Údarás Náisiúnta Iompair
National Transport Authority

Proposal to Directly Award a Public Bus Services Contract to Bus Éireann in 2014

2. Economic analysis of Direct Award Bus Contract outside the Dublin Market

September 2013

Report prepared for the National Transport Authority by

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1. Introduction and Overview

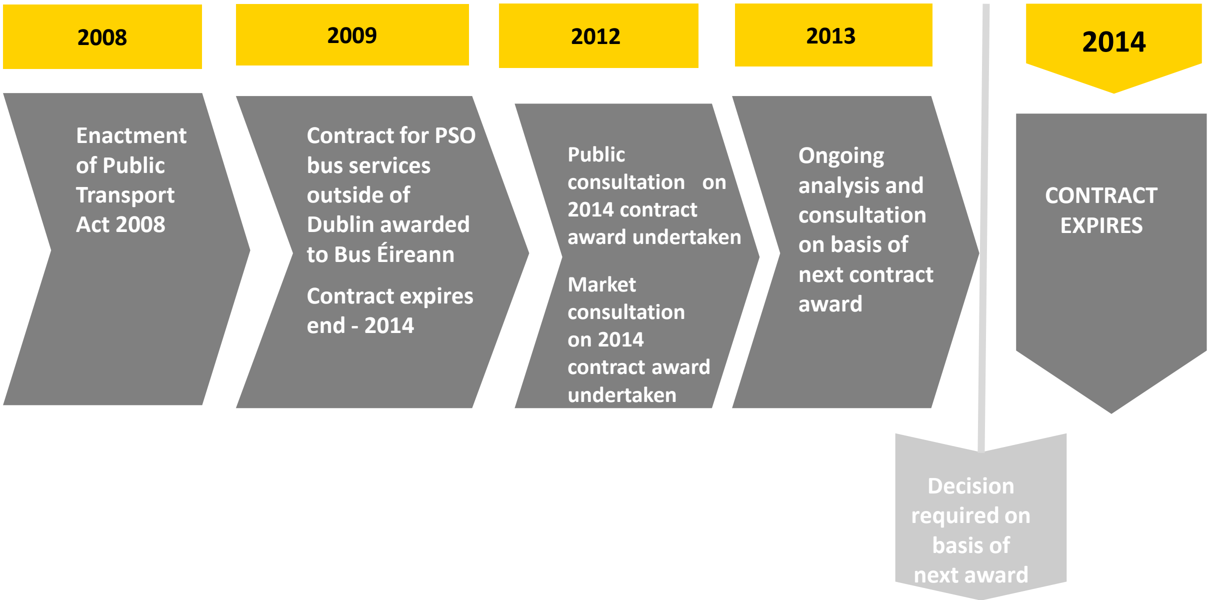
1.1 Background

The National Transport Authority (NTA) directly awarded contracts for the provision of public bus services in December 2009. Dublin Bus was awarded the contract for the operation of public bus transport within the Dublin area and Bus Éireann was awarded the contract for the operation of public bus services elsewhere in the State. These contracts expire on November 30th 2014. Under national legislation the NTA is required to put the next award for public bus services to competitive tender unless the Authority is satisfied that the continued adequacy of services can only be guaranteed in the general economic interest by a direct award contract.

The process of deciding on the basis of the next award of a public service bus contract outside Dublin is at an advanced stage. Figure 1 below provides more detail.

This report sets out the findings of an analysis of a proposal to move from the existing arrangement of directly awarding public service bus contracts outside of the Dublin area to a more competitive basis.

Figure 1 Timeline for decision on PSO Bus Contract outside Dublin



1.2 Approach and Structure

This report considers the relevant elements of bus contract award from a number of perspectives.

Section 2 discusses existing arrangements for public service bus operations outside Dublin. This encompasses:

- A recap of the rationale for government provision of public transport services
- A commentary on the extent of services in an international setting
- A brief description of the contract arrangements currently in place
- An outline of funding arrangements and recent trends

Section 3 sets out the specific proposal put forward by the National Transport Authority (NTA) for the transition to a limited form of competitive tendering in the public service bus market outside of Dublin. It sets out the type of routes proposed to be included and explains why these services have been chosen.

Section 4 assesses the proposal and sets out the related economic and commercial considerations.

Finally Section 5 distills the findings and next steps of the paper.

