

---

# The Right Lines.

---



ADAM SMITH  
INSTITUTE

**THE RIGHT LINES**

**By**

**Kenneth Irvine**

**From research conducted for  
The Adam Smith Institute  
1987**

## CONTENTS

	<u>Page</u>
1. The Context of Privatisation	1
2. The Potential for BR Privatisation	3
3. The Present Framework of the British Railways Board	5
4. BR Business Sectors and Subsidiary Companies	7
5. BR and the Private Sector: The Story so far	12
6. Expanding Private Capital in British Rail	17
7. Establishing the Infrastructure Company	20
8. Privatising the Sectors	22
9. Privatising the Infrastructure Company and Boosting Infrastructure Investment	25
10. The Japanese Comparison	27
11. Employee Issues	31
12. Conclusion	32

First published in the UK in 1987 by  
ASI (Research) Ltd, London SW1P 3DJ  
(c) Adam Smith Institute, 1987

All rights reserved. Apart from fair dealing for the purposes of private study, research, criticism, or review, no part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior permission of the publishers, ASI (Research) Limited, PO Box 316, London SW1P 8DJ (01-222-4995).

The views expressed in this publication do not necessarily reflect those of the publisher or copyright owner. They have been selected for their independence and intellectual vigour and are presented as a contribution to public debate.

ISBN 1 870109 031

Printed in Great Britain by Imediaprint Ltd, London SW1

## 1. THE CONTEXT OF PRIVATISATION

The present Conservative government has initiated the shift from collective ownership back towards private ownership. This has taken many forms from the sale of council houses to the privatising of local authority services and, biggest of all, the flotation of nationalised corporate structures. There can be no doubt that the flotations have been an outstanding success, witnessed by the massive public applications, but so far they have been limited to the easy options -- state-owned companies trading at a surplus.

If this trend is to continue, the next step must be to take on the challenge of privatising state-owned corporations which presently require the injection of taxpayers' money to keep them afloat. British Rail is the obvious candidate. However, there are considerable obstacles to the achievement of this goal. Surprisingly to some, public subsidy is not one of them.

### Overlooked Options

The major obstacle is a lack of understanding among politicians, civil servants and the general public as to how it can be achieved. This is despite several articles and publications each supporting the same basic principle of private rail companies running services on infrastructure maintained by a separate authority. It was therefore surprising to find that Nicholas Ridley, former Transport Secretary and supporter of the free market, believes that British Rail can only be sold as an entity, perhaps to one bidder.

In January 1987 there was considerable media speculation as to the government's plans for British Rail. Indeed, the government was rumoured to be planning for privatisation. Sadly, these rumours were quashed by Nicholas Ridley's successor, who reaffirmed the existing government policy of improving efficiency and productivity to reduce subsidies. The 'Guardian' went on to report that there are no "proposals to privatise chunks of BR". The mere threat of privatisation produced the usual arguments from opponents, privatisations will lead to line closures. Such arguments are even put by Jon Akass, columnist of the 'Daily Express' in 'Maggie's Waterloo', who finally pleads "tell us please that it isn't true".

### Aims and Objectives

The aim of this report is to explore new options for the complete or partial privatisation of the industry. It shows that steps towards this end are not only practicable, but that initial structural changes have already begun. This becomes clear when the report examines the current legislative and organisational framework of British Rail and describes its operations and businesses. British Rail is making increasing use of private capital to stimulate business in both the passenger and freight sectors, something which is given a chapter in its own right. Further measures to boost private investment are proposed in the following chapters.

The Japanese Railways are scheduled to be privatised on the 1st April 1987 and the Japanese programme has both differences and similarities to the measures proposed in this report. An outline and appraisal of the Japanese privatisation is included.

The Japanese see privatisation as a means towards improving efficiency and stimulating growth in rail passenger and freight traffic. Privatising British Rail would be done with the same aims in mind. However, the programme advocated in this report allows for continued public subsidy of rural lines.

Public subsidy is a general political issue and debating its merits would detract from the main thesis put forward. The objective is to liberalise the system, not to create a perfect free market in transport. There is much subsidisation of roads which would need to be tackled in conjunction with rail subsidies.

There is a small section included in the report which looks at employee-related matters and seeks to mitigate any fears employees of British Rail might have regarding privatisation. The section on the Japanese National Railways also looks at this area.

## 2. THE POTENTIAL FOR BR PRIVATISATION

The enthusiasm of both institutional and private investors to provide funding in areas which have traditionally been regarded as only capable of attracting state guaranteed finance has been a major feature of change and benefit to the UK financial system. Other than to specialist commentators, however, the railway system in Britain has not been readily seen as an early candidate for privatisation. Nevertheless, there does exist a straightforward course for separating government-supported funding of the system as a whole from operational activity, which is clearly capable of providing a potential for private investment.

