

Market Scan on Passenger Transport

September 2011

Management Summary

General

1. With the publication of this market scan, the Netherlands Competition Authority (NMa) provides insight into how the market for passenger rail transport functions. This market is characterized by the concession mechanism. A concession is a license to provide rail transport services in a specified geographical area for a specified period of time, or to operate rail transport services on a specified rail segment. The license for the main railway network in the Netherlands is awarded by the Minister of Infrastructure and the Environment, whereas the concessions for the regional rail lines are awarded by the provincial and regional governments. As rail concessions usually involve substantial investments, which the concession-holder must be able to recoup, concessionary periods are relatively long, between 10 and 15 years.
2. Since this market (supply and demand) is characterized by the concession mechanism, this study focuses on how the awarding and size of the concessions stimulate rail undertakings to operate more efficiently, to keep prices as low as possible, and to innovate. When reviewing the concessions, the NMa looks for opportunities to increase consumer welfare.
3. The NMa has found that, on the whole, this form of competition does pay off. Rail undertakings are stimulated to improve productivity levels. Riders benefit from this development as they are more likely to be able to sit when traveling (rather than having to stand during their trip), they pay a reasonable price for public transport, and they are able to benefit from various innovations.
4. Despite these market achievements and the concession mechanism, there is still room for the passenger rail transport market to improve even further. Opportunities thereto include the concession award process, the process of setting fares for riders, and the selection of innovative investments.

Main railway network concession is not transparent enough

5. There are major differences between the concession award process for the main railway network and that for the regional rail lines.
 - a. *National*
 - i. Directly awarded
 - ii. One bidder
 - iii. Trunk lines
 - iv. Evaluation by the concession-holder
 - b. *Regional*
 - i. Public tender
 - ii. Multiple bidders
 - iii. Specified regional rail lines
 - iv. Evaluation by the awarding authority

6. The concession for the mail railway network for the period of 2005-2015 has been directly awarded to Dutch Railways NS, which means that the awarding authority negotiates with a single bidder on the license. The concessions for the regional rail lines have been publicly tendered, which means that multiple parties can bid on a single exclusive contract. By its very nature, a system of mutual competition stimulates rail undertakings the most to submit competitive bids.
7. It is desirable that a study is conducted exploring the possibilities of using the method of public tendering for the mail railway network as well, which is the method of choice for the regional rail lines. At the end of the day, the choice between direct awarding and public tendering is a political choice. If lawmakers choose to directly award the concession of the mail railway network, improvements can still be made within this construction that would lead to more and better incentives.
8. It is notable that, in the case of the mail railway network, the minimum performance levels and the annual transport plan are currently specified in more generic terms than is the case with regional concessions. If direct awarding is chosen, more attention should be given to the price-quality requirements in the concession contract, and to the enforcement of compliance with the arrangements that have been agreed upon.
9. Another difference between the national concession and regional concessions concerns the way performances are evaluated. In the case of the main railway network, it is the concession-holder himself who monitors his own performance. The awarding authority periodically checks if this monitoring has been carried out satisfactorily. In the case of the regional concessions, the awarding authority carries out the performance checks. The NMa recommends having the performance monitoring on the main railway network carried out by an independent agency, and more frequently and in greater detail than is the case now. This will provide riders and awarding authorities more insight into the rail undertakings' performance levels.
10. Finally, regional and local governments should more often look into the possibilities of linking regional transport concessions to rights to commercially operate transport-related infrastructure, such as stations. This could yield synergy benefits, like on the main railway network. Although the regional and local governments are able to link concessions to commercial operation of stations, this is not something that is done very often in practice.

Dependence on NS hinders regional rail undertakings' efficiency levels

11. Short-term possibilities to increase efficiency are limited. Reasons include the fact that rail undertakings are faced with numerous types of fixed costs, particularly for rolling stock. Rolling stock on the main railway network has been deployed more efficiently in recent years. Transport performance levels have increased. Passenger-kilometers per unit of rolling stock have increased, and more seats were available to passengers. So there is progress, but, based on the data available, it is hard to tell whether more (or even much more) efficiency can be achieved.
12. It is highly likely that the improvement in the rail undertakings' productivity levels is related to efficiency-stimulating incentives that have been included in the concessions. A number of improvements seems necessary to further enhance the incentives to improve efficiency in passenger rail transport. One of the aspects that needs to be modified concerns the relationship between NS

and the other rail undertakings, both regional and national ones. This is particularly relevant if it is decided to re-award the concession for the main railway network directly to NS. Regional rail undertakings are dependent on NS for a number of services, for which it is the sole supplier, such as journey information, tickets, and ticket machines. In these areas, NS enjoys a dominant position, and regional rail undertakings are more or less forced to buy certain products and services from NS. Because of this dependence, they lack a good bargaining position vis-à-vis NS when it comes to setting fares and conditions for these products and services. As a result, regional rail undertakings are unable to cut back on the costs of these items, and, therefore, to work more efficiently. Although the concession of NS, drawn up by the Dutch Ministry of Infrastructure and the Environment, includes requirements in terms of reasonable fares and conditions, it seems desirable to investigate whether the regional rail undertakings' positions can be enhanced, for example, by oversight on such arrangements.

Fare adjustments may lead to improved seat-occupancy rates

13. The prices of a number of fare types appear to be economically inefficient. Discounted second-class rush-hour fares seem to be set too low. Riders possibly pay less than the costs that the rail undertaking incurs. Conversely, full-price first-class fares (outside rush hours) seem to be too high. Adjusting these fares may lead to improved seat-occupancy rates of trains, and, thus, to consumer welfare gains.
14. Regional rail undertakings are unable to adjust their fares independently, because they are dependent on the fare levels of NS and on the willingness of awarding authorities to adjust their prices. The current national public-transport card system is being fine-tuned in order to give regional rail undertakings more freedom to set their tariffs themselves. Regional rail undertakings thus become less dependent on NS. The effects of different fare systems on riders need to be closely watched.
15. The costs of increasing transparency by improving the quality of real-time journey information appear to be lower than the social benefits of such a move. Investments in improving real-time journey information would be recouped within a few years from a social point of view. Further improving transparency for riders is therefore advisable.
16. Judging from annual-report data, NS' return on investment in the main railway network appears to be at a competitive level. Due to a lack of information, profitability rates for the regional rail undertakings cannot be determined. However, it is unlikely they will have any excess profits either. It appears that riders on average do not pay any more than necessary for rail services in order to cover costs.

Investing in innovations pays off

17. The majority of recent innovations in passenger rail transport have a positive cost-benefit ratio. These innovations are thus socially efficient. Trains with reduced noise levels, installing Wi-Fi on board trains, the introduction of a more advanced passenger information display system (Infoplus), and the introduction of e-tickets are clear examples of efficient innovations. These investments have been recouped in a relatively short period of time. Despite the mostly negative media reports on the national electronic public-transport ticket media recently, it appears that the social benefits thereof

exceed its investment. This is less the case with regard to domestic high-speed trains: demand appears to be too little to make this investment a socially efficient one.

18. If transport undertakings themselves decide to make investments in innovations, such as in the e-ticket, it can be expected that such investments will be efficient. After all, it would be illogical if a transport undertaking made an unprofitable investment at the expense of its own earnings. When imposing certain innovations, the awarding authority should continue to carefully assess the social costs and benefits in order to reduce the risk of inefficient investments being made.