as to make access to the buses easier; ‘busways’ may be marked on the highway, into which other vehicles may not enter at certain times (though some bus lanes may admit motor cycles or taxis); and priority traffic lights may be placed to give the buses an advantage. There have also been examples of ‘kerb-guided’ busways (‘KGBs’), accessible only to buses fitted with

lateral guide-wheels that bear on the raised kerb and take charge of steering. Shelters will usually be more sophisticated than the traditional variety, with basic seating, and there has been investment in 'real time' displays, showing the actual time of the next arrival on a stated route. The co-operation of the police is regarded as an essential, both to control vandalism at shelters, to enforce busway regulations and to keep stopping places clear. It has to be said that the police at present find security a problem, and some bus companies are fitting closed circuit television cameras on their vehicles to provide evidence of offences.

The bus company undertakes to invest in new vehicles with ease of access and other passenger benefits, and in at least one case the drivers on the route concerned were actually trained in customer care. Substantial sums have been involved here, though allowance must be made for the normal requirements of fleet renewal. Route branding may also be involved, and in one example an entire fleet was converted to a new livery. Activity of this kind offers an opportunity for marketing, and it is usual to find an increase in bus use as a consequence; though there seems to be less evidence of any substantial transfer from travel by car. Quality Partnerships have so far rested upon voluntary agreement, but the first statutory partnership is currently proposed for the town of Harlow, in Essex.⁸ Developed by the County Council, it will require the Office of Fair Trading to be satisfied that the benefits offered will outweigh the adverse effects on competition.

Quality Partnerships may be open to criticism on the grounds that they are a belated attempt to do something that should have been standard practice for many years. It could be argued that a highway authority has a duty to provide for the road users, and that since the bus is more economical in the use of space than the car, the reservation of areas for bus use should have been introduced as car ownership increased after the 1950s. Bus companies may also be criticised for the length of time it took for more user-friendly vehicles to be obtained. Weaknesses in customer care might be seen to have followed directly from the disappearance of the conductor (after underfloor engines enabled front access and one-person operation by the driver). The greater capacity that the new vehicles permitted led to fewer buses providing for the same demand, despite the fact that passengers place a high value on frequency. These serious marketing mistakes were characteristic of public ownership

One long-standing problem that Quality Partnerships face is the relationship between the operator and the local authority. Railway companies traditionally owned and managed their own stations and terminals, but bus companies generally have to make use of publicly provided facilities. The interface between operator and authority is of considerable importance. Take, for example, the simple and basic function of listing the services that call at each point, and then displaying the timetables concerned. Where the authority allows the operator or operators to display the information, there should be no problem so long as they actually do it well (though poor marketing still exists). But where the authority retains responsibility for the display, much depends upon the operators notifying changes, and also upon the ability of the council's officials to respond speedily. Either way, there have been many examples of failure in this process, which has led to pressure for bus companies to

⁸ The terms of the partnership would set a minimum standard for vehicles and ancillary equipment, but would not extend to timetabling or the setting of fares. Access to the town's bus station would be restricted to members of the partnership

change their services only at stated periods of the year (except where competition requires instant response).

Quality Contracts

Quality Partnerships appear to have been introduced as a step toward the closer control of the industry which had been expected from the Transport Act by government backbenchers and the Passenger Transport Authorities. The possibility for such control was provided for in the form of *Quality Contracts*. Where an authority concludes that a Partnership is not providing the results it expected, it can ask the Secretary of State to impose a regime that could be similar to that found in London, with detailed control of vehicles, routes, frequencies and, essentially, fares. Such a contract would create a straitjacket upon management, which could effectively reduce the chosen bus company or companies to acting merely as agents for the Authority, while operators failing to submit an acceptable tender would be put out of business.

Contracts of this kind are to be found in some countries (see Section 3), where sole operating rights are offered to companies by tender, effective for a period of years. The successful tenderer may then be subject to detailed control, or may be allowed some degree of freedom of management; but the implication is that the provision of services is a government function, central, regional or local, and that their operation is permitted by licence. The underlying assumption seems to be that private enterprise will have lower costs and thereby reduce public expenditure, even where an element of subsidy remains. (This is also implicit in the London system, but in that example there are significant administrative costs involved in planning, design and enforcement.)