Given the legislative and policy backdrops are the same as in the case of the public service bus contract within Dublin, there is overlap in the structure and elements of the argumentation of the paper prepared relating to the Dublin market.

2. Background: Public Service Bus Transport outside of Dublin

2.1 Government Involvement in Public Transport Provision

Governments support the provision of public transport – including bus transport – in order to generate associated positive benefits. If left entirely to the private market, operators may not deliver a socially or economically optimal level of services.

Public transport is associated with a range of economic, social and environmental benefits. These are briefly described below:

- Public transport plays a vital role in enabling economic activity. Public transport aids in the functioning of the economy by contributing to more flexible labour markets and enabling other economic activities such as shopping and leisure. Public transport allows individuals to travel across a wide geographical area. In doing so it increases the number and range of jobs accessible to workers and jobseekers. This can be especially important for low income or less skilled workers who are less likely to have access to a car and may also qualify for a narrower range of jobs which are more likely to be scattered across a larger area. [1] For employers, public transport extends the available labour supply, which can be an important element in a firm's location decision.

- Public transport is an input to other forms of economic activity, such as tourism, retail and leisure activities. Outside the Dublin area, public transport is important for promoting tourism by facilitating the movement of individuals between different tourist destinations, which are often spread across wide geographical areas.

- Public transport brings social benefits by facilitating mobility, offering affordable alternatives to lower income groups and other vulnerable or isolated cohorts, including those living in rural areas and remote locations. These groups experience a range of challenges associated with accessibility and mobility. The availability of public transport enables individuals to gain access to public services, education and training which they otherwise may have difficulties accessing.

- In providing a mode of sustainable transport, it reduces congestion levels through demand and traffic management. This in turn is associated with more efficient supply chains and reduced costs for business, which has an impact of the final cost of goods for consumers. In the UK it is estimated that a 5 percent reduction in travel time for all business and freight travel on the roads could generate around £2.5 billion of cost savings – some 0.2 per cent of GDP.[2] Bus services play an important role in reducing the numbers of cars entering all of our major urban areas. Without them, there would be more traffic congestion , increasing travel times and reducing productivity

- It reduces and mitigates the impact of transport on the environment by diverting individuals from private vehicles, thereby reducing emissions from the transport sector. Emissions from the transport sector in Ireland constitute 20 percent of Ireland's overall emissions.[3]

If commercial bus operators were left to serve the market without any support, they would not provide sufficient services to fully deliver all of these social and economic benefits: there would be a 'market failure'. Governments therefore intervene to ensure that 'enough' public transport is provided. The specific market failures involved include:

- Positive externalities or 'spillovers' when non-users who are not charged for the service benefit from it. For example, where bus transport leads to lower road traffic volumes, remaining road users benefit from reduced congestion, shorter journey times and enhanced safety
- Where public transport reduces traffic volumes, non-users benefit from cleaner air and reduced pollution
- Where lower income groups benefit, public transport plays an important redistributive role.

Together these elements of market failure mean that Government involvement in the provision of public transport is socially, economically and environmentally desirable.

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[1] Abrantes, P, R Fuller and J Bray (2013) *The Case for Urban Bus – The Economic and Social Value of Bus Networks in the Metropolitan Areas*. Report for pteg

[2] Eddington, R. (2006), *The Eddington Transport Study: The Case for Action - Sir Rod Eddington's advice to Government*

[3] Environmental Protection Agency (2013) *Ireland's Greenhouse Gas Inventory 1990 - 2011*

2.2 Public Service Bus Provision Outside of Dublin

For the reasons set out above, public policy is to subsidise public bus services outside Dublin. This policy commitment is given operational effect through the Dublin Transport Authority Act, 2008 whereby the National Transport Authority has the power to enter into contracts with bus suppliers for the provision of bus services.

The current contract for the provision of public bus services outside Dublin was entered into with Bus Éireann in 2009 for a five-year period, ending on November 30th 2014. The contract arrangements specify the key performance standards required to be satisfied by Bus Éireann. These relate principally to issues of quality and reliability. NTA monitors performance against these targets and makes payment as per the contract.

Bus Eireann operates on a nationwide basis, providing services that can be grouped into three broad categories

- subsidised public transport services under its current direct award contract with the Authority;
- commercial services, under its Expressway brand, that are licensed by the Authority, and
- school transport services on behalf of the Department of Education and Skills, by way of an administrative arrangement with that Department

The analysis throughout this Report relates only to the first of these groups, namely subsidised public transport services.

