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The case for renationalising Britain's railways

By Robert Jupe

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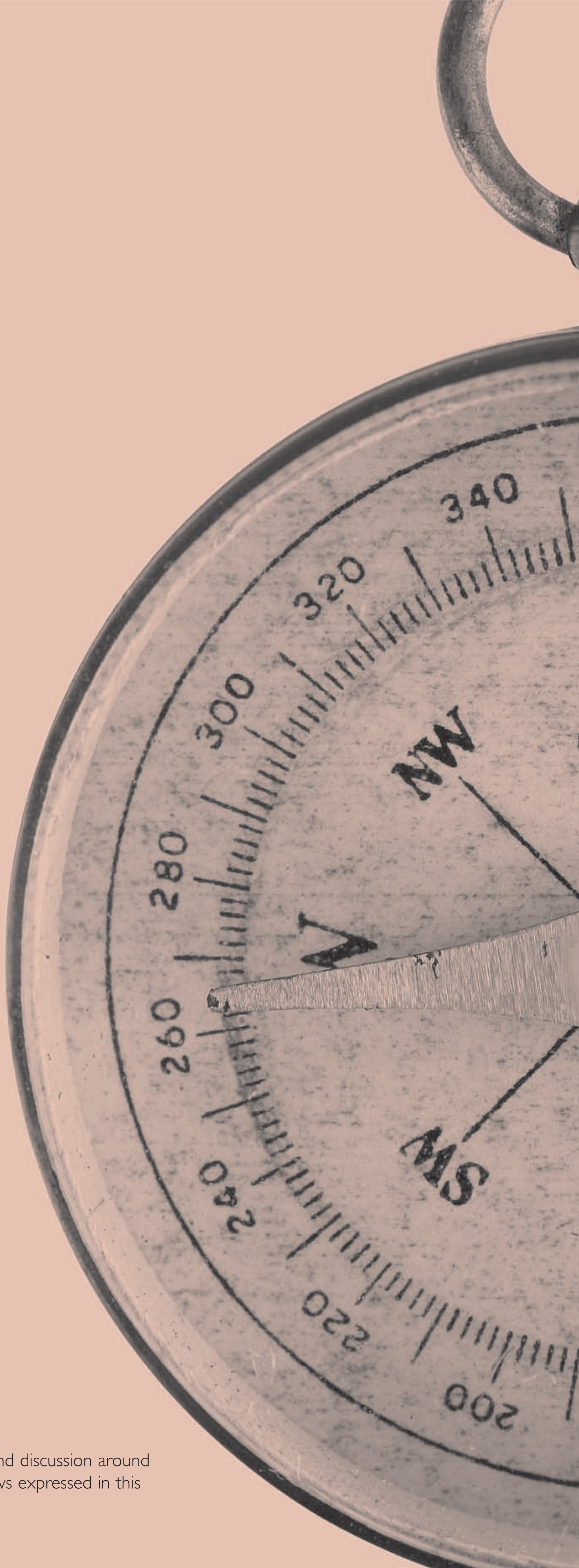

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The case for renationalising Britain's railways

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Context

In the 1990s the Major Government privatised Britain's integrated rail industry. British Rail (BR) was fragmented into many components: an infrastructure authority, Railtrack (later Network Rail); rolling stock leasing companies; engineering and maintenance companies; freight companies; and train operating companies (TOCs). The most controversial aspect of this policy, which did not have the support of railway professionals, was to separate the infrastructure from train operations. Privatisation, it was argued, by introducing market forces would bring 'improved efficiency' along with 'a higher quality of service and better value for money'.

Subsidy would be provided initially on the basis of competitive bids for TOC franchises, but in the long run would be eliminated as franchisees running profitable services would make payments to the Government.

In opposition, New Labour initially resisted rail privatisation on principle. In government, however, it ruled out renationalisation and took the view that the system could be made to work more effectively under private ownership. A new body was created – the Strategic Rail Authority (SRA) – which was intended both to enforce stronger regulation over the TOCs and to provide strategic leadership for the fragmented industry. This structural change, however, was both short-lived and unsuccessful. In its 2004 rail white paper the government expressed great concern about the 'inefficient and dysfunctional' nature of the rail industry, and its 'failure to control costs', and proposed to abolish the SRA and to transfer its responsibilities to the Department for Transport.

The fundamental problems persist, however, as both Network Rail and the TOCs remain in private ownership, and the fragmented structure of the loss-making rail industry has not been changed.

Analysis

The argument that rail privatisation would improve efficiency had little theoretical or empirical justification, especially as BR had achieved substantial productivity improvements in the 1980s under public ownership. Privatisation produced a very inefficient railway system, as an integrated network was fragmented into many components. This structure had serious implications for railway finances in the form of interface costs and cash leakages. Interface costs arise as many companies are involved in a supply chain, with upward pressure on costs as each company aims to make a profit. Thus there was a substantial increase in costs of at least £3 billion per year.

