

The Effects of Railroad Reform in Germany

Peter Häfner

First, a reminder why the railroad reform occurred at the end of 1993. The situation was characterized by decades of inactivity in the field of rail transport policy, by overcrowded roads and air traffic routes, by unbearable environmental impairment, by impossible-to-handle predicted future traffic increases, and finally by the catastrophic financial situation of the state railroads with a DM16 billion deficit and DM67 billion accumulated debts in 1993. Figure 1 shows how the yearly deficits would have grown from 1994 without reform.

The government was finally forced to take steps because the citizens and taxpayers were no longer willing to accept the situation, and because business was beginning to fear diminishing efficiency of the German economy due to lack of transport alternatives.

The Reform

The most important reform targets of the Federal government were better use of rail capacity and reduction of the burden on taxpayers. Calculation had shown that reform would reduce the load on the Federal budget by more than DM100 billion within 10 years. Table 1 shows how these savings were to be obtained.

For this purpose, it was necessary to make the railroad system efficient and marketable in order to increase its commercial opportunities. This could be obtained only by putting it on a par with competitors in the traffic market, so that performance would attract customers. In particular, it had been recognized clearly that the existing two Federal railway authorities, the Deutsche Reichsbahn (DR) in the East and the Deutsche Bundesbahn (DB) in the West, as government administrations had no chance at all of surviving in this hotly-contested market. Without discussion of any privatization dogma, the two German railroads were converted to

a stock corporation, i.e. an organization under private law. The Federal Republic of Germany today still holds 100% of the shares.

Development since 1994

In Germany, we differentiate between external and internal reform. External reform is the reshaping of the relationship between railroad and State. This has been fully realized—as intended—by legislation on 1 January 1994. The State is only the ordinary owner of the DB AG enterprise, and unlike in the past, can now influence the business only within the narrower limits of corporation law and general industrial regulation, to which all other private enterprises are subjected. DB AG was freed of its debts and received full entrepreneurial autonomy. The State finances investment in infrastructure on the basis of interest-free loans. It further finances a number of burdens of the past that are not connected directly with the entrepreneurial activity. DB AG no longer

Table 1 Expected Financial Consequences of Reform

Save DM 101 billion in 10 years for taxpayer through:

| | |
|-----------------------------|--------------|
| - Better position in market | DM18 billion |
| - Reduced costs | DM59 billion |
| - Reduced interest payments | DM14 billion |

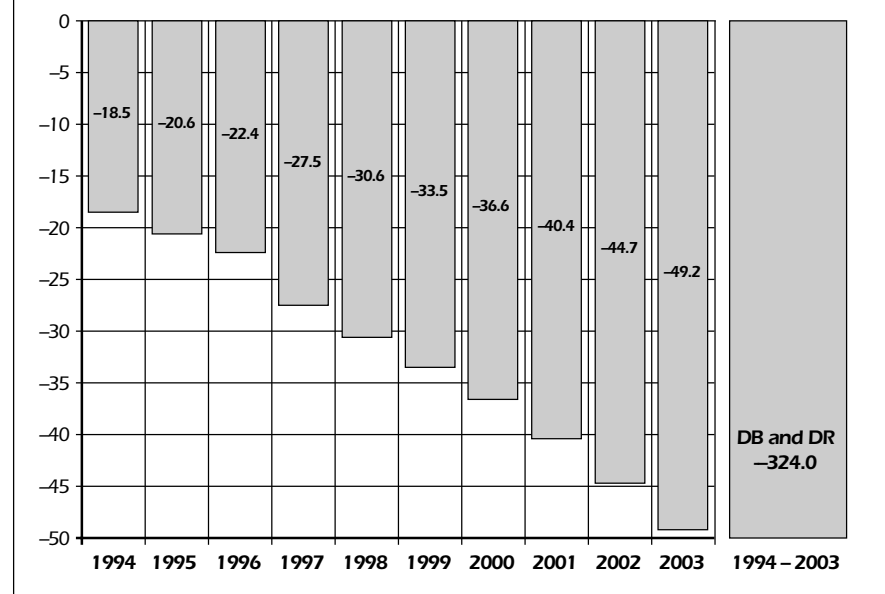
depends directly on the Federal budget, and employees no longer have the status of civil servants.

