



## Regulating public automobile transport: the major issues

### Summary

Public automobile transport in Belarus is both socially and economically important. As the structure of the sector changes with the development of private providers, the system of state regulation of public transportation needs to be reformed as well. The two major types of regulations needed are regulations on technical and safety standards, and market regulations. This paper focuses on the need for independent regulatory bodies to provide sound regulation for local transportation markets.

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## 1. Introduction

There are many forms of public transport in Belarus: intercity and suburban trains, subways, trolleybuses, trams and buses, not to mention air and river transport. Yet for most regions and for the majority of the population the most important daily mode of transportation is urban bus transport – which is why this paper is dedicated to the problem of regulating this kind of transportation.

The regulatory system governing public transportation in Belarus and the relevant legal framework are being shaped at this moment. This effort is being driven by the poor performance of the traditional public providers of passenger transportation services and the emergence of new, private ones. The sector that used to be dominated by state-owned regional monopolies until the late 90s is now open to competition. This creates an urgent need for a sound and up-to-date regulatory framework that can ensure fair competition among the different service providers and promote the development of this socially important service.

This paper discusses the special characteristics of public transportation and why the government needs to be involved (part 2), describes basic types of regulation (part 3) and analyses different possible structures for the new regulatory bodies to be created (part 4). Final remarks and policy recommendations can be found in part 5.

## 2. Public transport as a ‘club good’

Public transportation has some ‘public’ characteristics but nevertheless does not meet the classic definition of a public good. Firstly, the number of seats in a bus<sup>1</sup> is limited so that some customers can be excluded from consumption and consumption is only non-rival up to this capacity limit. Up to the capacity limit, however, the public good characteristic of non-rivalry is present. Secondly, in most cases a driver or other person can charge a fee for a ride, eliminating the free-rider aspect common to public goods. These characteristics of public transportation make it fall under the definition of a so-called ‘club good’.

Club goods fall somewhere between public and private goods. Customer exclusion is possible, but the optimal number of consumers is always more than one. Adding marginal customer doesn’t influence the consumption of other customers, at least to the certain limit. Cinema is the classical example of a club good.

Public transport also produces positive externalities since it eliminates congestion on roads: a bus takes on more passengers than private cars that would have to be used otherwise.

Since public transportation is not a pure public good, there is no theoretical justification for regulating this sector like other infrastructure sectors where pure public goods are produced. Competing providers cannot generate monopoly profits in public transport, and the market mechanism can function similarly to a classical private-goods market. Nevertheless there is significant scope for government regulation of this sector because of the positive external effects and the social importance of public transportation. This will be discussed in more detail in the following chapters.

## 3. Types of regulation

Depending on the priorities of a local administration there can be two major types of regulation of public transport. The first concerns regulations aimed at meeting safety

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<sup>1</sup> We will refer to buses throughout this paper, but public transportation can take other forms such as streetcars, subway trains, etc.

and environmental standards. The second type concerns market regulation to ensure that certain social goals (maintaining service on unprofitable routes, uniform tariffs etc.) are achieved.

In this paper we will not discuss the issue of road usage fees. Heavy buses damage roads substantially more than private cars. Thus providers of transportation services should - at least in theory - cover a part of the road maintenance costs by paying a fee graduated to the weight of the bus. In this manner all final customers, i.e. the bus passengers, would be charged for road usage – and this by including the road tax in the price of the ticket. Yet, in this paper we will assume that street maintenance is financed by some type of fuel tax, part of which is funneled to the local administration.

### *3.1. Regulation of safety and other standards.*

Public transportation plays an important role in the lives of the majority of the population. In small and medium Belarusian cities most working people use it to get to and from work on a daily basis. In rural areas public buses are the only means of transportation for most people with which to reach those places where they can receive public services. This implies that buses used for passenger traffic must be safe and reliable. The users of public transportation must be able to count on the vehicles being safe and clean: “If a bus is there it’s supposed to be safe because someone has checked it” – this kind of logic is commonly applied. Vehicles used in public transportation should also be sound from an environmental perspective since up to 80% of the CO emissions into the atmosphere in Belarus are produced by motor vehicles including buses. All bus stops should be in suitable locations so as not to disturb other road traffic or increase the accident risk.

