A Radical Option

— The Privatisation Britain's Railways

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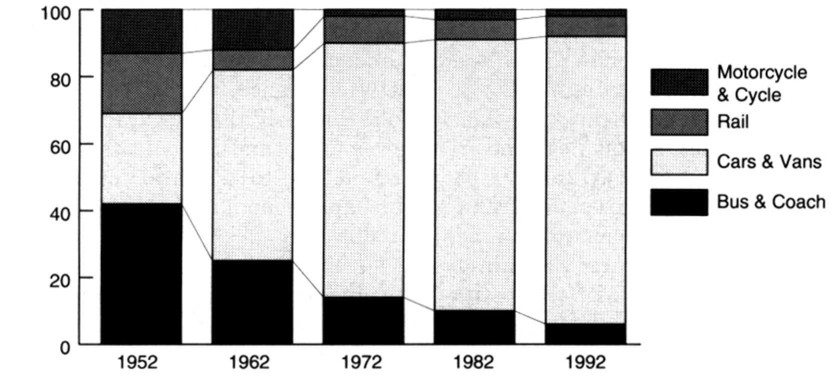
This article shows how railways contribute to transport Great Britain. It describes the development of the management structure of British Rail and the government proposals for privatisation.
Many new companies are being created within a complex legal relationship to provide infrastructure, and rolling stock and to operate train services. This article examines these controversial plans.

Statistical and Financial Background

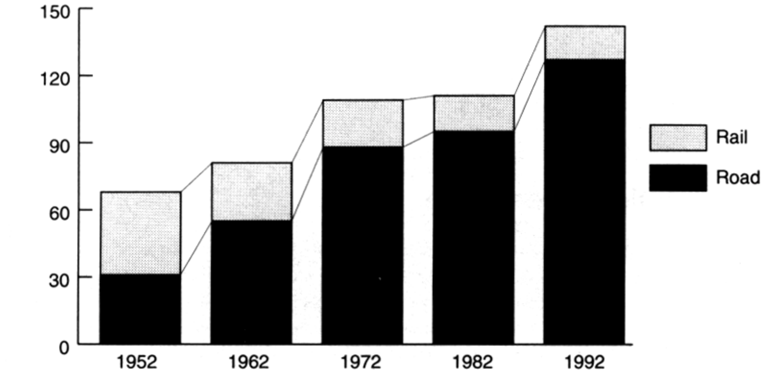
The share of passenger and freight traffic carried by the railways in Britain is shown in these diagrams below. The trend of railway carryings over the last 40 years is also shown.

TRANSPORT MODAL SHARE

Passenger (bn. passenger kms)



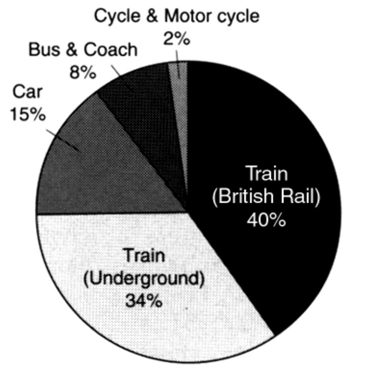
Freight (goods moved bn. tonne kms. excluding water and pipeline)



The railway enjoys a relatively high share of commuting journeys into London and on inter-urban trips between larger cities 100 and 400 km apart.