In 1994, for the first time, DB AG could pay year-end bonuses, premiums, and rewards for good performance on its own decision without approval by three ministries. It can make quick decisions matching market requirements in the framework of a pluri-annual investment plan approved by the supervisory council.

Third Party Access to Infrastructure

DB AG still has the right to manage the rail infrastructure, but, under certain conditions, it must grant third parties access

Figure 1 German Railways Without Reform (Results in DM1 billion)



without discrimination and under control of a neutral authority. It may not give privileges in regard to allocating train paths to its own business sectors for goods traffic and passenger traffic. It has lost the rail monopoly. New third parties and DB AG's own business sectors pay a usage fee. Initially, the railroad people did not like losing the rail monopoly and introduced a series of important counter arguments—for example, the technological and organizational interdependence of rail and wheel, the complex new relationships between parties participating in rail traffic, the possible risk to safety, and finally the danger of cherry-picking by the new third parties. However, they have accepted the political decision for the time being. After the sensational disencumbrance of debts and gaining of autonomy, they recognize some kind of moral obligation to the State and taxpayer to take up the challenge of avant-garde solutions. These surely have some favorable points. Thus, it can be assumed that the intermodal—although rather hard—competition perhaps may not be sufficient to shape the offer of suitable railway services for the market. Intramodal competition is considered a decisive chance for new ideas to obtain a foothold, and for still stronger cost reduction.

The International Dimension

Perhaps the most important aspect of third parties' access to rail infrastructure is the possibility to expand the business of railways with the aid of developing European law across Europe and to shake off national territorial restrictions. Until now, in international transport, the railway was the only transportation mode in which businesses were unable to cross borders. However, in the future they will have a chance to serve their customers across borders making it no longer necessary to