The safety standards for public transportation vehicles should include:

- Regular technical requirements, similar to private cars,
- At least two exits on each vehicle,
- Special technical requirements like a maximal allowed distance from the ground to the first step; bus route indications, emergency lighting, hand-holds etc.,
- The weight of the loaded vehicle shouldn’t exceed the maximum weight allowed on the roads being used, including bridges or other limited load structures.

There should be no limitation on the vehicle’s age or the minimum number of seats as long as it fulfils all the technical requirements. The environmental standards should generally focus on the emissions produced. Furthermore, all providers of public transportation must be properly insured against accident and negligence risks.

Another group of standards concerns the drivers of public buses. A driver should have a commercial driver’s license and be trained to respond appropriately to special situations (basic mechanic skills, provision of first aid, etc.). For the safety of passengers it must be ensured that the driver is not intoxicated and is able to drive the vehicle safely. Traditionally this is insured through a daily medical check prior to going on the road. Large firms employ a medic for this purpose; small companies may need to outsource this service.

Meeting the above-mentioned standards by providers of transportation services requires the constant control by a public regulatory body. In the past, when passenger transportation services were provided by regional monopolies, the need for such a body did not exist. However, nowadays there are many public transportation service providers, hence the need for an independent regulatory body is obvious. Independence of the regulator is primordial. This agency must objectively inspect and

control all service providers, public and private, and apply the same standards to both without discrimination.

### *3.2. Regulation of the market.*

Depending on what kind of policies the local authorities promote or what their urban-planning priorities are, there may be a need for regulating the public transportation market.

The local authorities may want to provide equal conditions for all residents of the city, for instance by ensuring that the cost of any ride from their home to downtown is the same. Or they may want to maintain service on an unprofitable route for retired people living in a suburb to get to the city, especially if such a service has been available for a long time in the past. Anyway, it is the right of all citizens (through their elected councils) to define the services their city will provide.

This being so, a local administration could artificially create a monopoly for passenger transportation services by regulating supply. The supply could be limited in order to create monopoly rents on profitable routes, in order to use these rents to achieve stated aims – such as the provision of service on an otherwise unprofitable route. For example, a provider might receive the right to operate 10 profitable routes and 2 unprofitable – with contractually determined numbers of seats and frequencies, and subject to regulated prices for all routes. In other words this is cross-subsidizing a fraction of the consumers who live in suburbs and villages at the expense of all others.

This type of market regulation requires that the costs and profits of the providers be constantly monitored. This is necessary to determine which routes are profitable and which are not, and to measure the monopoly rent (the difference between profits with and without regulation). Obviously, the providers will have incentives to inflate the costs that they report, and to hide profits, or to exaggerate the losses associated with servicing unprofitable routes. The right to limit supply – i.e. to deny some providers the possibility to provide a service creates rent-seeking incentives that may end up fuelling corruption among local officials.

Generally, if regulation is not done properly, market incentives will be destroyed leading to an increase of tariffs and an undersupply of the service (deficit). For this reason, to correctly structure the regulatory body is of great importance.

## **4. Designing regulatory bodies**

### *4.1 Two main types of regulatory body*

The structure of a regulatory body at the local level depends on the functions it is meant to perform. If the only function of the body is to control implementation by providers' safety and environmental standards (set by the central administration) then it is not really a regulatory body in the strict sense of the word at all. In this case, the function could easily be performed by already existing bodies, such as transport inspection, environmental protection services, etc. There will be no need for an independent regulator.