### No Radical Upheaval

There would not need to be a radical upheaval to the management structure of the British Railways Board to introduce a competitive element in the use of railway track and stations. The principle can be extended to loss-making rural services by negative tendering.

Within British Rail passenger, freight and parcels trains are currently operated by Sector Managers who are responsible for providing rolling stock, including locomotives and crews; they contract to BREL and the BR Engineering function for overhaul, maintenance and servicing needs. The track and the associated civil engineering, signalling and telecommunications costs are managed by Regional General Managers and the cost is allocated to the sectors on the basis of use.

This existing division of management authority forms the basis of an initial privatisation of operational activity followed by infrastructure activity. The split of activity would be as outlined in Figure 1.

Figure 1: Proposed Structural Division of BR

<u>Operational Companies</u>	<u>Infrastructural Authority</u>
Trains	Research and Development
Train Catering	Track
Traincrew	Overhead Power Lines
Freight Terminals	Signalling
Operational Land	Train Control
	Stations
	Non Operational Land

There are many potential benefits in liberalising the use of the railway system by allowing new operating companies to run trains -- particularly where the existing monopoly supplier often seeks to utilise unsuitable equipment for specific train service needs, and in some cases provides no service at all. The argument that there can only be one train operator on the network has disappeared with the introduction of new signalling and train control; technology and safety standards would continue to be set by the Department of Transport Inspectorate with the Infrastructure Authority licensing activity, a role performed by the British Railways Board today in respect of privately owned equipment using the network.



### 3. THE PRESENT FRAMEWORK OF THE BRITISH RAILWAYS BOARD

#### MANAGEMENT STRUCTURE

The British Railways Board is appointed by The Secretary of State for Transport, currently John Moore, to manage the railways in line with current legislation and government financial objectives. The Board is chaired by Sir Robert Reid CBE who has been appointed to serve until 1990. There are 11 members of the Board, 4 of whom are part-time members.

In addition to the Board there are 10 principal officers who include the Directors of British Rail's 5 business sectors. These sectors are:-

InterCity

Network SouthEast

Provincial Services

Freight

Parcels

The Sector Directors have complete responsibility for their businesses agreeing the cost of infrastructure provision and engineering services with the Regional General Managers. The regions are:

Eastern

Western

London Midland

Southern

Scotland

Regional General Managers are members of the Regional Advisory Boards which are generally made up of part-time representatives of industry and the community.

#### Subsidiaries

British Rail have a number of subsidiaries whose activities supplement the basic rail services. They are:-

British Rail Engineering Ltd (BREL)

British Rail Property Board

Freightliners Ltd

Transportation Systems and Market Research Ltd (Transmark)

## Travellers Fare

British Transport Advertising Ltd

### STATUTORY STRUCTURE

There are 6 main statutes which apply to the Board. These are the Transport Acts of 1962, 1964, 1978, 1980 and 1981 together with the Railways Act of 1974. These Acts provide the legislative framework under which the British Railways board operates.

#### The Public Service Obligation

The Board is obliged to provide railway services in Great Britain, the passenger services being comparable with those operated in 1974. This is known as the Public Service Obligation for which the Board receives a grant to cover loss-making services. Under the above Acts the Board can provide the other services which it considers to be expedient. The Board must break even, taking into account the Public Service Obligation grant, each financial year.

The Public Service Obligation grant is paid by the government under an EEC regulation. The Board also receives similar compensation from Passenger Transport Executives (PTE's) for whom it runs local services under contract. Claims for compensation are examined by the Department of Transport and the Passenger Transport Executives and are generally fixed amounts.

The breakdown of the PSO in 1985/86 was as illustrated in Figure 2.

Figure 2: PSO Receipts 1985/86

Grants from Central Government	£715.1 million
Special Replacement Allowance	£104.0 million
Passenger Transport Executive Grants	£ 76.8 million
Total	£895.9 million

In addition to receiving PSO and PTE payments, the board can use other methods of balancing the difference between income and costs. These methods can take the form of other grants, from central and local government or the EEC, borrowing from financial institutions and leasing arrangements. However, these methods of raising finance must take place within the confines of the External Financing Limit. External financing limits were introduced by the last Labour government in 1976 to limit public sector borrowing. External Financing Limits are vital to the government counter-inflation policies but can be very restrictive.

#### 4. BR BUSINESS SECTORS AND SUBSIDIARY COMPANIES

##### InterCity

InterCity originally developed as a brand name for long-distance services but is now an operating business in its own right with a trading account. The main InterCity routes are those to and from London but other routes include those which run from the North-East to the South-West and through services to the Channel Ports and North Sea Ports. InterCity also includes the Gatwick Express.