2.3 Demand Patterns and the Extent of Services

The availability of public transport services outside of the capital is lower than in Dublin. In 2009 (the most recent year for which information is available) 98 percent of Dublin households reported having access to local public transport compared to 69 percent for households from outside the Dublin region.

Use of public transport, where it is available, is lower outside the Dublin region where only 12 percent of those with a local public transport service use it at least once a week, compared with 40 percent of those in the Dublin region. Furthermore, 54 percent of those outside the Dublin region with a public transport service reported that they would never use it, whereas the corresponding figure for the Dublin region was 18 percent.[4]

These figures relate to 2009, and therefore do not take into account any changes to service availability and usage in the interim. They do however provide an insight into the use of public transport outside of Dublin.

In terms of demand issues, it is worth thinking about Bus Éireann operations separately in terms of the constituent services: city services, stage carriage / rural services and Dublin commuter services. Some relevant issues are noted below:

- City Services – Across each of the cities, car ownership is lower than the rest of Ireland. The relevant figures are:
  - Cork 68%
  - Galway 76%
  - Limerick 68%
  - Waterford 75%
- By comparison, car ownership in the rest of Ireland where Bus Éireann's stage carriage, rural and Dublin Commuter services operate is 83 percent.

Census 2011 shows that by comparison with the Dublin City and suburbs area, where 20% of travel to work is by public transport, fewer people commute by public transport in the Bus Éireann area, as follows:

- Cork City and suburbs 6%
- Limerick City and suburbs 4%
- Galway City and suburbs 6%
- Waterford City and suburbs 3%
- Rural areas 1.5%.

An important policy and strategic issue relates to the coverage and extent of the public transport offering outside Dublin. Elements of the overall vision for public transport set out by the Department of Transport, Tourism & Sport include increasing competitiveness through alleviating congestion and reducing travel demand and commuting distance by private car.

[4] CSO (2009), *National Transport Survey*

In a comparative international context, total public transport usage is low in Ireland. Issues including population density, extent of the rail network and urban scale influence Ireland's lower performance in this regard. Usage is lower again in the areas under consideration, compared to the Dublin region. Nonetheless improvement against these metrics is a public policy goal. Given its comparative advantage over other modes in terms of affordability and flexibility, bus transport will form a core element of the policy response to enhancing sustainability of public transport and expanding its use.

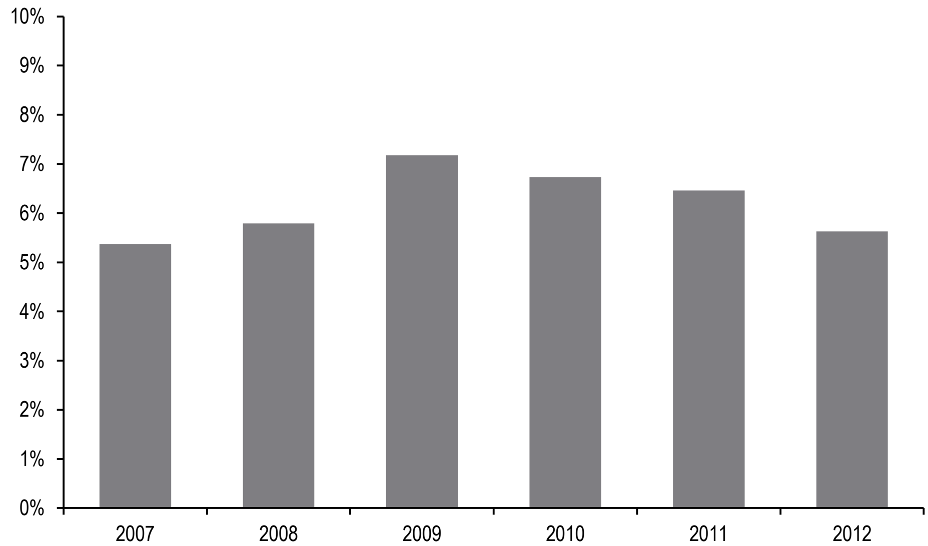
While the policy response will require action on a number of fronts, a sophisticated, expanded bus service which minimises cost pass-through to consumers will play an important role. From a public policy perspective, it will be important that public transport becomes a more attractive proposition in order to deter individuals from using private vehicles.

