

# Empirical Study on Government's Procurement of Urban Public Transport Services in China

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## ABSTRACT

Promoting the government's procurement of urban public transport services is helpful for upgrading the supply quality of public transport services and improving the efficiency of government's financing. Based on the field research in more than ten cities in China and a thorough analysis on their policies, this paper summarizes three modes of public transport services procurement in China, i.e. selection of the best through bidding & quotation based on competitive cost, direct granting of operation rights & affirmation of costs by the government, direct granting of operation rights & extensive subsidy compensation. By analyzing Foshan and Suzhou's exercises as typical cases, this research points out existing problems in the current unsound system and working mechanism, the insufficient development of the service procurement market and the inadequate financial guarantee. This article further puts forward countermeasures in specifying the governmental duties, improving the pattern of market operation and strengthening fund guarantee.

## I. RESEARCH BACKGROUND

Government's procurement of services initially originated from the countries such as UK and US in the 1970s and has exerted profound influences in the field of social services [1]. Since the 1980s, China has carried out exploratory pilot exercises in the government's procurement of public services, but there has been lack of a complete policy and institutional system. Only after the 18<sup>th</sup> CPC National Congress in 2012 did the relevant institutional system for the government's procurement of public services began to be gradually established and improved in China. The urban public transport features the attributes of quasi-public products and is one of the basic public services that the government should provide. To promote the government procurement of services in the urban public transport field is favorable for realizing regulated operations and managements of urban public transport and improving the supply quality of public transport services and the use efficiency of financial funds, so as to provide better public transport services for the general public.

## II. CURRENT STATUS OF GOVERNMENT'S PROCUREMENT OF URBAN PUBLIC TRANSPORT SERVICES IN CHINA

### A. Three Modes

Currently, city governments' procurements of urban public transport services in China are mainly in three modes as follows:

#### II. *Mode 1: Selection of the Best through bidding & Quotation based on Competitive Cost*

This mode is a market-based operation approach, in which the government proposes service standards, the operators compete for the bid through operating costs and anticipated profit rates, the bid-winning enterprise is determined through comprehensive evaluation of the service quality of the bidding enterprise in previous years and their quoted prices, the bid-winning enterprise's quotation based on operating costs is deemed as the operating costs agreed upon by both parties, the responsibilities and obligations of both parties are stipulated by signing the franchise operation/government's service procurement agreement, and these are fulfilled through evaluation and based on the results and contract provisions. This mode is applicable to the market pattern featuring the operation and full competition of several urban public transport providers, and such mode has already been implemented in some developed cities around the world, such as London, Berlin and Seoul. As this mode demands higher conditions for implementation, the majority of Chinese cities don't have the prerequisites for implementation and therefore, it has rarely been carried out. Currently, only Foshan's public transport TC (Transport Community) mode is rather similar to such mode in the form.

#### III. *Mode 2: Direct Granting of Operation Rights & Affirmation of Costs by Government*

This mode is mainly applicable to the market pattern featuring monopolization or limited competition. In such mode, the government directly grants the franchise rights (or operation rights) to urban public transport providers, signs the franchise agreement (operation rights agreement) and subsidizes public transport companies based on the costs affirmed according to certain standards. For example, some city governments regulate the costs of public transport companies, and after audit and verification, the government subsidizes the companies with regulated costs and signs the procurement contract as constraint. More than twenty Chinese cities including Suzhou, Qingdao and Hangzhou have applied this mode.

In addition, due to their limited financial bearing capacity, some local governments adopt the "budget-restricted" mode of purchasing services. In such mode, the funds for procurement of services can only make up for part of the operating costs of public transport companies and are difficult to synchronously adjust with the actual increase of the costs of enterprises. Some cities have adopted the fixed base methods, such as "three-year quota" of service purchase funds (Shanghai) or "quota for large part + cost regulation for small part" (Shenzhen). These cities' policies for procurement of public transport services are mostly temporary transient measures and still need to be adjusted.