The government has set the Railways Board an overall target of achieving a 2.7% return on its capital employed for the commercial sectors as a whole with the Board setting targets within this figure. The InterCity target has been set at 2% after taking net catering costs into account. However, in the year ending 31st March 1986 InterCity lost £117.2 million before interest and PSO grant. This figure is £30 million below the 1984/85 figure in real terms but InterCity has a long way to go before its target return is achieved.

InterCity will benefit from the electrification of the East-Coast Main Line, authorised in 1985 and now in progress. Not only will East Coast passengers benefit from new trains but passengers on other lines will benefit too as High Speed Trains are redeployed on to other services. Electrification was authorised on positive financial assessment and it is hoped that forecasts will come to fruition and help achieve the financial targets set by the government.

##### Network SouthEast

Network SouthEast is the new name given to the London and South East business sector. As the name suggests the sector is centred around London but extends as far as Milton Keynes, Cambridge, Oxford, Dover and Bournemouth.

A major chunk of the business is commuter season tickets to London, many issued jointly with London Regional Transport. In 1985/86 gross income was £643.8 million with an operating loss of £222.9 million.

##### Provincial Services

The Provincial Sector is responsible for those services not under the auspices of the InterCity or Network SouthEast sectors. The operating loss of £504.4 million is nearly two and a half times the gross income of £208.6 million.

The Provincial Sector is heavily involved with running services under contract for Passenger Transport Executives. Much of the rolling stock is old and £200 million has been authorised for investment in 846 new vehicles.

The deregulation of long-distance buses has resulted in increased competition for all three passenger sectors, particularly InterCity and Provincial Services.

### Travellers Fare

Travellers Fare has long been the butt of many jokes told about British Rail. However, the legendary stale British Rail sandwich is a thing of the past. Travellers Fare has undergone a major transformation in recent years, especially in station catering.

Travellers Fare has invested heavily in Casey Jones hamburger bars and refurbished many of its station public houses. On-train catering has also improved with Pullman InterCity services being extended. However, it is only the station catering which is profitable, contributing an operating surplus of £4.6 million compared with the train catering net loss of £6.3 million. Train catering operations have recently been transferred to Inter-City, and other passenger sector responsibility.

The trend in profitability is shown in Figure 6.

### British Transport Advertising Limited

British Transport Advertising Ltd is jointly owned with the National Bus Company but is currently for sale. The company sells poster advertising space on British Rail's and the National Bus Company's property. It contributed £5.1 million to the Board in 1985/6. At this stage it seems likely that the company will be purchased by More O'Ferrall Limited, one of the country's largest sellers of poster advertising space.

### Passenger Marketing Services and Public Affairs

Whilst there are five business sectors which have their own sales and marketing organisations, there are two functions which provide services to all sectors.

The Public Affairs department liaises with the government and deals with customer relations. Central Advertising Services also comes under Public Affairs. This organisation has two roles, as an in-house advertising agency and as go-between, between the business sectors and their advertising agencies.

### THE ROLE OF THE REGIONS

The marketing departments of the Regions have now been 'sectorised' and serve as out-based departments of the five business sectors. The main role of the Region is now concentrated on the provision of Infrastructure, track, signalling, overhead power systems, they provide train engineering support for the sectors' locomotives and rolling stock. Train control is also a Regional responsibility. It can be seen that these organisations have already adopted a profile based on infrastructure management.

Grants cannot be awarded for any facilities concerned with non-rail connected operations, e.g. manufacturing, distribution and marketing. Grants can also be awarded to bodies which provide rail freight loading and unloading facilities but do not consign traffic e.g. ports and harbours. Local authorities can also be eligible when they provide facilities such as the above or consign or receive freight themselves. This has important implications on the privatisation of local authority services. Grants are also exempt from Corporation Tax.

Grants are normally 60% of the total capital cost for providing the eligible facilities although a grant of up to 60% may be offered if exceptional environmental benefits will accrue.

There is no doubt that these grants have resulted in major traffic gains for British Rail. BR's Annual Report for 1985/86 intimated that since the inception of the scheme 169 grants worth over £63 million have been awarded, representing 37.4 million tonnes of traffic annually.

\*The government is now reviewing the continued existence of the Section 8 scheme following a fall in applications.

### Future Prospects

In addition to private sidings, private companies have been willing to put up their own money for other aspects of Railfreight operations. Many companies own the wagons which carry their goods. This is prevalent in the petroleum and chemicals sectors where specialised wagons are necessary for safe carriage. Both Railfreight and private companies put orders for new wagons out to tender. In addition to British Rail Engineering Limited there are several private manufacturers of rail wagons. These include Standard Wagon, Procor (UK), and WH Davis. Other companies run hire fleets comprising of wagons constructed in Britain and Europe.

The manufacturing and hire companies provide maintenance support for their vehicles.