2.4 Funding Public Service Bus Provision outside Dublin

Public service bus contracts are funded via voted current expenditure by the Department of Transport, Tourism and Sport, through the National Transport Authority. As part of the broader process of fiscal consolidation, the scale of the subsidy to Bus Éireann has been reduced over recent years. The subvention peaked at a level of €49.4 million in 2009[5] and it was €36.9 million in 2012.[6]

In proportionate terms, the subvention represents roughly the same share of total current expenditure by the Department of Transport as it did at the outset of the downturn, although in 2008 and 2009 the subvention rose in absolute terms, in the face of a general reduction in total spending in the later year.

Figure 2 Bus Éireann Subvention as a Proportion of Total Current Expenditure on Transport



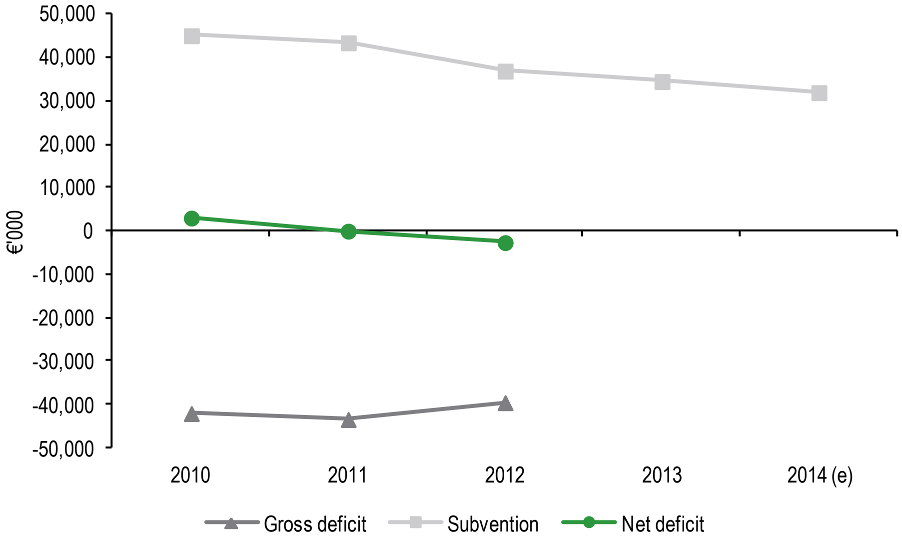
Sources: Department of Public Expenditure and Reform Revised Estimates for Public Services 2007 – 2012; Bus Éireann Annual Reports

Figure 3 shows the position with regard to revenue, gross deficit and resulting net deficit.

Figure 3 Bus Éireann Subvention and Deficit Information (relating to PSO services that are subject to the contract)

5 Bus Éireann Annual Report 2009

6 Quarterly performance reports (schedule C), submitted by Bus Éireann to the NTA



Source: Quarterly performance reports (schedule C), submitted by Bus Éireann to the NTA 2010 – 2012; NTA for subvention data in 2013 and 2014.

As the chart shows, Bus Éireann incurred a deficit in net terms in 2012. As the process of public expenditure reduction continues into 2014, the total level of subvention available can be expected to fall again in the short-term, as indicated in the 2014 estimate.

3. NTA proposal for competitive tendering outside Dublin

3.1 The move from direct award to competitive tendering

According to analysis by the NTA there is value in introducing competition in the bus services market outside Dublin while maintaining a smaller Direct Award Contract to Bus Éireann. Therefore, the NTA propose a Direct Award contract to Bus Éireann from 1 December 2014 with adaptations to facilitate a move to a limited form of competitive tendering in 2016. The NTA notes that this approach is being pursued in order to adequately plan for the transition and to comply with the necessary EU notification process (i.e. one year prior to launching a tender competition).[7]

The transition to any new arrangement for public bus provision requires the necessary lead in time to consider the issues involved and to adequately plan for potential eventualities. The NTA undertook preliminary planning and discussions in 2011 and 2012 but these activities were overshadowed by the difficulties posed by financial instability of the incumbent. As a result discussions and preparations did not evolve at a necessary pace to comply with EU notification periods. Therefore the transition to the new arrangement of awarding contracts for bus provision is being deferred until 2016.

