

## **7. CENTRAL AND EASTERN EUROPE: A SPECIAL SITUATION**

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CER brings together 49 railway and infrastructure companies from all EU states, Switzerland, Norway, the EU accession states, and states on a road-map towards EU membership. It provides advice on all issues relating to the EU and its laws.

The CER works on all political questions relevant to the railway business (in close co-operation on technical issues with the International Union of Railways (UIC) in Paris). It provides information and advice to political decision makers in Brussels.

### Legal Framework for Public Service Transport in EU

The European Commission in the Third railway package proposes further liberalisation of the rail passenger market. Furthermore EC proposes to revise Regulation 1191/69, which was historically adopted with a view to secure proper compensation for public service obligations. CER demands in its position paper *'Public service Transport by rail and road: a new legal framework'*<sup>1</sup> special attention for:

- Scope of application of the proposed regulation i.e. synchronisation with third railway package, definition of regional and public service transport.
- Securing proper compensation of Public service obligations.
- Duration of Public Service Contracts.

On these issues the situations in the new EU Member States and EU-15 countries are significantly different.

### Situation in Central and Eastern Europe

The Chief Executive Officers (CEOs) of the CER members in Central and Eastern Europe demanded urgent attention for their loss-making passenger services in November 2003. This led to a series of special CER activities on passenger rail services in this region:

- 28-30 April 2004: EC/UIC/CER/UN-ECE conference on regional passenger services, Paris.
- 25 June 2004: The problem of cross subsidisation of passenger services discussed in meeting with F. Lamoureux, Director General Transport & Energy.
- 27 January 2005: High level EC/CER Conference on public passenger rail transport services in an enlarged EU.
- November 2005: 'CER overview of Public Service Rail Transport in the EU'.<sup>2</sup>

The CER overview on the current situation as regards rail passenger services in the new EU Member States shows that in these countries payments by the state for compensation of losses on public service obligations are still paid in the form of annual subsidies. Moreover, not the level of services rendered, but the budgetary situation of the state is in most cases determining the level of payment. The latter is emphasised by the practice of negotiating payments under the annual Public Service Contract in the course of the ongoing contract year. This means effectively that the operators have hardly any possibility to adjust the service proposition to the level of payment received under the Public Service Contract.

Summary of ‘*CER Overview of Public Service Rail Transport in the EU*  
on Current Situation in new EU Member States

CER Overview, November 2005	CZ	EE	HU	LV	LT	PL	SK	SI
Is there a PSC for passenger services?	√	√	√	√	?	√	√	√
Is proper compensation for public service obligations secured?	X	?	X	X	X	X	X	X
Is the PSC longer then 1 year?	X	X	X	X	X	X	X	X

The conclusion to be drawn from the CER overview is that cross subsidy of passenger services with revenues from freight operations prevails in Central and Eastern Europe. But these cross subsidies of passenger services with revenues from freight operations must stop, because:

- The freight sector will be fully liberalised in the entire EU 12 months. New entrant railway undertakings will compete with the incumbent national railway companies on freight operations. For obvious reasons the new entrants will not embark on loss making passenger operations, so that only the incumbent railway companies lose a significant share of their revenues from freight on obligatory passenger services. This undermines the competitive position of the incumbent railway companies.
- Regulation 1191/69 obliges EU Member States to compensate losses from public service obligations.
- Directive 91/440 (Article 9) obliges EU Member States to provide a sound financial basis to the rail sector.

### What is needed in Central and Eastern Europe?

Public Service Contracts (whether negotiated through competitive tendering or not) require that service propositions are defined and that matching budgets are available, but:

- How much is the cost of a product/service proposition?
- How much budget is there for a product/service proposition?

Authorities when taking decisions on payments for public services and multi-year Public Service Contracts must also take decisions the features of the service propositions demanded from the transport operators. These decisions require that the authorities know which budget is available in the forthcoming years, which services are required by the inhabitants of their region, and what it costs approximately to produce these services (in a cost-effective) manner. Only with this knowledge can authorities be expected to decide on best-value-for-budget service propositions. Whilst not secure on the services needed, not certain on cost-effectiveness of services and not certain on availability of budgets, authorities are reluctant to negotiate multi-year contracts, which impose long term financial obligations.

On the other side the railway operators need to invest in their operations and in rolling stock, but will do so only with a long term expectation of sufficient revenues.