The year 1986 saw a major new development in private sector ownership of railway equipment. Foster Yeoman, an aggregates customer, purchased four main-line diesel locomotives from General Motors USA to pull stone trains between their Somerset Quarry and depots in the South East. Since the company already had their own wagons, British Rail's role is limited to providing the infrastructure, driver and maintenance; the latter under contract. This scheme provides a useful precedent to be examined more fully in the next chapter.

### Private Funding for Passenger Activities

The Foster Yeoman scheme is mirrored in the passenger business by the Venice-Simplon Orient Express, the famous luxury train which operates between London's Victoria station and the continent. The 'Orient Express' is also available for hire by companies and promotional purposes and travels on other lines. The 'Venice-Simplon Orient Express Limited' owns the luxury coaches and negotiates a fee with the appropriate business sectors for the use of the track, and the hire of locomotives and drivers.

Recently the Network SouthEast pioneered a new concept of private funding. Allied Lyons plc paid for the internal refurbishment and external painting of the coaches operating on London's Waterloo and City line, a British Rail line connecting Waterloo and Bank stations previously known as 'The Drain'. In return, Allied Lyons received considerable publicity and their company logo is painted on the coaches' exterior.

British Rail has also been very successful at leasing sites on its terminals to retailers anxious to trade with BR's passengers. Companies like Tie-Rack have joined the newsagents and Travellers Fare station outlets.

## 6. EXPANDING PRIVATE CAPITAL IN BRITISH RAIL

In contrast to the privatisation of Japanese National Railways, it is not proposed to break up British Rail into private companies in one major exercise. A more gradual approach is favoured. This approach takes account of British Rail's present corporate structure examined earlier. The objective is to ensure as smooth a transfer to the private sector as possible with little disruption to employees and customers.

### Privatising BR's Existing Subsidiaries

British Rail, as stated previously, has already sold some of its non-rail interests. Sealink, British Transport Hotels and the hovercraft business have all been sold and British Rail Engineering Limited and British Transport Advertising are set to follow. The remaining subsidiaries are the Property Board, Freightliners, Transmark and Travellers Fare.

Freightliners is the next obvious candidate. If it had remained part of the National Freight Corporation, it would probably be private now. Freightliners, as a separate company from Railfreight, pay a negotiated charge for haulage and use of the railway infrastructure. In privatising Freightliners British Rail would be obliged by law to continue to allow Freightliners to operate on the track and pay according to the criteria.

Freightliners would also benefit from the Section 8 rail freight facilities scheme. There is no reason why a private railway operating company should be excluded from the scheme whilst it is government policy to maintain its existence. A private Freightliners would be able to borrow and invest out with the confines of the External Financing Limit, thereby boosting prospects for expansion of its business.

It might be necessary to grant Freightliners a licence to operate through the Channel Tunnel when it opens. Under current plans British Rail will have a monopoly on the rights of way through the tunnel, a matter which will be examined later.

Travellers Fare is also a candidate for privatisation. British Rail have tried putting InterCity train catering out to tender but companies like Grand Metropolitan and Trust House Forte saw it as unprofitable. It is strange that British train catering should be considered unprofitable. The Swiss have recently announced that a private catering firm currently trading at stations is moving into restaurant and buffet services. The company will also provide a waitress service. The company has converted existing passenger coaches which contain more modern appliances, such as dishwashers.

The fact that train catering in Britain is seen as unprofitable should not necessarily be taken as an argument against tendering out. On-train catering is a vital part of the overall InterCity product, especially business travel. A loss on train catering can be regarded as a cost in providing the service like the cost of providing drivers or cleaning the coaches. Tenders would go to companies offering the lowest fee for providing a specified level of service.

Travellers Fare could be privatised immediately. The station catering operations like Casey Jones would pay a rent for the use of the premises just like WH Smith and other private tenants. Again the company would be free of the External Financing Limit. Casey Jones could roll into the High Street.

Transmark. The privatisation of Transmark might prove difficult due to its reliance on British Rail for the secondment of staff at low rates. Its contribution to the railway finances is very small and therefore its privatisation should not be regarded as a priority.

Property Board. The Property Board is a prime candidate for privatisation but its property marketing expertise will prove valuable for the second stage of the privatisation plan.

### Privatisation of Ancillary Services

Like Local Authorities and the health service, considerable savings could be realised from putting ancillary services out to tender. The obvious candidates are in the cleaning sector. Station and coach cleaning are performed by direct labour under the respective Regional and Area operating managers. Very often station cleaning is part of the general work of the rail staff who also man ticket barriers. Coach cleaning is a most unenviable task and the coach cleaners deserve much admiration for the work which they do, often with the most basic of equipment.

However, the use of private contractors would bring in specialist firms whose expertise in those areas would be most valuable. In many cases the private firms would recruit existing BR personnel, as has happened in the privatisation of health service ancillary services. Indeed, one would expect the employees to enjoy better employment conditions, using specialist equipment. All too often BR's cleaners have to perform major activity equipped with a cloth and a bucket.