As illustrated in Figure 4, it is proposed that the 2014 direct award contract will contain two elements:

1. The direct award to Bus Éireann of routes that later will be open to competitive tender. This element of the contract will run for a two year period, and will be open to competitive tendering in 2016.

2. The direct award of the remainder of routes for a five year period up to 2019.

Figure 4 Breakdown of the 2014 Direct Award Contract

3.2 Potential Services to be competitively tendered

The NTA's consideration of suitable routes for potential competitive tendering outside the GDA was informed by the following criteria, which were developed from the public and market consultations:

[7] EC 1370/2007, Article 7

- Geographical coherence to ensure efficient bus operations and management
- Type of competition that would attract tender interest
- Size of award that facilitates a managed downsizing by the State bus companies.

Bus Éireann PSO operations comprise three market segments: rural services, city services and Dublin Commuter services. The NTA considers that there is potential to introduce varying levels of competition acros each market segment.

Analysis in the NTA's accompanying Technical Paper[8] concludes that the preferred competitive tendering scenario is to select between 7 and 10 percent of services from a suite of options comprising:

- All city service in Waterford
- Some City services in Cork
- Some rural stage carriage in the South East region
- Certain Dublin commuter services

3.2.1 Scale of contracts

The proposed options involve tendering routes involving something in the region of 7 to 10 percent of the Bus Eireann PSO fleet, or 30 to 40 buses.

3.2.2 Other arrangements

In order to support the most competitive tender from the market, the NTA will be in a position to provide the winning tender with the fleet to operate the services. This can be achieved at no extra cost to the State as the NTA has retained the right to reclaim the bus fleet recently purchased by Bus Éireann as part of funding agreement it entered with the NTA. NTA will identify suitable depot space options and may seek to secure options on their leasing for the contract period.

A contract period of five years is envisaged by the NTA for the tendered services, in keeping with the feedback from operators during the market consultation.

The NTA envisage that all tender competitions will be run concurrently using the same tender procedure. This will reduce tender costs and increase the attractiveness of the competition by allowing operators to tender for multiple lots at the same time.

Any details that are available on the contracts will be published in the notice required by Regulation 1370/2007 in advance of the Direct Award and the competitively tendered contracts, which will be issued in November 2013.

[8] NTA (2013) *Proposals to directly award Public Bus Services Contract to Bus Eireann in 2014*

4. Assessment of NTA proposal

4.1 Enhancing value for money and customer service levels

The key advantages associated with a move beyond direct award to competitive tendering stem from elementary economic theory in relation to the effects of competitive pressures and market discipline. In essence, by putting the contract out to tender, market forces are brought to bear to reveal the most economically efficient provider, thereby leading to lower costs and – all things equal - a reduced requirement for subvention. An enhanced level of customer service quality can also feature as an element of the contract award criteria. Additionally, potentially increasing the number of service providers in the public bus service market could relieve the current dependency on a single operator, making the bus service more resilient, with consequent benefits for the economy.

Experience from a range of international examples lends weight to this contention. Meta analysis of economic reform in public transit conducted in 2008 reviewed experience over a thirty year period[9]. Table 1 reproduces the evidence from Europe and the UK in relation to a move to 'controlled competition' – the category of market reform which includes competitive contracting.

Table 1 Summary of Analysis of Cost Efficiency and Controlled Competition

Date	Jurisdiction	Impact on cost efficiency
1990, 1999, 1997	London	Improved
1992	Sweden	Improved
1995	Norway	No change
1996	France	Improved
1997	Spain	Improved
2001	Spain	No change
2003	Switzerland, Italy	Improved
2005	Netherlands	Improved

Source: Karlaftis (2008)

Further analysis, specifically on moving to competitive tendering, shows substantial initial cost impacts.[10] Reviewing experience of 20 cities across 10 developed countries, the work found unit cost savings up to 50 percent, with many estimates clustered in the 20-30 percent range. While these results regarding an initial move to competitive tendering are encouraging, a cautionary finding of this analysis is that second and subsequent awards can lead to increased unit costs from the first tender (but can still offer benefits). While some of the observed increases can be attributed to developments which would be evident in the counterfactual scenario without tendering (such as fuel and other cost increases and tighter labour market conditions) at least some of the increases represent an erosion of the initial gains through market evolutions such as bidders becoming more experienced. A further point accounting for this trend is authorities becoming more specific in their requirements as they become more experienced.