This means that authorities and railway operators are in a sort of vicious circle. Authorities will not negotiate multi-year contracts, because the product needed is not defined (or budget is inadequate). Railway undertakings will not invest in the product, as long as they do not have a viable multi-year Public Service Contract. *Meanwhile services are inefficient and unattractive, while rolling stock is at the end of its technical lifetime.*

In some new EU Member States it can be witnessed that authorities and railway undertakings are gradually reaching a balance in the service proposition and level of payments for public services. However, still the (less than) one year contract durations prohibit the railway companies to invest in their operations<sup>3</sup>. It is remarkable that Latvia is the first new EU Member State where for the first time a multi-year Public Service Contract has been successfully negotiated. In this case the Government allocated € 15 million from the European Fund for Regional Development for modernisation of rolling stock.

Authorities and railway undertakings need to negotiate multi-year Public Service Contracts with detailed service propositions and a matching level of payment. The uncertainties on budget availability, operational costs and customer demands, a history of cross-subsidisation and a vast investment backlog make these negotiations into major challenge.

### CER Position

When negotiating Public Service Contracts and transferring responsibilities from the public to the private sector, it is required that the best value-for-public-budget is obtained and the appropriate private partner is selected. Competitive tenders could be instrumental in negotiating Public Service Contracts when:

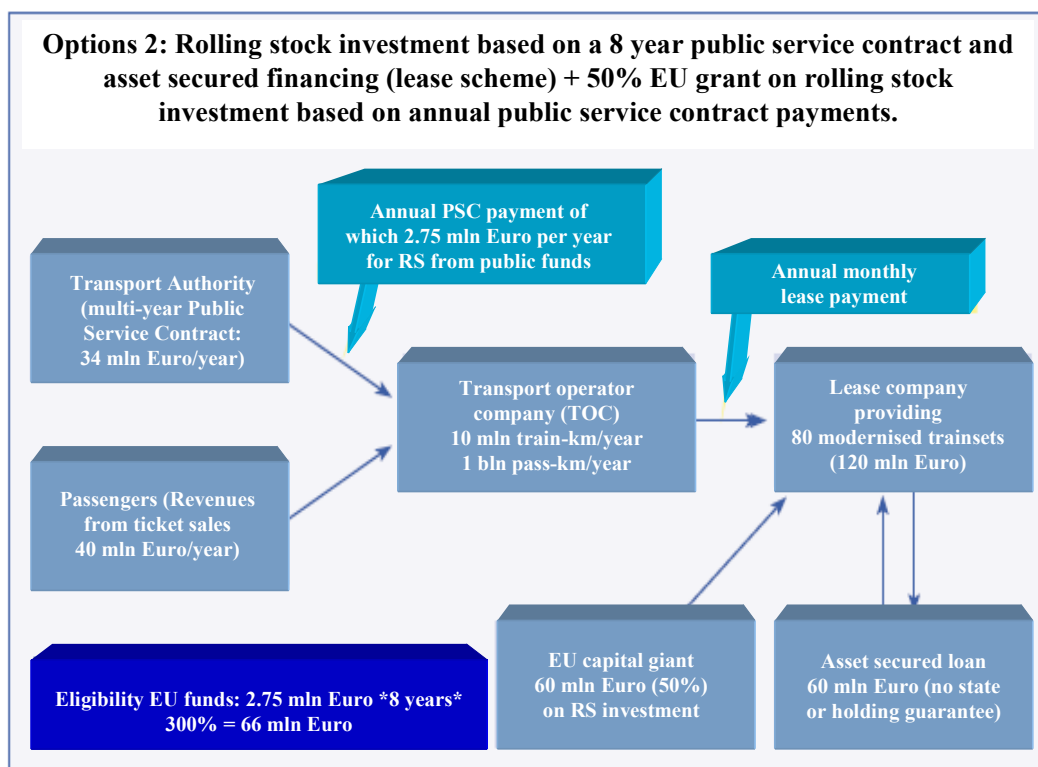
- Various potential bidders are able and interested to offer the services, but as yet in most new EU Member States there is only 1 national company obliged to provide services at the expense of freight operations.
- Authorities know what they want and what they can afford, but as yet costs, budgets and service levels are not clear in Central and Eastern Europe.
- A rolling stock market or financing scheme bridges the gap between the duration of the Public Service Contract and the technical lifetime of the rolling stock, *but as yet the poor condition of rolling stock is likely to cause collapse of the system.*

The above shows that as yet it is too early for competitive tendering in the new EU Member States. Therefore Public Service Contracts will in the next years need to be negotiated with the incumbent operators or possibly in some exceptional cases with pre-qualified new entrants.