However, if the national standards are deemed too low or do not meet the regional needs, the residents of some regions (cities) may want to adopt higher standards. Here too, the existing institutions can control the implementation of the higher standards set by the local council. Another approach would be to establish a special regulatory body that will develop the standards for providers of passenger transportation services and then control their implementation. Theoretically, there is no ultimate need for such a regulatory body, hence the decision either to establish it or not should be up to each local council. It is important though to ensure that the standards instituted and controlled are objective, and not a hidden way to

discriminate against private providers. All providers must always be subject to the same standards, without discrimination of any type.

If the local authorities are to engage in the regulation of the passenger transportation market, a regulatory body becomes absolutely necessary to perform the following range of functions:

- Plan the transportation network – roads and bus routes,
- Determine which of the routes are profitable and which are not,
- Share out routes among different providers,
- Constantly control the costs and profits of the providers,
- Manage the transportation network infrastructure.

There are two possible structures for regulatory bodies. Both will be discussed, comparing the situations in Belarus and in Poland.

#### Department under local administration.

The functions of the regulatory body for public transportation can be filled by a department of the local administration. This scheme existed in Belarus up to 2004<sup>2</sup>. Appropriate departments of the local executive committees regulated the markets. The main disadvantage of this system is that the local council usually owns the public transportation company and thus, will tend to attempt to create more favorable conditions for itself as compared to competitors. This system can function efficiently only if there is no competition on the market (which is not efficient in a broader sense) and where only one monopoly provider is allowed to provide service.

#### Independent regulatory body.

An independent regulatory body is created to ensure fair competition among different service providers. In international practice, regulatory bodies (sometimes called 'boards') consist of representatives of all interested parties: local authorities, service providers, road maintenance providers, consumers and labor unions. The body is independent both from the local administration and from the service providers, and a statute regulates its activities. Such a body is likely to be more impartial with its decisions based on purely economic arguments instead of political ones, as in the case of a local administration being the regulator. All procedures within independent regulatory bodies should be fully transparent, especially route distribution decisions. The criteria for all actions and procedures should be clear and all decisions should be made in a public forum.