Nonetheless, the clear finding of the literature is that enhanced value for money is available through a move to competitive tendering.

A further benefit put forward for moving to competitive tendering relates to the potential for enhanced customer service levels. The meta analyses cited above also found evidence of service improvements in the studies reviewed and the Competition Authority has noted the potential benefits in this regard.[11]

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[9] Karlaftis, M (2008) *Privatisation, Regulation and Competition: A Thirty-Year Retrospective on Transit Efficiency*

[10] Hensher, D and I Wallis (2005) 'Competitive Tendering as a Contracting Mechanism for Subsidising Transport – The Bus Experience' in *Journal of Transport Economics and Policy*, Volume 39, Part 3, September 2005 pp 295-321

[11] The Competition Authority (2012) *Public Consultation on 2014 Bus Service Contracts*. Submission to the National Transport Authority

As also pointed to by the Competition Authority, the tendering process is capable of specifying the frequency of services and the quality of bus vehicle required as well as requirements around integrated ticketing. While these issues will obviously feature in any tender competition, it is likely that there will be trade-offs with the magnitude of cost savings achievable. Nonetheless, the proposed option offers potential for improved customer service levels and enhanced value for money.

In addition, the potential proposal to introduce competitive tendering in aspects of the the Cork, Waterford and/or South-East market signals that market opening is not merely a policy for the Dublin area.

4.2 Implementation Issues

4.2.1 Sufficient time for mobilisation and market awareness

In its submission to the NTA's consultation process, the Competition Authority pointed out the need for careful design of the competition to ensure a fair and equitable competition and prevent the emergence of cartels and bid-rigging.

Research from the MARETOPE project found that unpreparedness both of contracting authorities and operators is a common barrier to smooth implementation of market reform.[12] The contracting authority should therefore be appropriately resourced to effectively manage the competition.

On the point of preparedness of potential operators, the market consultation undertaken by the NTA showed that for a 50-100 bus contract, the operators' view, as a median, was that a 6 month tender period is achievable.[13] Regarding the necessary mobilisation period, if buses and depots have to be sourced, a period of 9 – 12 months is considered necessary, with a shorter period if depots and buses were provided.

Requirements relating to national and EU-wide procurement rules must be complied with. Lead-in time requirements are a function of the scale of the competition. Given the scale of the competition under consideration, a timeframe of 2016 should be sufficient to put in place the necessary conditions.

4.2.2 Appropriate size of bundles

The specific bundles which are tendered should be selected so as to maximise the level of market interest and thereby increase the level of savings and enhanced customer service available. The market consultation undertaken by NTA in 2012 showed that Irish operators wanted less than 50 buses in a contract, and preferably of the order of 20 buses, while international operators wanted at least 50 buses and either strongly or absolutely preferred a contract for more than 100 buses. Therefore, the scale of the opportunity in each option considered for Bus Éireann may be sufficient to attract Irish operators. The scale of the opportunity in the Dublin Commuter area, when taken in conjunction with the proposed tendering of the orbital routes, could be sufficient to attract Irish operators and possibly international operators, although they are dispersed over a wide geographical area which will present operational challenges.

4.3 The potential options: opportunities and relevant risks

Making changes to the way bus services are contracted, and potentially introducing new service providers can create opportunities, as discussed in Section 3. As with all processes, there are also potential risks that need to be identified and managed.

4.3.1 Opportunities for market growth

As discussed in Section 2, growing modal share of public transport is a public policy objective. A more extensive network and enhanced level of customer service can assist in achieving this.

In the case of Cork, socio-economic characteristics point to potential opportunities. For example the presence of third level institutions and a large young adult population strengthen the market for public transport. Like Dublin, car ownership in

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12 EU (2003) *Managing and Assessing Regulatory Evolution in Local Public Transport Operations in Europe* – MARETOPE Handbook

13 National Transport Authority (2012)

Cork City Centre is relatively low – a feature which further strengthens the market opportunities.

4.3.2 Executing the competition

International evidence cited previously has shown that there are risks associated with lack of expertise and experience of authorities and unpreparedness of operators.