In addition, there have been very significant cash leakages from the system in the form of dividends and interest as companies have rewarded the owners of capital. Railtrack alone, for example, distributed dividends totalling £709 million, equivalent to 41% of the total operating profits of £1,700 million generated before its collapse in 2001. Its replacement, Network Rail, is a private company without shareholders, but is financed by debt which is guaranteed by the government up to a limit of £21 billion. The company's total debt reached £16 billion in 2005, and is expected to reach £20 billion by 2008, when interest payments will be £1 billion per year.

Before privatisation BR's borrowing comprised £2.5 billion of public sector debt, which did not involve any cash leakages to the private sector.

The interface costs and leakages in the privatised rail system were important in themselves, but were also crucial factors in Railtrack's poor performance. Railtrack's main source of revenue was the track access charges paid by the TOCs and freight companies. Far from encouraging the company to maintain and renew the network, 91% of the access charges were fixed and so gave little incentive to Railtrack to maintain or increase network capacity. Further, this guaranteed revenue was underpinned by subsidy to the TOCs. Faced with the need to reward the holders of capital, Railtrack attempted to save money on the maintenance and renewal of the network. This policy, coupled with management problems arising from the complete outsourcing of maintenance and renewal work to infrastructure companies which operated through extensive subcontracting, led directly to the Hatfield crash in October 2000. This crash, and the emergency programme of speed restrictions which followed, brought near paralysis to the network, devastated rail finances, and destroyed Railtrack. Network Rail claims to have made some progress towards better cost control, partly through taking maintenance work in-house, but total expenditure on the network has still risen substantially, especially when compared to the generous funding settlement of £15 billion negotiated for Railtrack shortly before its collapse. Renewals work, which accounts for around two-thirds of Network Rail's expenditure, is still outsourced and so subject to management problems and cost pressures. The company's increased network expenditure led the Office of Rail Regulation to authorise a 50% increase in funding for Network Rail to £22.4 billion for the period 2004/09. This disaggregated as £10.29 billion from government grants, £8.96 billion from track access charges, and £3.14 billion from additional borrowing. Thus the combined direct and indirect public support for Network Rail now represents 60% of its revenue requirement, which is a dramatic move away from the original privatisation model where an unsubsidised Railtrack was meant to be funded and incentivised by track access charges.

Privatisation has also led to an inferior quality of service for customers. The TOCs have had substantial performance problems, with the punctuality of all trains arriving on time falling from 89.7% in 1997/98 to 79.2% in 2002/03. One major reason for the deterioration in the quality of passenger rail services has been the poor performance of the infrastructure authority, which was discussed above. Other factors relate to the TOCs themselves. The majority of rail franchises went initially to bus companies, which did not anticipate the growth in passenger numbers after privatisation and attempted to secure 'efficiency' savings through economising on skilled labour, such as train drivers. The need for these attempts at cost reductions persisted as most of the TOCs would be loss makers, without subsidy, and the bulk of their costs are fixed as they are obliged to pay track access charges and rolling stock leasing charges. Other salient features in the poor performance of the TOCs are the complex but ineffective system of incentives and fines; difficulties in bringing new rolling stock into service; and the pervasive underlying factor of the fragmented rail industry.

Finally, privatisation, far from providing better value for money for taxpayers, has led to a substantial increase in public subsidy. Network Rail now has both direct and indirect government support, and the majority of the TOCs are dependent on a continuing subsidy of over £1 billion per year. Thus the total rail subsidy to the infrastructure provider and the operating companies is now around £4 billion per year, four to five times the annual subsidy received by BR before privatisation. According to the original privatisation plan, the initial subsidy of £2 billion was planned to taper each year, and so by 2006/06 there would be no rail subsidy but net receipts from profitable TOCs paying a premium for their franchises.

Prescription

New Labour has now made three attempts to improve the privatised rail industry. The first was the creation of the SRA, and the second was the replacement of Railtrack by Network Rail. The third, and most recent attempt, included the abolition of the SRA and the transfer of its powers to the Transport Department, along with the allocation of responsibility for improving network performance to Network Rail. It is very unlikely that the latest attempt will solve the problems inherent in the fragmented structure of the loss-making rail industry. Fundamental problems will persist as both the TOCs and Network Rail remain in private ownership. Thus 'systemic' problems remain as the railways cannot meet the 'financial dictates of private ownership' without subsidy.

The government has ruled out renationalisation on cost grounds. However, taking Network Rail into public ownership, as the Transport Select Commitee argued, would secure 'cheaper funding for, and more effective control over, the railway infrastructure'.

There would be a one-off increase in public sector debt, equivalent to less than 2% of GDP, but there would be substantial savings and a fall in cash leakages. Interest payments on the debt would fall, and bringing renewals work in-house would save money as there would be no more profit margins of contractors and subcontractors to fund.

Further savings and efficiency improvements could be made by bringing the TOC franchises back into the public sector at no cost as they expired. Savings would be made as no profit element would be required in their funding, and the rail industry could be gradually reintegrated as Network Rail took over responsibility for train operations. As the Transport Select Committee argued, BR's record in the 1980s 'when subsidy was reduced, financial targets met, and service quality improved, demonstrates that an integrated railway can function efficiently'.

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