Where an area franchise comes to an end there may be serious problems (as we have seen), since the previous contractor will have a substantial investment in vehicles for which there may be no alternative use, where the newcomer's tender provides for improvements. There has been an attempt to mitigate such problems in London by seeking tenders for individual services or groups of services, and the privatisation of railway services in the UK assumed that the successful tenderer would hire rolling stock from commercial undertakings, which could then be transferred to the newcomer.

But the fact remains that the successful tenderer is given an element of monopoly power within the area or on the route or routes concerned, but this power is limited to the carriage of passengers, and not to the movement of people; while the market is wider than just for buses. Those who advocate such systems say that they replace competition in the market with competition *for* the market; but this is absurd, for what they do is invite competition for a monopoly – a limited monopoly, maybe, but still a monopoly.

The concept of a Quality Contract under the Transport Act 2000 can be extended quite far, permitting any system from the complete franchise downward. A current proposal from the six English Passenger Transport Authorities (PTAs) is set out in Box 5, and is worth a more detailed examination.

Box 5: Controlling transport: the Authorities' vision

A Passenger Transport Authority would, under the new proposals, be able to:

- specify integrated routes, timetables, network tickets and fares, with emphasis on the social, environmental and economic importance of bus services rather than the profit motive
- remove wasteful 'on the road' competition which uses up valuable resources
- operate a bus service 'of last resort' where commercial bus operators cannot or will not operate a service
- make sure public finance and subsidies are used in the most effective manner
- lease buses to smaller bus companies.

Source: *Transit Magazine*, 4 July 2003

It would seem that the proposals are something less than an outright franchise such as applies to the Train Operating Companies, but they are hardly comparable to the ethical franchises common in the retail and catering trades. A fast-food outlet competes with others of the same kind, and while prices may be set by the franchisor, they are designed to maximise profits, not to meet 'the social, environmental and economic importance' of the product. This first point is therefore the most significant, in that it removes commercial objectives from company management, a measure that can only distort the economic efficiency of the industry. A bus company should (though not all do) set fares that vary to meet demand on various routes and at various times, and it is difficult to visualise officials in a Passenger Transport Executive having sufficiently detailed local knowledge of routes and demand to identify 'social objectives' and the like.

The proposal then takes the political argument further, in terms of its attitude to competition. Although the bus industry is itself marked by monopolistic tendencies, the existence of or potential for competition leads the dominant operators to pursue healthy commercial objectives, and to identify and satisfy effective consumer demand. The pursuit of commercial objectives, after all, leads to benefits to passengers, and not just to shareholders. To describe such competition as 'wasteful' indicates a disturbing ignorance of economics – the idea has been around ever since bus services started to appear, but it was disposed of by the late Gilbert Ponsonby forty years ago.⁹ It is far from clear what are the 'valuable resources' that are mentioned here, or to whom they may be valuable

A contradiction then appears where it is argued that commercial bus operators may not be able or willing to provide a service. We have, after all, just been told that commercial objectives will not be allowed in pricing, which leaves very little room for bus operators to take commercial decisions. The provision of socially necessary services has been problematic for some time, and tendering authorities are notorious for not deciding until the last minute what provision they require, and which operators should be chosen to provide it. Such

⁹ G J Ponsonby, 'What is an unremunerative transport service?', *Journal of the Institute of Transport*, March 1963, Vol. 30, pp. 90-94.

services are subject to frequent and sudden change, and are often badly publicised, so that it is hardly surprising to hear that many of them operate with few or even no passengers. No-one can say that this means that 'public finance and subsidies are used in the most effective manner'. The final proposal, leasing buses to smaller companies, must be the most peculiar of all, implying the provision of financial assistance to 'the competition'. An alternative might be the use of existing local government loan markets to contribute support where 'kick-start' programmes are considered.

Intervention and the market

To the European Commission, as well as to the Passenger Transport Authorities and other parts of local government in the UK, it would seem that commercial objectives are improper for public passenger transport, whether by road or rail. Why it should be believed that the provision of bus and train services is in some way exempt from the advantages of the competitive market that have been understood since the days of Adam Smith is a subject worthy of deeper examination than we have time for here; suffice it to say that the movement of goods does not seem to attract the same attitude (and indeed it was a Labour government that privatised the last remaining part of the nationalised British Road Services).