Sufficient lead-in times must be provided for both in order to satisfy regulatory requirements and in order to ensure all necessary conditions are in place and all actors in the process are ready.

Collusive tendering and the emergence of cartels is a risk to the process. Under such circumstances, the winning bid will be higher than it would otherwise have been had unadulterated market forces prevailed, leading to deadweight loss of taxpayer resources.

4.3.3 Financial risks

Uncertainty or instability in funding constitutes a barrier to regulatory reform in urban transport which has been experienced internationally. Given that the subvention from the Department of Transport, Tourism & Sport is paid on an annual basis, and in light of the prevailing climate of fiscal consolidation, this risk is present in the case of Ireland.

A potential implication of this is that international operators will price this risk into tender bids, thereby driving up the price against what it otherwise might be. This is not considered to be as significant a barrier as it may have been in 2010 and 2011.

As the process of fiscal retrenchment moderates and the public finances return to a more sustainable path, this risk will diminish over the medium-term.

A further issue relates to financial risk to the incumbent associated with downsizing operations in the event of the contract being awarded to another company. However, this is offset to an extent by the fact that Bus Éireann has elements to its operations other than PSO services; namely school transport and Expressway services.

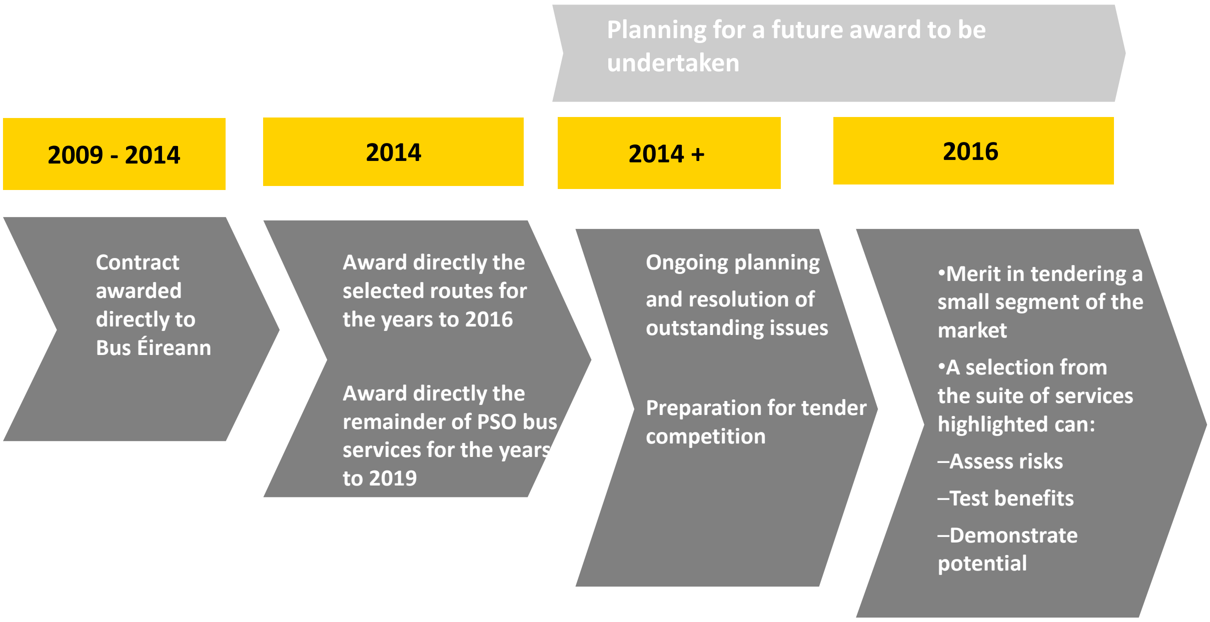
5. Conclusions and Next Steps

This paper has reviewed the factors that will inform a decision on the basis of the next award of public service bus contracts in outside of Dublin.

While preparations have been progressing for a move to competitive tendering, a further direct award to Bus Éireann will be required in 2014.

Moving further into the medium-term however, there is clear merit in a competitive tendering process for a segment of PSO services in order to test the process and understand the capacity to realise the potential benefits on offer. Figure 5 presents a schema of the potential approach.

Figure 5 Potential Timeline for Future Contract Award



This approach is well placed to understand the potential benefits of market reform while guaranteeing the continued reliability of bus services outside Dublin.

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