Figure 2 Separation of Infrastructure Division from Railway Operations

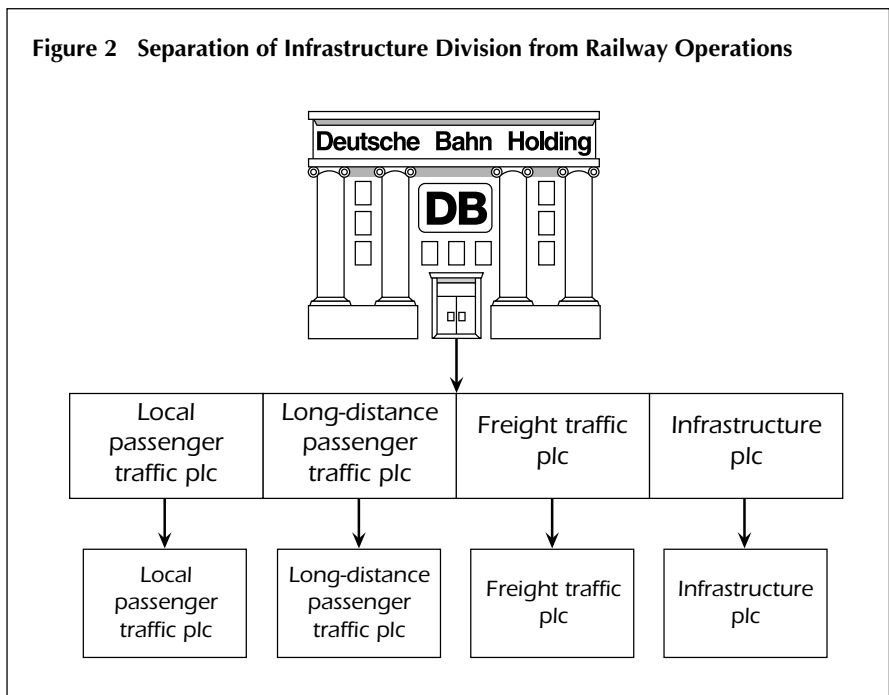


Figure 3 DB AG Organization

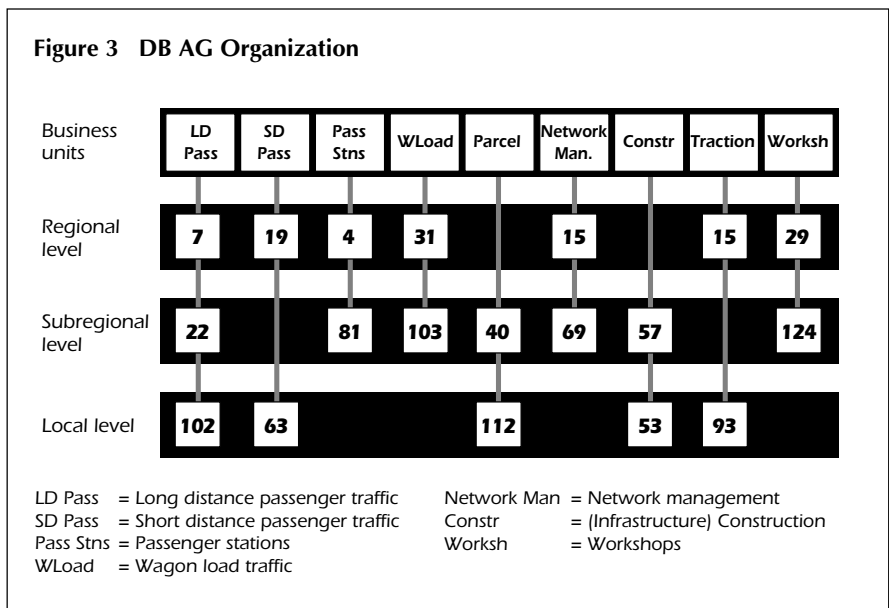


Table 2 Staff Development DB/DR and DB AG (Number at year end without trainees)

| | |
|-------------|---------|
| 1958 | 800,000 |
| 1993 | 350,000 |
| 1994 | 302,000 |
| 1995 | 277,000 |
| 1996 (plan) | 250,000 |
| 1997 (plan) | 220,000 |
| 1998 (plan) | ? |

Table 3 DB AG Investment Programme 1996 to 2000

| | |
|----------------------------|--------------|
| Infrastructure | DM51 billion |
| Rolling stock | DM18 billion |
| Passenger stations | DM 6 billion |
| Electronic data processing | DM 2 billion |
| Total | DM77 billion |



Container Depot in Hamburg

(DB AG)



Inter City Express Passengers in Lounge Car

(DB AG)

depend on a foreign business partner—another railway.

Although cooperation with other railways across Europe will remain indispensable for DB AG in the future, this will be used only when the participants see real economic advantages. For railways, it is a completely new perception that it is possible to cooperate in some sectors while competing in others.

Pricing System for Infrastructure

DB AG has introduced a price system for using the rail infrastructure. It is not based on average cost for the entire network, but instead, is based on prices per train kilometer on the different line sectors. There are 10 line types and 12 train categories, resulting in a considerable number of different fee combinations. Although the number of third-party users—about 30 in 1994—remains limited at present, business with them increased from DM25 million in 1994 to DM40 million in 1995. Transactions of DM70 million to DM100 million are expected in 1996.

Internal Reform

However, internal reform is much more important for DB AG's survival than the above-mentioned external reform. Here, the enterprise—the management and employees—shapes its own future. It will no longer be possible to claim omissions and political mistakes to the same extent as before, and the enterprise will take responsibility for itself.

Organizational Measures

The business sectors are now strictly separated within DB AG. By late 1998, they will change into separate stock corporations as daughters of DB AG Holding (Fig. 2). Already, cross subsidization is no longer possible. Quasi-profit-and-loss-accounts for each business sector lead to full accountability. Decisions can be made more accurately on the basis of clear successes and failures.

Purely intermediate management hierarchy (the former regional offices of Reichsbahn and Bundesbahn) has been eliminated. Each enterprise sector keeps only the regional and local representation it needs to provide performance and cus-

tomers service (Fig. 3). As far as possible, decisions are decentralized and made at the point where the added value is produced. Pure "mailman" functions have been given up.

Entrepreneurial Decisions

In business, investment is concentrated in areas with long-term commercial prospects. Finally, DB AG can start catching up with the technological backlog in comparison to the other modes of transport. In this respect, it exerts considerable pressure on the supply industry, which, based on laws from Brussels, is in competition all across Europe.