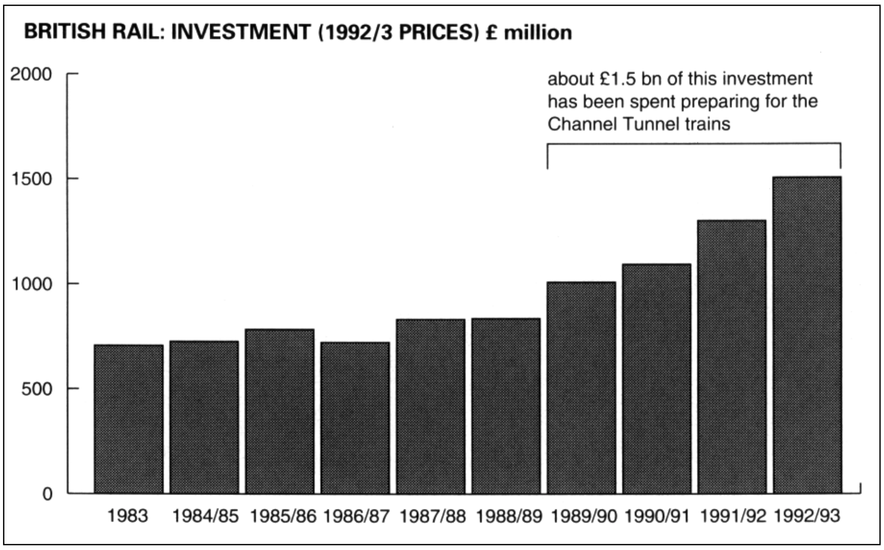
RAIL MODAL SHARE

(i) Commuting into London (arrivals 07.00 – 10.00 hrs) figures for 1992



(ii) InterCity travel – market share
Journeys over 50 miles share = 9%
On particular flows up to 40%
66% journeys are leisure trips.
Business trips 25% but account for 35% of revenue split 40% First and 60% Second Class

Railways in Britain have a small share of freight traffic and this is declining further as electricity generation changes from coal to gas as the major energy source. A decision was made by British Rail in 1991 to abandon conveyance of freight in less than trainloads



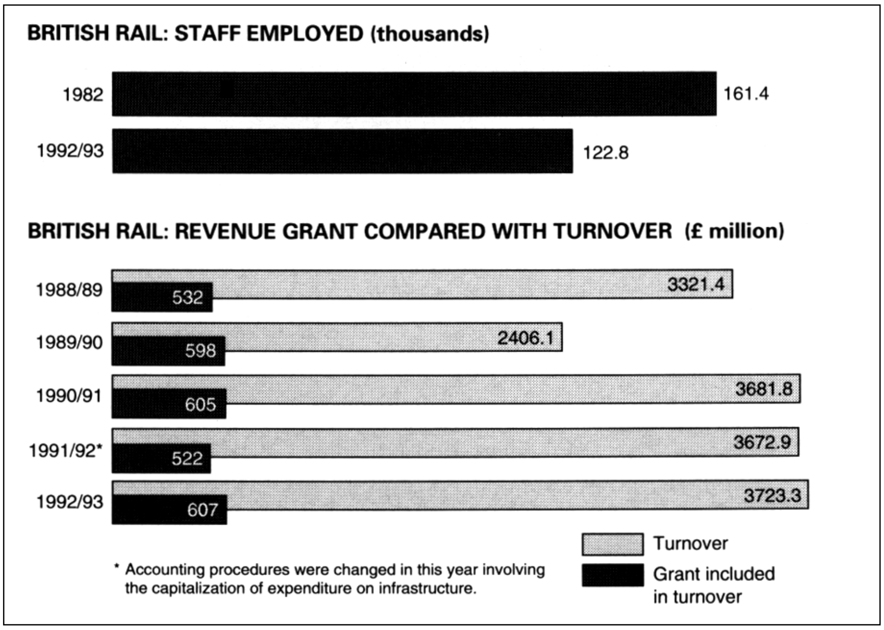
except for containers which are still carried between a few intermodal terminals. This decision contrasts with New Zealand where the privatised railway company intends to make conveyance of less than trainload freight profitable by a dramatic reduction in costs and improvement in the quality of service which is offered.

Although there has been substantial investment, for example the electrification of the East Coast Main Line from London to Scotland, there are many lines and much rolling stock require modernisation. In a recent publication[1], British Rail estimate that investment of £830m is needed over each of the next 10 years to bring the system up to date. At least another £170m per annum is needed to pay for new lines such as the Express Link to the Channel Tunnel and new services across London.

The financial performance of British Rail throughout the 1980s showed substantial improvement until the recession at the end of the decade. Subsidy is low by the standards of many countries. There is no substantial borrowing[2] as this has been written off in previous capital reconstructions.

1) Future Rail

2) Outstanding debtowed to the government is between £2 – £3bn.



Previous Organisation

Traditional

Until the 1980s the railways in Britain were organized on traditional lines with a number of geographical regions organising all services under the control of British Railways Board. Relationships with government and policy were determined centrally but all operations, engineering and sales activity were the responsibility of the Regional General Managers. The railway was organised in a vertically-integrated fashion with all major repairs and maintenance of assets carried on inhouse.