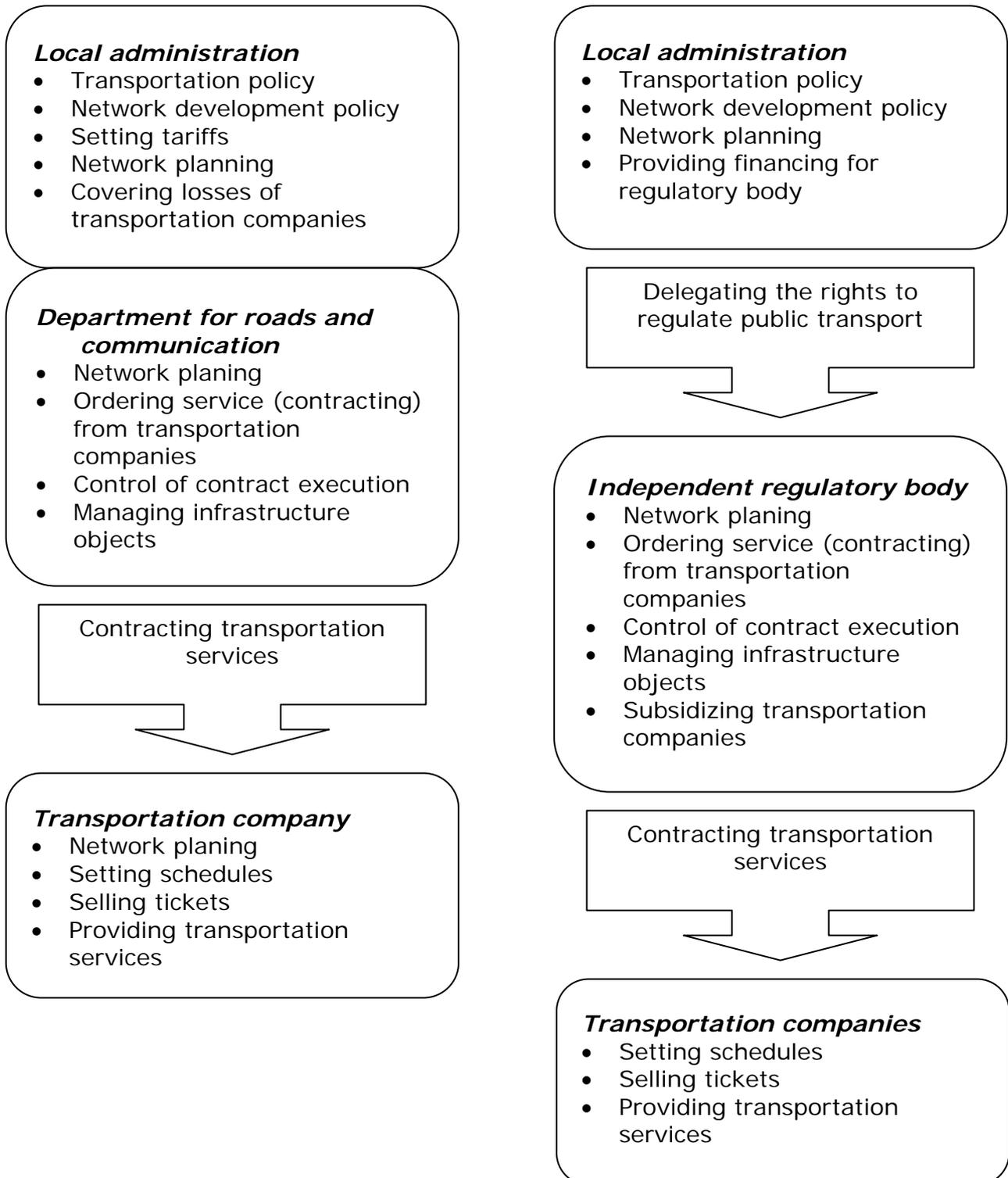
Poland provides an excellent example of how a central government can delegate rights to structure regulatory systems for public transportation to regional authorities. According to the law "On communal economy" the gmina<sup>3</sup> authorities should decide how the system of public services provision is to be organized (including public transport). Thus it is up to the regional or city councils to decide which of the two above-mentioned systems to use. Up to now, most regions and cities use the old system whereby a department of the local council is the operator. Yet, in more than a dozen cities independent regulatory bodies have been established (see Figure 1). The authorities of the majority of Polish cities have in the meantime come to appreciate the advantages of a regulatory system based on independent regulatory bodies and are in the process of establishing such boards.

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<sup>2</sup> Up to 2003 local councils were also the licensing authority for local providers.

<sup>3</sup> The lowest level of political division of Poland.

**Figure 1. The regulation of public transportation in Polish cities: Centralized system versus system with an independent regulator**



#### *4.2 The present Belarusian transportation market*

According to Belarusian legislation there are three major players in the transportation market: principal, operator and provider. The principals are the executive bodies of the local administrations – for urban and suburban transport, and the Ministry of Transport for intercity and international transport. The principals are required to contract transportation services from an operator. According to the “Provision on operators of passenger auto-transportation services”<sup>4</sup>, the operator from whom the principal obtains the service can be a legal entity or an individual entrepreneur. This means that, theoretically, any economic agent can become an operator. Moreover, it is not specifically mentioned in the document that there can be only one operator. Also, no criteria are given for selecting operators by the principal. According to the “Provision” an operator should fulfill the following functions:

- Advising the principal on measures to develop a route network,
- Operational control of keeping schedules by service providers,
- Signing contracts on provision of transportation services with providers,
- Coordinating bus schedules with the schedules of other modes of transport,
- Operational control for implementing the safety standards by the service providers,
- Checking tickets in the buses (with the help of Mintrans transport inspectors and representatives of the providers if needed),
- Regulating and changing schedules,
- Recommending tariff changes,
- Preparing offers for the principal to limit the number of permits.