British Rail have already started the process of privatisation. At King's Cross station in London, contract cleaning is performed by Exclusive Cleansing Limited. The toilet system is similar to British Rail's Superloo concept with a small charge levied to cover maintenance costs. Market research has shown that customers do not mind paying a small charge if it ensures cleanliness.

### Privatisation of Engineering and Maintenance

British Rail's mechanical, signalling and telecommunications departments enjoy a virtual monopoly of permanent way and traction design, construction and maintenance. The privatisation of BREL is already at the preparation stage and there is no reason why these departments should not be formed into companies, initially under the Board.

The Department of Transport must ensure the tendering of all major projects with the new companies competing against the private sector. A fall in maintenance costs is vital to sector-performance, especially rail freight. The Department should also ensure that there is no bias in favour of the BR companies. To be fair it must be pointed out that BR do use private firms on projects like electrification.



### Allow New Private Rail Companies to use the Infrastructure by Law

The Venice-Simplon Orient Express demonstrates clearly that new market opportunities for expanding rail travel exist which the British Rail passenger sectors have either failed to exploit or decided to ignore for their own reasons. Since the Orient Express is not competing in the same markets as BR, it is convenient for BR to allow the company to run its services using BR's tracks and terminals in exchange for additional marginal revenue. It is unlikely that BR will prove to be accommodating to companies who wish to run services to compete directly with BR's own services -- a highly understandable reaction.

To overcome this reticence may require that legislation be introduced obliging British Rail to enable new private rail companies access to the infrastructure. Under such arrangements, a fee would be charged for infrastructure use, based on the precedents set by the Orient Express, Freightliners and Foster Yeoman. One could reasonably expect new passenger, freight and parcels rail companies to spring up. Newspapers might have their own rail subsidiaries. Such competition would put pressure on British Rail and the rail unions to eliminate restrictive practices and reduce overmanning.

Acquiring rolling stock wagons and locomotives would present no problem, but the new rail companies would initially have to rely on existing BR traincrew to drive their trains, either on contract from BR or by hiring existing BR personnel.

The question arises as to whether or not anyone might be allowed to run trains. Supporters of free competition would be opposed to any attempt to regulate entry into the market, but interest groups could clamour for some form of restriction. Since the infrastructure is in the hands of the State, existing safety regulations would remain in force and safety would be guaranteed. Safety regulations regarding rolling stock and locomotives would also remain in place. Further restriction would then be unnecessary. In the January 1984 issue of Transport, Malcolm Gylee has raised the possibility of licencing operators, as in the road haulage and coach industries, with licences being granted by the Traffic Commissioners.

The new private companies would put pressure on BR to reduce track maintenance costs and therefore act as an additional force towards contracting out. This feature coupled with the additional revenue would lead to a lowering of the Public Service Obligation grant.

Liberalisation would also lead to faster development of new rail technology, especially in the design and construction of rolling stock. Private rail companies would be able to fund development restricted only by commercial considerations and not by government borrowing limits.

## 9. PRIVATISING THE INFRASTRUCTURE COMPANY

Having opened up the market, privatised the sectors, privatised subsidiaries and tendered out catering and engineering, the only remaining step will be the privatisation of the infrastructure company itself. The above measures will hopefully lead to dramatic reductions in the PSO grant if not its phasing out, given the profitable rental and sale of property.

A private infrastructure company monitored by the Department of Transport or a monitoring body like Oftel or Ofgas is the best solution. Malcolm Gylee has suggested that all capital work be handled by the Department of Transport or the Welsh and Scottish Offices in the same way that they handle highways. In both cases the benefits of the market are brought to bear. Preferably, the Department of Transport should have sole control, thereby reducing bureaucracy and potential confusion.

Again it must be stated that the private company should be free to undertake new track investment free from government borrowing restrictions. The infrastructure company would then be able to build new lines or re-open closed lines on commercial grounds. Naturally no subsidy would ever be paid should these new lines make a loss. The PSO grant would only be paid in respect of lines receiving a grant at date of privatisation.

The infrastructure company could run its own services provided it did not misuse its monopoly position -- using infrastructure subsidy to cross-subsidise the services, for example.

### Private Railways

There are still many private railway lines currently in existence, mostly run by dedicated railway enthusiasts. Most are steam railways but some do use diesel. The enthusiasts purchase closed lines, the locomotives and rolling stock. They are an important part of the local community.

There is still a need for more such operations and new operations. Private investment in new lines is vital to a growing railway network. The government must encourage such investment if design, construction and maintenance technology is to improve. Tax concessions is an obvious method.