Rolling stock investments play a crucial role in the negotiations on Public Service Contracts. For financing rolling stock without sovereign guarantees the cash flow expected from the Public Service Contract must provide sufficient security for the private investor. However, even when the states duly compensate public service obligations, the duration of Public Service Contracts will for the time being be too short to offer sufficient security<sup>4</sup>. Under these conditions asset-secured financing (or lease) schemes can offer additional security to private investors. Such schemes present a solution for bridging the gap between the duration of the Public Service Contract and the technical lifetime of the rolling stock and thus make it feasible to attract private funds to the rail sector of the new EU Member States.

For facilitating the negotiations between authorities and railway operators on Public Service Contracts and for breaking the vicious circle, which hinders investment in passenger services in the new EU Member States, CER recommends that the European Commission uses a 'stick- and-carrot' approach. In this approach EU should support investments in passenger rolling stock in the new Member States under the condition of a viable multi year Public Service Contract. Meanwhile EC should continue to enforce and verify compliance with relevant EU legislation on (compensation for) public service obligations. The EU investment support should have a transitional character and promote the establishment of schemes for financing rolling stock with private funds.

**The CER position paper 'Developing coherent rail services in Central and Eastern Europe; making use of the EU's Cohesion and Structural Funds' presents an example of EU support for investment in rolling stock and the establishment of a lease scheme.**



Source: CER.

## NOTES

1. 'Public service Transport by rail and road: a new legal framework' November 2005, see [www.cer.be](http://www.cer.be)
2. CER overview of Public Service Rail Transport in the EU, November 2005, see [www.cer.be](http://www.cer.be)
3. In such situation the railway companies would be able to invest in rolling stock with sovereign guarantees on the financing as was done traditionally. This implies that the public sector provides all the financing and bears all the risks, while it does not give maximum incentives to the operator for enhancing cost-effectiveness.
4. Even in fully liberalised markets (e.g. U.K.), the duration of the Public Service Contracts are usually shorter than the technical lifetime of the rolling stock.

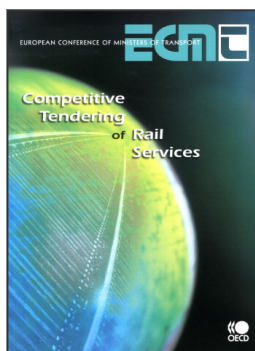
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**ABBREVIATIONS**

AFI	Annual Financial Improvement
BOT	Build, Own and Transfer
BR	British Rail
CEO	Chief Executive Officer
CER	Community of European Railway and Infrastructure Companies
CN	Canadian National Railway Company
CPTA	County Public Transport Authorities
CUP	Capacity Utilisation Policy
DB AG	Deutsche Bahn AG (German Railways)
DfT	Department for Transport
DOI	Department of Infrastructure
DSB	Danish State Railways
EWS	English Welsh and Scottish Railway (freight operating company)
GDP	Gross Domestic Product
GNER	Great North Eastern Railway
GOVIA	Partnership of Go-Ahead and Keolis (train operator)
ITC	Independent Television Commission
MBO	Management Buy Out
MTL	Rail subsidiary of MTL Holding (operator of Merseyrail services)
NAO	National Audit Office
NEG	National Express Group
NERA	National Economic Research Associates
NPV	Net Present Value
NR	Network Rail
NS	Dutch National Carrier
OPRAF	Office of Passenger Rail Franchising
PSR	Passenger Service Requirement
PTC	Public Transport Commission
PTE	Passenger Transport Executive
RBI	Rail Business Intelligence
ROSCO	Rolling Stock Leasing Companies
RRPS	Regional Rail Passenger Services
SJ	Swedish State Railways
SRA	Strategic Rail Authority
TOC	Train Operating Company
WAGN	West Anglia Great Northern





From:  
**Competitive Tendering of Rail Services**

Access the complete publication at:  
<https://doi.org/10.1787/9789282101636-en>

**Please cite this chapter as:**

Toet, Ad (2007), "Central and Eastern Europe: a special situation", in European Conference of Ministers of Transport, *Competitive Tendering of Rail Services*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789282101636-8-en>

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