That there are market failures is undeniable. Throughout the history of the bus and coach industry they have turned on issues of scale and power. It is said that the late Nicholas Ridley (Lord Ridley), when he was presenting the 'deregulation Bill', expected that the outcome would be small firms, often owner-drivers, competing with each other. Instead, the inherent tendency to territorial control, similar to the state of affairs before nationalisation (see Section 1) quickly reappeared. Nevertheless it is easier to manage a small firm than a big one, and the holding companies of today retain decentralised management in some form, though there are suggestions in the media that certain of the major holding companies have problems in this area. What is inescapable is the greater market failure that must follow from public control, whether by outright purchase or through the franchise proposals that are appearing from local government in its various forms, encouraged not least by members of the Scottish Parliament and the Welsh Assembly.

Ultimately, having to pay for your own productive capital and make a decent return on it, is the most powerful motive for satisfying customers. Public authorities do not have the same requirement to cover their investment and operating costs, nor to make a proper return over and above them. Therefore we can never be assured that their decisions will tend to achieve allocative efficiency. When we add the hidden costs that follow from the impact of bureaucracy on the supply of public goods, it becomes plain that administrative failure causes inefficiency, such that intervention to correct market failure can only make things worse. The intervention proposed by the Authorities seeking Quality Contracts is manifestly a classic example of the problem.

5 Who knows best?

A pressing question

The bus industry in Britain today is at a turning point. ‘Politically correct’ thinking is moving toward the European attitude that sees the provision of bus (and rail) services as the responsibility of the state. A strange refusal to accept that the industry is just like any other, best provided for profit, subject only to safety regulation, is implicit in the public attitude as well as in the thinking of politicians of all parties. Yet the increased use of buses in London, which involves a growing subsidy from public funds, is taken in some quarters to justify a similarly prescriptive and expensive policy in the remainder of the country. But we have seen many times before the spiral of intervention, subsidy, decline, and further intervention.

The industry is not without problems. At the current level of fares it is often difficult to recruit and retain enough drivers, and since bus operation is labour-intensive this can affect reliability and customer care. Nottingham City Transport, a municipally owned company which the Council is not allowed to subsidise, increased its fares by ten percent at the end of July 2003, and at the same time withdrew several services and introduced revised timetables to run fewer buses in the evenings and at weekends. Decisions like this will inevitably attract criticism, turning upon the two issues that have wider political significance today: reducing car use on the one hand and improving ‘social inclusion’ (see Box 1) on the other. (It is ironic that Nottingham has recently seen an increase in bus passengers, partly because of ending free on-street parking). On the other hand, Cardiff Bus, another municipally owned business, has achieved improvements in the past year for staff recruitment, retention and sickness absences, and has reduced blameworthy accidents by 28 percent through improved training in defensive driving skills.

The provision of ‘socially necessary’ bus services has become increasingly difficult to manage as local government authorities have faced rising demands on their budgets. These services, identified by the councils’ staff and committees (not without an eye to the vote motive), are to be found in rural areas, and increasingly in the wealthier parts of the country, where car use is greatest. In urban areas, tenders are often called for to replace evening and other off-peak services that the commercial operator has announced its intention to withdraw. While subsidy of this kind may appear to be justified where only marginal demand exists, the system is under serious criticism because of the way it is administered. Last-minute decisions and sudden changes of contractor make it difficult for the users to find out what is on offer; and some small firms may submit cost-cutting tenders that do not then deliver satisfactory standards of customer care; and the prospective change of contractor leaves little incentive for an operator to grow the traffic.

What is more, cost-cutting on these lines may undermine customer care, and does little for standards of employment and staff morale. In rural areas there have been examples where well-intentioned subsidy of this kind has attracted demand away from existing but marginal

services operated on a commercial basis, and thus increased the provision of subsidy. It is not unknown for buses funded by government grant to travel country roads carrying nothing but fresh air. Is that a good use of 'valuable resources'?