#### IV. *Mode 3: Direct Granting of Operation Rights & Extensive Subsidy Compensation*

Currently, most of city governments in China give moderate subsidies to the public transport companies. Local governments of some cities such as Hefei

determines the subsidy for policy-related losses through the extensive manner of bargaining with transport companies. This means that, after consulting with the local financial department, the public transport companies annually determine the items and amounts of public transport subsidies based on their actually incurred losses. Sometimes they solve it through negotiations on specific circumstances, and in some cases, the amount and quantity of subsidies are specified in the documents of local governments and there lacks the contract constraint. Such mode is only the “initial stage” of government’s procurement of public services. As the subsidy given afterwards doesn’t conform to the standard requirements for government’s procurement of services beforehand, there exists serious problems.

#### **A. Typical Cases**

##### *1) Foshan City’s TC Mode (Mode 1)*

Foshan (a city in Guangdong Province) started to implement the TC (Transport Community) mode reform in its public transport sector in 2008. The core of Foshan’s TC mode lies in the “separation of ticket and operation” [2]. The organizational structure of such mode consists of three layers - government, management and operation.

The layer of government, which consists of the transport bureau and relevant government departments, is responsible for formulating and guiding policies, coordinating the overall public transport planning and the investment and construction of infrastructure, design a reasonable fare ticket scheme and providing a good environment of urban public transport services. The funds needed for government’s procurement of public services are listed in Foshan’s municipal and district-level financial budgets.

The layer of management, i.e. the Transport Community Management Center (TC Company), is responsible for collecting ticket fares and planning transit lines according to the policy and business guidance and specifically in charge of the station management. On behalf of the government, TC Company carries out supervision and assessment of services provided by public transport companies, the affirmation of operating costs, the planning and readjustment of public transport network and the line operation management. The result of service quality assessment largely decides how much the enterprises get paid.

The layer of operation consists of several public transport companies. These companies obtain the line operation rights through public bidding and tender. The government signs a three-party contract of five or six years with the bid-winning operator and the TC Company. Among them, Party A is the transport bureau, Party B is the public transport operating company and Party C is TC Company. That Contract clearly puts forward the requirements for service quality, the establishment of the mechanism for supervision, assessment and punishment, the calculation of the lines, quantity, vehicle and funds with respect to the purchased operation services, the time limit, the way of fund payment and rights and obligations of three parties. The operating company provides public transport services according to the service standards as stipulated in that Contract and does not have the income right in the ticket fare. In addition to the payment of operating cost, the government also give transport companies a profit return of 6%.

Public transport services in Foshan city has improved significantly due to the

implementation of TC mode reform. From 2003 to the end of 2014, the total number of bus lines has increased from 158 to 588; the 500 meters radius of station coverage rate in the city center increased from 68% to 98%; the city's daily passenger volume of buses has grown from 330 thousand passengers to 2 million 159 thousand passengers; and the share of public transport increased from 3.7% to 30.1%.

The advantages of applying TC mode in Foshan are threefold: firstly, because of the separation of ticket and operation, it encourages public transport companies to focus on providing better services without taking responsibilities of investment risks, therefore, the public welfare of public transport has improved. Secondly, the TC mode promotes fair use and effective allocation of public transport resources. Thirdly, it promote the management standardization and specialization of government's procurement of services by establishing the layer of management – the TC Company.

## *2) Suzhou City (Mode 2)*

Suzhou (a city in Jiangsu Province) has implemented the service procurement mode of “regulation of annual costs + performance assessment-based incentive” since 2014. As there is only one public transport company as the operator, i.e. the Suzhou Public Transport Company, the Suzhou Municipal Government directly grants this company the line operation rights and determines the subject of undertaking the procurement of services.

The contents of service procurement include the public transport operation services of all urban bus transport lines in the urban area of Suzhou (excluding Wujiang District). The detailed contents include the sum of various subsidies (total subsidy for preferential ticket prices, discounted interests on loans for procurement of buses, subsidy for fuel oil and regulated costs) + 5%-8% return on investment (ROI) + adjustment reward for performance assessment (maximum 30% of ROI) [3].