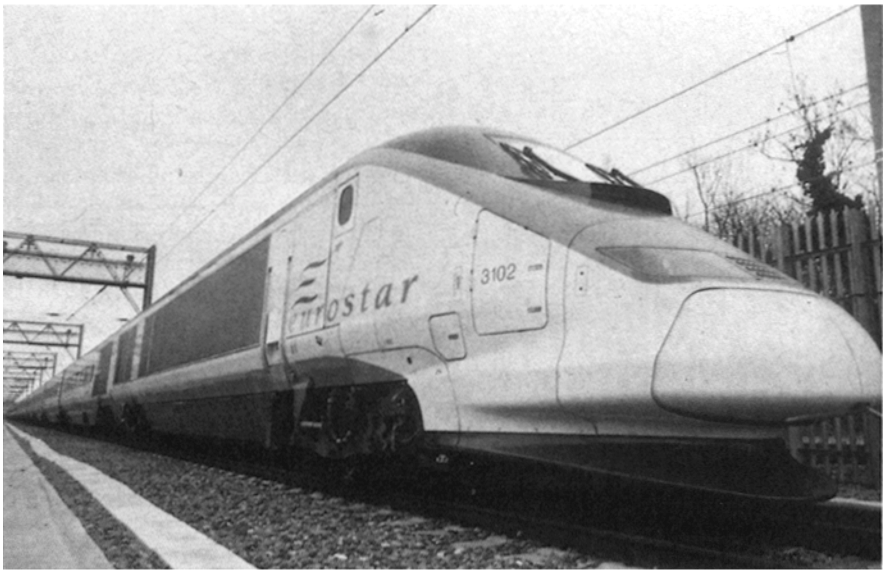
Business Sector Management

In the 1980s new managers were appointed with responsibility for major elements of the business across all the regions. These "business sector" managers controlled InterCity, Network Southeast (commuter travel into London) Regional Railways (all passenger services outside the London area except major InterCity Services) Freight and Express Parcels. Gradually, the organisation of the railway in Britain was re-structured to eliminate the geographical companies. Each sector of the business became responsible for those parts of the track of which it was the principal user and each had it's own team of managers looking after engineering, operations, personnel, finance and marketing. Trading accounts were developed to account for the use of assets and staff by other businesses. This new organisation was finally completed in 1993.

Privatisation

General Principals

Since the election of the Conservative government in 1979, there has been a steady move towards privatisation of state-owned industries. Under these policies, the road transport, shipping, hovercraft, hotels, station catering, advertising, rolling stock workshops and consultancy services of the railways have been sold to the private sector. As these activities were potentially profitable, this presented no great problems although none of the sales produced very significant sums of money for the government. Among the major



■ New EUROSTAR train used on service through Channel Tunnel

privatisations in Britain were the utilities: gas, telecommunications, electricity and water. Government recognised all these industries had potential monopoly power, so each is regulated. The independent regulators appointed to supervise each industry have devoted much effort to keeping down prices by use of a price cap formula (RPI -x) where prices are only allowed to rise by a number of percentage points below the inflation index. As well as targeting price quality, the regulators have also attempted to promote competition in the supply of services by different producers by allowing access to the network of pipes and cables at an agreed (regulated) charge. Thus competing suppliers of gas, electricity and telephone services can now use the network of the former monopoly owners to reach their customers. This has had two major consequences. First, it has been necessary to work out the cost of providing and maintaining the network so that new users are charged a fair price for access. Second, the old utility companies have had to become very much more efficient to compete with the new entrants.

European Railway Policy

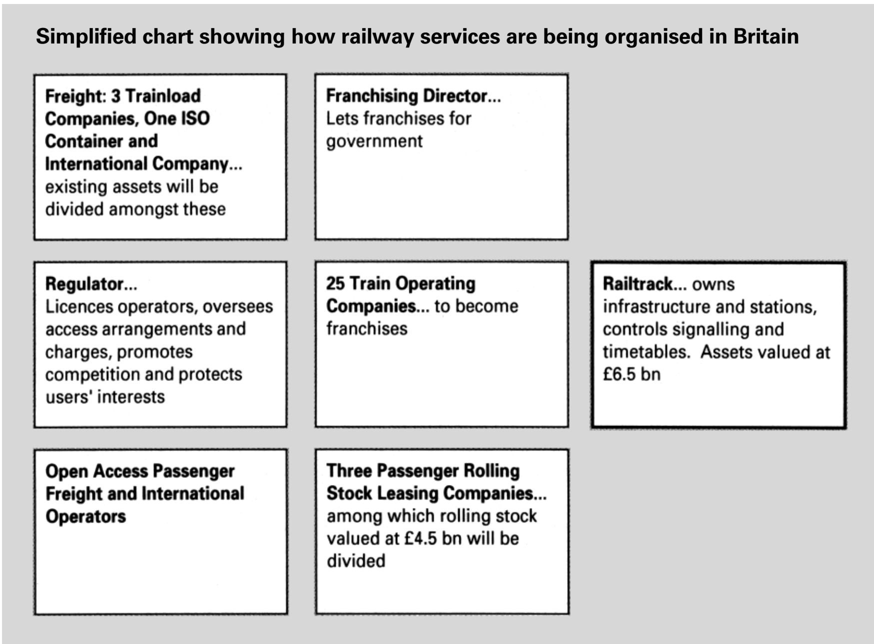
As a result of Directive 91/440, the European Commission ruled that railways in Europe must open their networks to companies wishing to operate international freight and passenger trains. For this reason, the railway companies must prepare separate accounts for the cost of their infrastructure so that access charges for new international operators can be calculated. These charges must be non-discriminatory – they must not favour the state monopoly company.