Problems of the day

Buses rank low in the estimation of people and politicians in Britain today. When Light Rapid Transit (LRT, a supposedly superior form of tramcar) became fashionable some years ago, dozens of local authorities put forward proposals, among which by far the greatest number were turned down by government. Those that were built have not usually been particularly successful, if at all, and few of them have been able to attract income sufficient to begin to cover the opportunity cost of their capital. Schemes in South Hampshire and West Yorkshire are already facing problems as bids from the private sector are being raised to require substantially greater sums of public money than originally expected. The Transport Secretary has recently criticised the incremental growth of construction costs for LRT, and several schemes, including that from South Hampshire, have not been accepted. It may be that public authorities turned to LRT investment after they lost the power to provide public transport by bus, and that their limited success may account for the current pressure to take the buses back into local government control. Be that as it may, there are two questions that must be answered if the bus is to increase its efficiency and its effectiveness in satisfying demand for movement. These are the cost structure of private car use and the way that road users pay for the infrastructure. It is against these that the pressure for 'franchise' must be tested.

Quite apart from the convenience and prestige offered by the private car, the fact remains that its labour cost is so much lower than that of the public transport operator, who has to pay the driver and other staff. Even the repair and maintenance of a car can be relatively cheap insofar as owners are able to do the work themselves. The car industry requires high sales in order to spread its costs, so that cars are designed for a relatively short life and frequent replacement; to achieve this, prices are kept low, while the knock-on effect on the secondhand market is well known. It should be no surprise to find that among car owners about half are now to be found in the lower socio-economic groups. The car is a working man's lifeline, not least when jobs are scarce, and to see the car as a middle-class luxury has not been justified for many years now. The real cost of buying and running a car is continuing to fall.

Some of the leading bus companies are, belatedly, using effective marketing to attract customers who own cars. But until there is a rational pricing system for the use of the roads they will remain at a disadvantage. Car drivers seem prepared to put up with congestion, though it is a significant opportunity cost for the commercial business, whether passenger or freight. The arguments for road pricing have been well rehearsed since Professor Smeed defined them in 1964, and mere congestion charging will not deal with the problem.

The way we pay for using the roads is a total nonsense. A recent Adam Smith Institute study has shown that rural road users are *overcharged* by 4.81 pence per kilometre driven, while

drivers in city centres in the peak time are *undercharged* by 37.8 pence.¹⁰ Motorway users have been overcharged by an amount similar to rural drivers, while all urban users are undercharged to a greater or less extent. In such terms it appears that rural users, including bus operators, have been subsidising urban road users by something between two and eight times the taxation that they pay.

No-one can claim that this is rational, and in terms of bus operation it makes no sense at all. A point-of-use pricing system, together with the removal of Vehicle Excise Duty and a reduction in fuel tax, could lead to road users paying proportionally for the costs they impose, while the revenue, provided it were not swallowed into general taxation, could make better provision for the roads we use. With prices at an optimal level, congestion could be avoided, and bus managers have said that they could then run more reliably to timetable, attract more passengers, and save some 20 percent of both capital and operating costs. Such a system would enable bus operators to grow their market while playing their part alongside the private car. Their greater operating efficiency could do much to meet the problems of social exclusion.

A new perspective

Radical reform such as we have examined could place the bus industry on a commercial footing within a reasonably contestable market. Intervention by franchise would then be no longer relevant. But conventional wisdom today is moving in the other direction, and might well lead to the wider introduction of the European pattern in Britain.

As we have seen, the argument is spreading, that the London ‘franchise’ system should be extended to the rest of the country, or, at the least, more public money should be spent on subsidising bus services, in order to attract car users to turn to public transport. More than one view is held about how such subsidy should be used: to improve provision, or to lower fares. How far either measure would attract the car user is highly questionable, but there can be no doubt that direct subsidy must increasingly transfer control of the industry to the ‘competent authority’ that provides the money. That is what happens in much of Europe, resulting in a substantial and largely unmeasurable burden of taxation, whose opportunity cost must be unknowable. The European view may be right, that a commercial organisation can provide what an authority requires at lower cost; but this is to ignore the profit motive that drives the market and makes operators strive to give customers what they really want.