### The Railway as an Enterprise Zone

One real method to encourage growth and investment in railways is to declare the railway network an enterprise zone. The zone's boundaries would be the land owned by BR and private railways. Additionally, the boundaries could extend to allow for more terminals to be built.

The privatised companies, existing and new rail companies would receive tax benefits for investing in the railways, primarily for construction or re-opening of lines and stations. Similar rates allowances would exist to extend the benefits to companies wishing to manufacture at the track side, thereby boosting employment in the company and on the railway.

### The Channel Tunnel

The bill currently progressing through Parliament gives British Rail a monopoly of rights of way through the Channel Tunnel. It is hoped that the privatisation programme would be complete come the opening of the tunnel. The rights of way would be transferred to the infrastructure company and its customers. The infrastructure company would charge in the normal manner: the rail companies would negotiate with the French railways, SNCF, and other continental railways for use of their infrastructure. Such rights of way have to be enshrined in EEC law but may be covered in the free trade clauses in the Treaty of Rome. However, one should remember that free trade agreements are frequently flouted by member states.

### The BR - LRT Relationship

London Regional Transport is split into two groups -- trains and buses. British Rail has agreements with LRT for joint ticketing for commuter season tickets and cross-London journeys, although InterCity have recently introduced through-London services via Olympia and are examining another option.

Privatising British Rail's sectors would require each sector negotiating its own agreement. If Network SouthEast lost its franchise for certain lines it would be in the interest of the new franchisee to negotiate a similar agreement.

### The Shinkansen Railway Holding Organisation

Japan's experience will provide a useful guide for the private infrastructure company proposed in the ASI plan. However, the British infrastructure company will be free to lease lines to new private operators competing with the privatised British Rail operating companies.

In Japan, the state-owned ferry and bus services will be run by the appropriate Regional passenger company. Sealink, British Rail's ferry operation, was sold to British Ferries in 1984. Reports suggest that London Regional Transport, which is responsible for operating the Capital's underground and bus services, is being considered for privatisation after the next election. British Rail and London Regional Transport have many joint arrangements, especially on commuter tickets. The present proposals would allow for British Rail and London Regional Transport to be privatised together. This option is examined further in this report.

### Liabilities

Like British Rail, the Japanese National Railway have considerable debts and long-term liabilities. The International Railway journal broke down the JNR's liabilities as follows:

	<u>Billion Yen</u>
JNR	17,000
3 Honshu Railways and the Freight railway	4,600
Pensions obligations	4,900
Shinkansen assets at replacement value	3,800
Conventional Honshu lines	1,100
Joetsu Shinkansen facilities	1,900
Seikan Tunnel facilities	1,600
Others	2,400
	-----
	37,300
	-----

Under the plan each company will be targeted to produce only a 1% margin on revenue, capital of 20% of revenue and a 5% return on capital employed. British Rail's InterCity and Freight sectors were originally set a 5% return on capital but this has now been reduced to 2.7% as stated earlier.

### Settlement of Account Enterprise

The Japanese plan provides for a 'Settlement of Account Enterprise' which will retain all the assets and liabilities not transferred to the new private companies. In Britain, privatisations have been a straight transfer from the public to the private sector, with no need for such an institution. However, the British Gas Corporation remained in existence after flotation to allow all legalities and outstandings to be taken care of. It is possible that a similar 'Settlement of Account Enterprise' SAE, will be required for a British Rail privatisation programme, given British Rail's liabilities and wide range of assets. The JNR SAE will also seek to place employees not required by the new companies into alternative employment. A similar pledge on privatising British Rail would alleviate many of the fears of BR's workforce regarding privatisation.

Under this proposal, the privatisation of British Rail will be staged. Under Stage 1, the British Railways Board will remain as the state owned infrastructure company. It is expected that job losses will be absorbed through early retirement and wastage. Therefore, any job losses at later stages will be minimal and there will not be the need for the 'Settlement of Account Enterprise' to take on such massive responsibility.

JNR is slimming its workforce by 62,000 to 215,000 by 1st April. 20,000 voluntary retirements and redundancies are being sought. The remaining 41,000 will be retrained and placed by the Settlement of Account Enterprise.

### Operating Problems

The main disadvantage of the JNR privatisation compared to the present proposals lies in splitting up the JNR into geographic companies, particularly on the main island of Honshu. The ASI plan sees the private operating companies being market based. The JNR plan would result in each of the private regional companies running local and long distance services no matter where their marketing expertise may lie. A market orientated set-up would have allowed for the speedier development of business skills.

Under the Japanese plan each company will assume responsibility for long distance trains as they pass through its territory. The management plan negotiated contracts to ensure the smooth running of trains. Agreements will be required for maintenance and breakdown assistance. Since the JNR currently coexists with over 80 private railway companies, such agreements will present little difficulty.