British Railway Policy

When the British Government decided to privatise the railways, it was greatly influenced by the idea that the railway is a network, like the other utilities described above. Government wanted to provide for competitive access by many different operators to the track. In order to do this and to conform to the European Directive, it believed it was necessary to separate completely the provision of the track, including the management of the timetable, control offices and signalling centers from the operation of the train services. The present plan to privatize Britain's railways has emerged from this theory of the need for a separately managed network as a necessary condition to competitive access. While it might seem that Britain is following the Swedish example, it should be noted that the main aim of the Swedish Government was the equalisation of the competitive conditions of road and rail transport to take account of wider social and environmental costs. There is no such objective in Britain, neither is there any plan for large-scale investment in railway infrastructure by the state as is the case in Sweden.

As a result of the recent legislation the organisation of railways in Britain is developing as shown in the chart.

A new government-owned company, Railtrack, came into being in April 1994. This has taken over control of all infrastructure – track, electric power equipment, signalling, stations, control offices and is responsible for the timetable. These assets have been given a book value of £6.5bn, based on modern equivalent asset values. Railtrack has to earn a rate of return on these assets of 5.6% in the first year amounting to



£364m rising to 8% (£520m) in 1997–98. This means that track charges are likely to be high – it is estimated they will be at least 50% higher than British Rail allocated to its own businesses. It is worth noting that no attempt is being made so far to calculate the asset value of the road network or to seek a rate of return from road users.

Passenger Operations

Trains will be operated by 25 Train Operating Companies. These companies are in course of being formed into "Shadow Franchises". In due course it is anticipated that the private sector will be invited to bid to operate these companies as franchises. It is possible that groups of manages may bid to run franchises either by themselves or with others. British Rail may be allowed to bid in circumstances which are not yet entirely clear and in any case will continue to run services if no satisfactory bid is received.

The franchises for the services will be let, on behalf of the government, by the Franchising Director. When bids are negative, i.e. the franchisee requires a subsidy to operate the service, the Franchising Director will have access to funds from the government with which to make this payment.

The passenger rolling stock fleet belonging to British Rail is being split into three parts. Each of these parts will become the responsibility of new Rolling Stock Leasing Companies which, like Railtrack, will be expected to earn a return on the asset base which will be valued at modern equipment asset value.

Most stations, although owned by Railtrack, will pass to the management of the principal franchisee. However some of the larger stations will be let as separate franchises with the aim of exploiting their commercial potential.

■ New Gatwick Express logo

The Franchising Director will negotiate with Railtrack to obtain paths in the timetable for the first franchisees. It is, however, the intention that Railtrack will attempt to sell paths to other operators although, for an initial period, direct competition with franchisees will not be allowed. In some cases competition will take place between different franchisees over common sections of track. For example there will be three different franchised operators offering services between Gatwick Airport and London. However, the stated intention of government, in due course, to allow "open access" to any operator who is willing to pay the access charge and can meet safety standards.

A Regulator has been appointed who will license operators, promote competition, be concerned with ensuring fair access to the track, the level of fares and charges where the railway has any sort of monopoly power (for example commuting into London) and finally ensuring that users' interests are safeguarded.

Freight Operations

It is likely that a number of customers using the freight services of British Rail will hire their own locomotives and wagons and will negotiate with Railtrack to operate their own services. Some companies already own wagons and locomotives. The freight business of British Rail is being divided into three companies plus a business responsible for moving ISO containers and these will compete with each other and with private operators. Government has recognized that freight operators, who face fierce road competition, will not be able to pay very significant track charges. It is stated that freight should pay at least the cost of wear and tear on the track but charges may fall even lower because government has said it is willing to subsidies track charges if significant environmental benefits arise from transferring freight to rail from the roads.