The situation in Britain today is therefore at a turning point, with politicians and administrators in the conurbations and elsewhere finding cause in the weaknesses of the industry to transfer it to public control. There are hints from the trade press and elsewhere that some of the administrators are not too happy at the idea of running bus services without the certainty of adequate public finance, but politicians of all parties are pressing for it. Current practice in the provision of subsidised ‘socially necessary’ services does not augur

¹⁰ Peter Mumford, *The Road from Inequity – Fairer ways of paying the true costs of road use*. (Adam Smith Institute, 2000)

well for widespread public control, and the industry is understandably opposed to it. To take away the freedom so effectively used to satisfy the market by the most progressive bus firms would be a mistake. But there is the danger that the EC Proposed Regulation would play into the hands of those seeking control on the lines of the European franchises, as examined in Section 3.

We should scrutinise these developments very critically. Statutory power exists for local authorities to enforce, subject to the agreement of the responsible minister, a Quality Contract that would be binding upon the chosen operators to whom it would apply. We have seen in Section 4 what the Passenger Transport Authorities have in mind for such a contract, and that it is close to the European pattern of control. Certain of the UK ownership groups have experience of this, and are aware of the restrictions that it places upon their freedom to grow the market. Bus managers who before 1985 had experience working in the National Bus Company and the Passenger Transport Executives (while the latter were operators themselves) will not have forgotten the weaknesses and inefficiencies of public ownership and control. Yet in today's public perspective there are dangerous proposals for putting the clock back.

Where the public's demand for a commodity such as travel by bus can be exercised in a market situation, we may expect user satisfaction to be maximised and those who provide the commodity to be sensitive to consumer demand. Despite a range of petty regulations, there are many bus companies which today are performing in just this way. Perhaps some of the larger firms are too constrained by the short-termism of City financiers; but then the smaller firms can step in at the margins, offering lower fares and higher standards of service that keep the larger firms on their toes. No market solution can be perfect, but the argument that a public authority can know better what it is that the user wants cannot be maintained.

Where do we go from here?

Whatever its structure, the public transport industry has no monopoly of the market for the movement of people. No argument therefore exists for its public ownership, but neither can it be said that it requires some form of public control (safety standards apart): for this would make it no more than the creature of the 'competent authority'. That is what the London bus companies are today, in a system that is kept alive only with a serious and growing level of public subsidy and at the cost of a great administrative burden falling on the public purse.

Remember too that the detailed decisions in such matters as bus services are taken at some distance from the democratic process. The bus industry may be criticised for some of its past marketing failures. But if the provision of public transport were directed from outside the market, then those decisions would have to be taken by a bureaucracy over which the elected representatives have little control. This is what European practice and the EC Proposed Regulation must imply, and it is what the Transport Act of 1985 was designed to avoid. The worry there is the emergence of "an active bureaucracy behaving as a private monopolist in

the supply of the public good”,¹¹ except that the EC-style ‘competent authority’ cannot have a monopoly of the people-moving business – unless it intends to control the use of cars too.

Can such an authority be trusted to know best what the customers want? Lacking the profit motive, and subject to the (properly) risk-averse behaviour of public administrators, the answer clearly must be no, and this would be as true in other European countries as it is for us. And that is not even to take into account the self-serving behaviour of politicians and officials, which is all too clear in the government in Britain today.

Re-regulation is the objective of those who want to see Quality Contracts enforced on the bus industry, transferring management to Passenger Transport Executives (PTEs) and local authorities. The PTE Group sets out to develop the case for “the regulatory reform that is necessary if bus services outside London are to really fulfil their potential”. The industry opposes it – the Director-General of the Confederation of Passenger Transport has asked the key question: “Is it really about getting more people to travel by bus, or is it just about Town Hall control? Because, put bluntly, regulation does not put one more person on one more bus”. Those who represent passengers oppose the move as well; the National Federation of Bus Users regards calls to re-regulate as “an unwelcome distraction from the challenges facing the bus industry”.¹²

Pressure from local authorities and the PTE Group to force re-regulation on to the political agenda comes at the time when the new EC Regulation may be seen to support the argument. But it cannot be said that public ownership was markedly successful in finding what consumers want in the past. Highway Authorities should do much more to enable the buses to grow their market, but it is those who own the bus companies that have the greatest incentive to combine passenger satisfaction with sound financial management. It is this that makes the ‘European Model’ positively unhelpful – indeed, dangerous – for the industry at home.

¹¹ Patrick A McNutt, *The Economics of Public Choice*. Edward Elgar, 2nd edn 2002, p.xi.

¹² All quotations are taken from letters to the Editor of *Transit Magazine*, 1 August 2003