The government and the company signs the Contract for Government's Procurement of Urban Public Transport Services, in which Party A (procurement) is Suzhou Transport Bureau, Party B (service provider) is Suzhou Public Transport Company Limited and Party C (witness) is Suzhou Finance Bureau. The Contract stipulates the contents and time limit of service procurement, the funds for procurement of services, the payment of funds and the regulation and audit of costs, the commitment on service quality, and both parties' rights and obligations and default liabilities. According to the actual conditions, the government annually makes appropriate adjustments to the clauses of the contract and renews the service procurement contract with the company.

In terms of the management of the funds for purchase of services, it is stipulated that the funds needed for the procurement of public transport services are all listed in the financial budgets of the municipal government and district governments of Suzhou. In 2014, the subsidies granted by Suzhou municipal finance to the public transport were up to RMB 1.2 billion, and it is estimated that the figure would be over RMB 1.5 billion.

In terms of performance and supervision management, the assessment is conducted according to the Measures of Suzhou for Performance Assessment of Public Transport Companies and pegged with the funds for purchase of services, and an accounting firm is entrusted to regulate and audit the operating costs of public

transport company. If the score of performance assessment is above 85, the company will obtain the total adjustment rewards; if the score is below 85 and above 60, for one score lower, the performance assessment-based adjustment rewards that the enterprise obtains will be reduced by 3%; if the score is below 60, the company will not obtain the performance assessment-based adjustment rewards [4].

### **III. PROBLEMS IN CHINESE GOVERNMENT'S PROCUREMENT OF URBAN PUBLIC TRANSPORT SERVICES**

#### **B. Mechanism for Procurement of Public Transport Services Being Unsound**

Different cities in China have made different progresses in establishing the government's procurement of public transport services, and they generally have the following problems: first, there lacks the constraint of service procurement agreement, and some cities replace the legal contracts with meeting minutes and notices of government, resulting in the unclear responsibilities and rights between government and enterprises; second, the service procurement procedures are not standard and some cities still use the subsidies given afterwards instead of listing the service procurement contents and funds in the budget in advance; third, since it's hard to accurately distinguish the policy-related losses from operating losses in urban public transport operation and the multiple supervision and examination by the departments of finance, price and audit makes it difficult to coordinate and unify the enterprises' accounting, audit and regulation costs of operation, resulting in more than one statistical caliber, and besides, due to the lack of sufficient historical data as the reference basis, it is hard to accurately check and ratify the funding budget for government's procurement of services; fourth, the performance assessment and incentive mechanism for procurement of services remains unsound and the institutional design fails to realize the rewarding of the good and the punishment of the bad, resulting in the companies lacking the impetus of decreasing costs, increasing benefits and improving service quality.

#### **C. Insufficient Development of the Service Procurement Market**

In terms of the current bus and trolley operation and management in main cities of China, most of them have developed a situation of the de facto monopolization by one state-owned or state-owned holding public transport company, resulting in that the government lacks choices and price comparison in the procurement of public transport services and is hard to implement an effective incentive mechanism for the quality of purchased services. According to the investigation and research, of the main cities nationwide, there is only one state-owned public transport company in Shijiazhuang, Nanchang, Hohhot, Yinchuan and Lhasa respectively; the local government share of public transport vehicles is over 90% in the cities such as Zhengzhou, Jinan and Hangzhou; the pattern of public transport companies featuring state-owned holdings and coexistence of diverse forms of ownership has been established in Guangzhou, Xining and Shenyang; and the market share controlled by state-owned public transport companies is also around 50% even in Harbin, Nanning, Tianjin and Changsha where such percentage is relatively lower.

#### **D. Local Government's Financial Guarantee Being Unstable**

In China, funds invested in urban public transport mainly come from the local governments' financial budget. The sources of investment in local public transport

are limited and unstable. The local government's investment of funds is mainly subject to its own financial situation, and it is lack of relatively stable fund investment channels and supportive policies for the construction and operation of public transport system. As a result, there exists the situation of "giving more subsidies if there is more money and giving less subsidies if there is less money" with respect to the local public transport.