### Private Maintenance

The JNR has long used private companies for maintenance and engineering work. British Rail's civil and mechanical engineers have been a monopoly supplier and where contractors are now beginning to compete much reduced costs have been evident. These monopolies will disappear under the proposals suggested for the UK.

## 11. EMPLOYEE ISSUES

### Pension Rights

Whilst the privatisation programme sets out to ensure as smooth a transfer to the private sector as possible, employees would be justified in worrying about their pension rights. The British Rail Pension Fund is an excellent performer and there is no need for its dissolution. Legislation for privatisation would ensure the infrastructure company and privatised sectors would continue to pay into the fund at existing levels should the employees so wish. This right would exist only for employees of British Rail at the time of privatisation. The privatised companies could offer new employees the right to join the fund or set up a new fund of their own. Ex-British Rail employees could exercise the choice to remain in their existing scheme or leave their contributions in the BR fund and join the new fund, as provided for under current legislation.

### Travel Facilities

British Rail employees enjoy generous free and reduced rate travel facilities on British Rail and London Regional Transport train services. When the British Transport Hotels and Sealink were sold off the buyers bought out the employees' travel facilities i.e. the employees retained the facilities but their new employer paid British Rail compensation for loss of revenue. Such arrangements could exist between companies or a reciprocal agreement could be reached.

## 12. CONCLUSION

British Rail has not enjoyed a happy existence since it was nationalised in 1947. It has become a political football with the number of post-war Transport Acts now in double figures. The British Rail management has had to take into account political constraints as much as market constraints in the running of its business.

Despite these distractions British Rail's sector managers have displayed many entrepreneurial qualities, especially in attracting private capital and the branding of their services. These qualities will be enhanced with the separation of the businesses from the infrastructure authority. As John Hibbs of Birmingham Polytechnic rightly points out in Transport Without Politics this will prove "the incentive to railway management to take a more entrepreneurial attitude towards their business than in the past, when the allocation of infrastructure costs has absorbed so much of their attention." These features will be enhanced by the market approach to infrastructure tariffs.

Although the original financial targets set by the Secretary of State have been reduced and the sectors are still some way from their achievement, British Rail finances are improving due to the business orientated attitudes adopted by the sector Directors and their staff. The Appendix shows clearly the reduction of the amount of subsidy per passenger mile. Privatisation would be a reward for existing achievements and an incentive to better performance.

The sectors still have some problem in controlling operating expenses. In the passenger business it is train operations, for the freight sector it is train maintenance. The setting up of the engineering departments as companies will enhance their commercial awareness which will be heightened by tendering out.

The Beeching Report of 1963 was a watershed for British Rail. Many rural lines were closed as a result of its findings. This report leaves line closures and levels support as measures to be decided separately by the government. However, the report does agree with one of Dr. Beeching's conclusions, already to some degree endorsed by the government, that British Rail is best left to running rail services. This is reflected in the proposals for privatising British Rail's subsidiary companies. However, the retention of Travellers Fare in order that their station catering profits be offset against the PSO grant is an option that should not be ruled out.

The franchising of local lines and Provincial profit-centres will benefit local authorities, taxpayers and passengers alike in addition to keeping the Provincial sector 'on their toes'. News that this approach is being adopted by the Argentinian railways, Ferrocarriles Argentina, was reported in The Financial Times on 9th March 1987. Local branch services will be put out to tender to attract private capital and thereby leave the state to concentrate on urban passenger and freight traffic.

The Japanese privatisation has been examined; the Swiss are tendering out catering; the Italians contract out track maintenance; the Argentinians will franchise local service; the Malaysians are in the process of selling their entire railways system for one dollar! Privatisation in the railway sector, in other words, is growing worldwide at an increasing pace. It would be remarkable indeed if the Thatcher government, which has been the pioneering force of privatisation, were to fall behind the rest of the world in the industry most in need for reform -- especially with a privatisation enthusiast in charge at the Department of Transport.

The report sets out to bring the beneficial effects to bear and to outline a painless programme to privatisation, taking account of potential fears of the interest groups.

These proposals are 'pro-rail'. They offer a means to expand the network and reduce the burden to taxpayers. Unlike the ideas of the road-to-rail conversion lobby, the present options represent a market that can grow and develop to respond to the new challenges for rail transport in the future.