The fact that the operator should be a legal entity or an entrepreneur is interesting: a department of the executive body of a local administration cannot become an operator according to the ‘Provision’.

Currently, operators are either local executive bodies (i.e. the principals themselves) or state-owned transportation companies that used to be regional monopolies. The latter contradicts articles 36 and 50 of the law “On automobile transportation services” as well as the anti-monopoly legislation because in these cases private service providers are regulated and controlled<sup>5</sup> by their major competitor – the state-owned service provider. Usually operators ask all service providers to sign contracts with them before they are allowed to provide service on their assigned routes. Since no standardized contracts are available, operators write them as they see fit, so that they quite often contain illegal clauses. For example, in Gomel and Mozyr there are clauses in the contracts forcing the private service providers to provide one free seat for privileged passengers without compensation.

The procedures used by operators to share out routes frequently remains shrouded in obscurity. There are no precise rules: thus there have been cases in which certain private firms with technically unsound vehicles (prohibited shortly after) received permit for the most profitable routes while other entrepreneurs were driven out of business. In most cases special ‘competition committees’ share out the routes. These committees consist of representatives of the local authorities (the principal) and operators (state-owned providers), making fair competition among different providers nearly impossible.

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<sup>4</sup> By the Council of Ministers, February 8, 2005.

<sup>5</sup> Including the authority to share out routes, allow private firms to provide service, control their activities, and to issue and cancel permits to operate routes.

The administrations of some towns have started to auction off routes without any legal basis.<sup>6</sup> In Babrujsk the procedure was organized like a regular auction and bids for permits reached as high as USD 7000. In Grodno, private providers were asked by the local council to make contributions to the city coffers and the ones who contributed most (up to USD 10000) received permits to operate the most profitable routes.

Technical and safety standards are set by the central authorities (like the Ministry of Transport) and do not take into account regional differences. For example, 7-seat vans are prohibited from operation. This may be a useful measure for Minsk where the flows of transport and passengers are massive but is quite unrealistic in other cities where many suburban routes are used by only a few passengers.

## **5. Conclusions and policy recommendations**

Public transportation is not a public good, but a club good. There is no need for intervention on the basis of non-rivalry, competition will assure that the market remains contested, and that there are no monopoly profits provided the regulation is non-discriminatory and objective. However, there are two justifications for regulation. One is the need to develop technical and safety standards and control their implementation by the service providers. Secondly, regulation can achieve socially important goals like maintaining service on unprofitable routes and maintaining uniform tariffs.

The decision about how to structure the regulatory framework for passenger transportation should be up to the regional authorities. Even some technical requirements, such as the minimal number of seats in a vehicle, may depend on specific regional conditions such as the size of the city, the parameters of the road network, and the degree of congestion.

There is no need for a special regulatory body if the regulation only concerns safety aspects. In that case all the regulatory and control functions can be performed by existing state organizations. However, it must be ensured that the regulation of standards is not a hidden form of discrimination against private providers.

If the local administration sees the need to intervene in the local transportation market in order to offset any 'market failures', then a specially created regulatory body would be best to perform the regulation. To ensure fair competition on the market and thus to better develop the sector, the regulator needs to be independent both from the local authorities and the service providers. It should consist of representatives of all interested parties like consumers, road maintenance services, labor unions as well as the service providers and the local authorities.

It is an important task for the central authorities in Belarus to create a regulatory framework for public transportation that will allow local councils to establish independent regulatory bodies. At the same time national laws should ensure minimal standards and effective prevention of misuse and corruption.

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<sup>6</sup> The national legislation requires government administrations and state-owned companies to request competitive bids for any service or good they buy, but clearly private provision of transportation services does not fall under this requirement. It would be a good idea to include transportation services, especially if the bidding was properly organized, but under current legislation that is illegal.