Many urban public transport companies are financially unsustainable. On the one hand, their fare income is constantly decreasing due to multiple factors, such as the development of subway, online car-hailing services and industrial restructuring, the passenger volume of the conventional bus and trolley transport has reduced in recent years; and in some cities, the passenger volume has notably decreased and the fare income has dropped year by year. On the other hand, the operating costs of public transport companies have largely increased, particularly the labor cost has increased by 10% annually, and the asset-liability ratio of some urban public transport companies has been up to over 70%.

#### IV. POLICY RECOMMENDATIONS FOR IMPROVING GOVERNMENT'S PROCUREMENT OF URBAN PUBLIC TRANSPORT SERVICES IN CHINA

Ideally, a typical mode of government's procurement of urban public transport services in China should have the following factors and features:

**Table 1 - An Ideal Mode of Government's Procurement of Urban Public Transport**

<b>Factors</b>	<b>Features</b>
Market Structure	Full competition of several urban public transport providers
Government's Responsibilities and Rights	Formulate industry admission & exit criteria and service standards; implement supervision and assessment; provide necessary infrastructure and equipment needed for operation; pay the companies on time
Transport Company's Responsibilities and Rights	Provide services strictly according to the quantity and quality requirements stipulated in the contract; no responsibility for fare and revenue risks
Service Quality and Quantity	Matched with the local government's financial capacity, basic public transport service demand and urban transport development objectives
Purchase Mechanism	Tendering based on service quality or regional franchise mechanism
Service Evaluation	Service evaluation by the third party
Incentive	Put incentives on operation service quality and efficiency
Financial Budget	Government's procurement of public transport is listed in the annual financial budget in advance

#### E. Clearly Specifying the Government's Role and Responsibility in Procurement of Services

Firstly, the government should create favorable software and hardware conditions and basis for the procurement of public transport services. In terms of hardware, the government should improve the construction of infrastructure such as roads and stations and provide the necessary vehicle equipment and safety facilities. In terms of software, the government should create a fair and open market competition environment, rationally determine and adjust the public transport operation plans and transport capacity resources, establish scientific service procurement standards and evaluation index system, and set up the service level assessment and reward and penalty system.

Secondly, the government should regulate the service procurement process,

including: whether the service procurement activities conform to the provisions of relevant laws and regulations; whether they are carried out according to the approved plans and standards; whether the performance of the service procurement agreement conforms to the requirements; whether the process of allocating purchase funds is in compliance with provisions; whether there exist rent seeking and other circumstances etc..

Thirdly, the government should supervise and evaluate the results of public transport services provision. The government should put forward standards for the procurement of public transport services beforehand and evaluate the results after the completion of procurement. The supervision and evaluation should be focused on the use of financial funds, service attitude and quality, service effect and the satisfaction of service objects, and the evaluation results shall serve as the basis for paying funds for the procurement of services.

#### **F. Optimizing the Market Operation Pattern of Government's Procurement of Public Transport Services**

On one hand, efforts should be made to foster the service procurement market and optimize the operation pattern of urban public transport market, actively push ahead the reform of the urban public transport sector and on the principle of "scale operation and moderate competition", moderately integrate the urban bus and trolley operation subjects.

On the other hand, public transport companies should have clearly defined ownership and independent operation while the responsibilities of government and such enterprises should be clarified. Therefore, we should actively boost urban public transport companies to deepen reform and build up modern corporation system, improve the governance structure and the incentive-restriction mechanism of public transport companies.

#### **G. Strengthening the Fund Guarantee for Government's Procurement of Public Transport Services**

For one thing, national and local support policies for the priority development of public transport should be strictly implemented, and preferential policies in the fields of land use, taxation, investment and financing should be given to public transport operating companies. It should be encouraged for enterprises to carry out diversified operations, enrich the form of urban public transport services, and actively promote the comprehensive development of urban public transport land use, and enhance the sustainable development of public transport companies.

For another, both the central and local governments should actively build up sustainable and stable sources of service procurement funds. For example, it can set up the earmarked fund for development of urban public transport, use the urban land transferring fees, the proceeds from the auction of car license plates, parking charges and congestion charges as the sources of funds, and jointly support the urban public transport development through the mode of public-private partnership (PPP).

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