Rationalization in previously unfamiliar dimensions is taking place in all sectors. Step-by-step, costs are being reduced and

Table 4 Turnover by Business Sector

| Sector | (DM billion) | | |
|---------------------------|--------------|------|------|
| | 1993 | 1994 | 1995 |
| Long-distance passengers | 4.8 | 5 | 5.2 |
| - ICE | 1.2 | 1.3 | 1.4 |
| Short-distance passengers | 10.2 | 10.8 | 11.4 |
| Freight | 8.0 | 8.0 | 7.8 |

Table 5 Business Results DB AG and DB AG-Group

| | (DM billion) | | |
|--------------------------------------|--------------|-------|-------|
| | 1993 | 1994 | 1995 |
| DB AG Turnover | (23.3) | 23.7 | 24.6 |
| Pre-tax Profits | - | 0.090 | 0.280 |
| DB AG-Group Turnover (167 companies) | - | 28.9 | 29.5 |
| Pre-tax Profits | - | 0.492 | 0.550 |
| Saving for taxpayer | - | 3.0 | 5.0 |

opportunities are increasing. The number of employees is decreasing steadily and in a socially-acceptable manner (Table 2), although additional staff is being hired in customer service areas. Train operation, management, line equipment, customer relations, and many other items are computerized and automated as much as possible.

Employee Training and Motivation

As a service enterprise, DB AG depends on its employees being efficient and motivated. It was and is not easy to make civil servants, who swore to serve the welfare of the Federal Republic of Germany, quickly become employees fighting for economic survival, cost cutting, and profit making. In preparation for the foundation of the stock corporation, DB and DR have made considerable investment available for training and retraining personnel. Approximately 100,000 employees were trained and prepared for the new challenges. The concept that the customer really must be at the centre is simple, but it is not easily carried out. It requires a basic change in the attitude of each employee. The fact that this is not possible from one day to the next, but is a process requiring time, is an important lesson learned. Preventing the customer from feeling the difficulties as little as possible is a large challenge confronting DB AG.

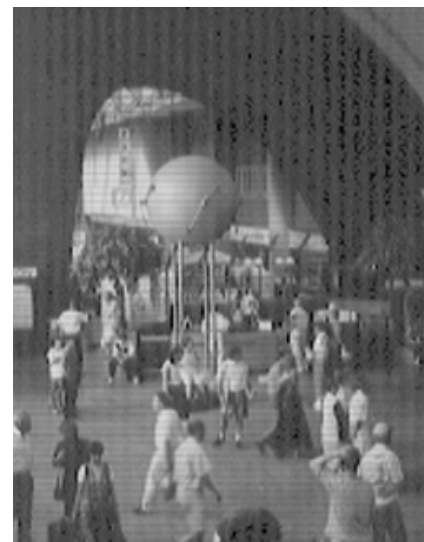
First Results of Reform

The first results have confirmed the opinions of those who courageously pushed through the rail reform in Germany. The first two business years closed with pre-tax profits of DM90 million and about DM280 million. Planned cost reductions, a considerable increase in productivity by cuts in personnel expenses, accompanied by extensive investments, and increase in turnover, provide justifiable grounds for optimism. Compared to before the reform, full use of negotiation margins is now possible in the field of purchasing and the entry into strategic alliances with private partners and their capital participation, as well as aggressive marketing of train paths for third-party users are outstanding examples of business development.

Of the DM100 billion savings potential for the Federal budget mentioned above, DM3 billion and DM5 billion were achieved in 1994 and 1995, respectively, and the trend is rising. The essential developments are shown in Tables 3, 4, and 5.

Outlook

The railroad reform in Germany is not purely a national invention. Various concepts from reforms in other countries—especially Japan and Sweden—were considered. This reform is also certainly no miracle cure. However, it is a serious effort to provide DB AG with a meaningful



Cologne Central Station (DB AG)

future in the interest of the public and market participants. It would not be sensible to simply transplant the German reform to other countries. Each government must find a solution specific to its country and the historic and institutional situation. However, the development in Germany is worth critical and careful observation.

For the DB AG employees, there is finally light at the end of the tunnel. The first positive results provide hope for the future. It will be a long journey to success, and there are no guarantees, but the employees recognize that personal effort is worthwhile again.



Peter Häfner

Dr Peter Häfner undertook postgraduate studies at the University of Kansas in the USA on a Fulbright scholarship. He worked for the German Federal Railroad (DB) from 1967 to 1995 in various departments including the International Tariff Department and Freight Marketing Department. He was DB representative in Paris from 1974 to 1978, and Director of International Relations from 1979 to 1995.