The Way Forward

A feature of the privatisation is that the government has not set down any national transport policy nor described in any detail the role which the railway might play in future environmental or land-use strategies. This contrasts both with Sweden and the Netherlands where clear policies exist. The railways in Britain badly need investment the whole of which government says it is unable to provide. While British Rail is not in the same condition as the railways of Argentina, at least the privatisation plan in that country has a clear objective of attracting investors by creating long, stable and exclusive franchises.

■ Gatwick Express approaching London

It is the intention in Britain to transfer Railtrack and the Rolling Stock Leasing Companies to private ownership and the Chairman of Railtrack, Bob Horton, has taken a strong stand on the necessity of an early transfer from government ownership.

The new organisation of railways in Britain will be taking shape throughout 1994. So far, the interest of the private sector in becoming involved with franchises seems small. At first, government said franchises would be short "in order to keep franchisees on their toes". Periods of 5 years were mentioned. It has become clear that considerable investment will be needed to bid for a franchise and if any capital has to be spent, a longer franchise will be required to make bidding worthwhile. One way of extending a franchise is to offer a guaranteed renewal for meeting performance standards. Potential franchisees are nervous about committing

■ Privately-owned freight locomotive and wagons

themselves to achieving high standards of operation when so many of the factors involved in running a train service are under the control of others. On lines where track and signalling equipment requires modernisation, up to 50% of delays result from infrastructure faults and these will be outside the management scope of the train operator.

Another feature worrying potential bidders for franchises is the fact that both Railtrack and the Rolling Stock Leasing Companies have had a very high value placed on their assets bases, and have to earn a rate or return not previously achieved by the railway. This means that all franchise bids, even for InterCity routes, are likely to require substantial subsidy. Some estimates suggest that the annual subsidy required by British Rail will rise from £930m to £2bn to meet these costs. Potential franchisees thus have very serious doubts about whether the Treasury will continue providing, for the duration of the franchise, the high levels of subsidy necessary to meet the charges for access to the track or for the lease of rolling stock.

All potential investors are aware of the very weak competitive position of the railway compared with road transport in Britain. Unless the cost of using roads is raised to more accurately reflect congestion, pollution, accidents and other environmental costs, and the road transport industry works within the same very strict regulatory climate as rail transport, then this competitive balance will never allow railways to compete. In Britain, the method of appraising infrastructure investment in road and rail schemes is completely different and heavily biased in favour of roads.

It is possible that in selling Railtrack and the Rolling Stock Leasing Companies, the government may choose to write off the asset base allowing new private-sector companies a favourable starting position from which they could seek to build up business at lower charging levels while they increase efficiency. It is not yet clear how much scope exists for the dramatic productivity increases that would be needed to increase efficiency to the levels where rail can compete with road.

The government is seeking private sector investors to build a new Express Link between London and the Channel Tunnel and have proposed that the successful bidder will take over the operation of international trains between Britain and the Continent to provide a cash flow while the new Express Link is built. This method of funding is being adopted for the new road bridge across the estuary of the River Severn where the tolls on the existing bridge are paid to the consortium building the new bridge.

A second competition is being held to find a private sector consortium to modernise the West Coast Main Line from London to Scotland including services to Birmingham, Liverpool and Manchester. It has yet to be decided whether the successful consortium will be involved in train operation or what risks over and above those normally assumed by contractors they will be asked to bear. The object is to obtain access to capital while transferring some risk to the private investor. This is always more expensive than public funds so some advantage will need to be demonstrated.

Private enterprise regards the railways in Britain as an uncertain investment. In large part, this is because of concern about the weak competitive position of rail, the narrow scope for control by managers when infrastructure and rolling stock are provided by separate organisations, the short duration of the proposed franchises and uncertainty about the commitment of the government to high levels of subsidy in the longer term. ■

Bill Bradshaw

Professor Bill Bradshaw joined British Railways in 1959 as a Management Trainee after graduating in Political Economy. He was appointed Director of Operations in 1979, Director of the Policy Unit in 1981, and General Manager of the Western Region in 1983. Following injury, he took sabbatical leave at the University of Oxford and was appointed Professor of Transport Management at the University of Salford in 1986. He became Chairman of Ulsterbus and a Fellow of Wolfson College, Oxford in 1987. He is also a specialist adviser to the Transport Committee of the House of Commons.