## BIBLIOGRAPHY

1. Pryke, Richard, Public Enterprise In Practice; MacGibbon and Kee, 1971.
2. Tivey, Leonard (Ed), The Nationalised Industries Since 1960; George Allen and Unwin, 1973.
3. Hibbs, John, Transport Without Politics ....? Institute of Economic Affairs, Hobart Paper 95, 1982.
4. Starkie, David, 'BR - Privatisation Without Tears', in Economic Affairs, Vol. 5 No. 1 October - December 1984, published by the Institute of Economic Affairs.
5. Gylee, Malcolm, 'Alternative Way to Run Railways', in Transport, January/February 1984.
6. 'JNR Gets the Kiss of Life, in International Railway Journal, November 1986.
7. 'Transport Policy' in The Omega File, Adam Smith Institute.
8. 'Railtalk and Overseas News' in Modern Railways, Ian Allan, March 1987.
9. Coone, Tim, 'Argentina Takes Branch Line Route to Privatisation' of its Railways, Financial Times, 9th March 1987.
10. Comfort, Nicholas, 'Tube Candidate for Privatisation If Tories Win' in The Daily Telegraph, 21st January 1987.
11. Akass, Jon, 'Maggie's Waterloo', in the Daily Express.
12. Annual Report and Accounts 1985/86, the British Railways Board.
13. 'Section 8 Facilities Grant', Memorandum for Applicants, the Department of the Environment, 1976.

# PROPERTY BOARD

*% Operating Margin*

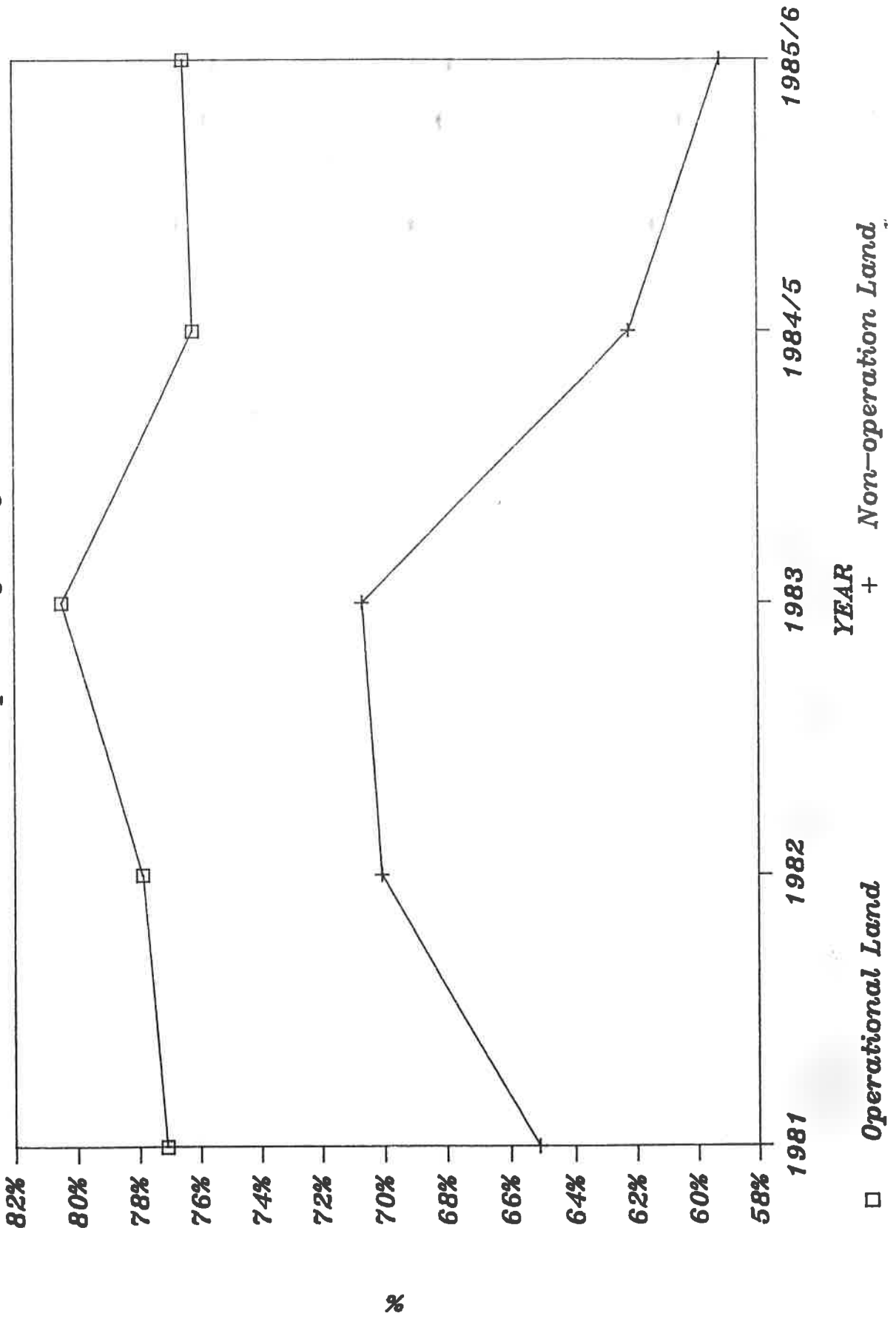


Fig 3