

TRACK TO THE FUTURE

By

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**This report is dedicated to the memory of my close friend John Macintyre, like
Adam Smith, a native of Kirkcaldy, Fife, Scotland**

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INTRODUCTION

It is now eighteen months since the institute published my paper on privatizing British Rail, 'The Right Lines'. The immediate objective of the paper was merely to put the issue on the political agenda and to increase awareness in the media and the railway industry.

The Transport Secretary, Paul Channon, confirmed in an interview with the 'Independent' that rail privatization is now firmly on the government's agenda. This followed the Economist's report that Greg Bourne was working on this issue at the Downing Street Policy Unit. 'The Right Lines' has achieved much more than its immediate modest objective.

Interest in the privatization of British Rail has been further fuelled by the recent furore which greeted British Rail's announcement that there are to be dramatic increases in the cost of long distance season tickets. There is now considerable interest in the possibility of private sector competition entering the market to keep fares down. This issue stimulated a debate on rail privatization in the House of Commons just prior to the summer recess (Hansard, 28th July 1988, column 661). The debate, sponsored by Keith Mans MP, covered topics such as the increased role of the private sector and potential privatization schemes — the topics which this paper will examine in detail.

Earlier this year the Centre for Policy Studies published another report on rail privatization which called for the abolition of the entire British Rail organization to be replaced by around a dozen regional companies based on the structure of the railway prior to the enforced amalgamation of the railway companies in 1923. This followed a report in the 'Sunday Times' that British Rail were lobbying the government strongly that any future privatization should take the form of selling British Rail and its subsidiaries as a single entity similar to the approach taken to the flotation of British Telecom.

There is now much debate as to the form which privatization should take or even whether privatization itself is desirable. In a speech to the National Association of Conservative Graduates Viscount Whitelaw supported the concept of privatization but doubted whether it could be made into an attractive proposition.

This paper restates the case for privatization, evaluates the three proposals on the table and makes final proposals to form the basis of legislation. In order to put together one final authoritative document it has been necessary to update some material included in 'The Right Lines'. The paper also looks briefly at the possible privatization of the London and Glasgow Undergrounds, the Docklands Light Railway and Tyne and Wear Metro. However, each of these possibilities needs more detailed investigation. Some wider aspects of a free market in transport are also addressed. This issue however is worthy of a paper in its own

right and only the surface issues are touched upon, A summary of recommendations is included at the end of the report.

1. NEW DEVELOPMENTS IN THE BRITISH RAIL ORGANIZATION

There have been some interesting changes to the British Rail organization since the publication of 'The Right Lines' in March 1987. The basic structure of five business sectors and operating regions remains. However British Rail formed a new region, Anglia, which was previously part of the Eastern region.

Sectors	Regions
InterCity	Scottish (ScotRail)
Network SouthEast	London Midland
Provincial Services	Western
Parcels	Anglia

1.1 The sectors

Each sector has its own Sector Director who is a 'Principle Officer' of the British Railways Board, chaired by Sir Robert Reid. However the Sector Director is not an executive member of the Board itself. The Sector Director has 'full bottom-line' responsibility to meet its remit from the Department of Transport.

Since the sectors are business based they have laid down requirements for specialist locomotives and rolling stock. The Railfreight sector has gone as far to allocate wagons and locomotives to its sub-sectors such as petroleum, metals and automotive, coal and construction. The 1987/88 BR Annual Report shows an InterCity track repair machine. It can be seen that the sectors are operating like subsidiary companies.

1.2 Subsidiary companies New Subsidiaries

In 1987/88 British Rail formed its new British Rail Maintenance Ltd subsidiary for the servicing and repair of locomotives and rolling stock. This responsibility was previously allocated to the regions. This new initiative has improved the service to the sectors both in terms of quality of work and costs.

The new British Rail freight distribution company was vested on the 10th October. It comprises the old Speedlink Distribution sub-sector of Railfreight and Freightliners, BR's former deep seas container subsidiary. The objective is to promote a total transport package including rail and road haulage for the small loads market. This logical with the opportunities which will arise with opening of the European market in 1992.

British Rail have several additional subsidiaries:

British Rail Engineering Limited (inc. BREL 1988 Ltd)
British Rail Maintenance Limited
British Rail Property Board
TravellersFare Limited
Transportation & Market Research Limited (Transmark)

Therefore the railway is developing into a new structure quite different from the regional one which was envisaged on nationalization. This change is outlined below.

Sectors & Distribution Company

Sales and marketing
Locomotives & rolling stock

On-train catering

Regions

Timetabling
Terminal & Infrastructure
management
Train control

Subsidiaries

Station Catering
Research & Development
Locomotive & rolling stock manufacture, design and maintenance
Property sales and leasing
Consultancy

2. THE FINANCIAL PERFORMANCE OF BRITISH RAIL

2.1 The public service obligation grant

Under the 1974 Railways Act The British Railways Board is obliged by law to provide railway services in Great Britain, the passenger services being maintained to a level comparable to the level of services operated in 1974. This is known as the public service obligation for which the Board receives a grant to cover the cost of maintaining loss-making lines which the government considers should be operational for social rather than commercial reasons. How one calculates the social worth of any line is open to question especially if one attempts to include an element of 'opportunity cost' — the benefit of investing the resource elsewhere, especially if the money was filtered into the economy through tax cuts or invested in a local bus service with the savings being rechannelled elsewhere on the railway. It is interesting that the PSO grant is paid by the government under an EEC regulation, 1191/69 Section 1, worthy of Monsieur Delors himself.

It is recommended that the Department of Transport re-examine the current method of bulk PSO grant payment to the sectors. "The Right Lines" suggested that the PSO grant be paid on either a line by line basis or a profit/cost centre basis. The D o T must draw up guidelines for evaluation of individual lines and their grant requirement. This will form the basis for the tendering out of local services as is happening in Argentina.

The financial year 1987/88 saw a significant improvement in the financial performance of British Rail. The organization as a whole returned a surplus of £291 million, after including the Public Service Obligation grant, the highest ever. The railway itself returned a surplus of £109 million after grant, the highest since the British Railways Board was formed in the early 1960s.

This improved performance has been achieved in conjunction with a reduced PSO grant. In 1983 the grant requirement was £1,080 million. It is forecast that this figure will be more than halved by 1992/93 to £477 million (figure at current prices).

PSO Grant Req't	1987/88 Actual	1989/90 Forecast
Network SouthEast	231	149
Provincial	429	385
InterCity	120	0
Contingency		48
	781	582
(millions of pounds at 1987/8 prices)		

2.2 Sector and subsidiary performance

As intimated above, Railfreight has now achieved profitability after significant losses of business following the miner's strike. The InterCity is forecast to achieve profitability by 1989/90. From this year the InterCity sector is ineligible to receive PSO grant — losses will have to be absorbed elsewhere. The Parcels sector lost nearly £7 million last year on a turnover of just over £120 million. This is only the second operating loss in seven years.

Freightliners lost £6.2 million last year on turnover of £97.7 million. Its amalgamation with the Railfreight's Speedlink sub-sector will enable a more integrated marketing package to be offered to customers and should help turn the business around.

The largest consumers of the Public Obligation grant are the Network SouthEast and Provincial Sectors. Network SouthEast lost £170 million on turnover of £805 million and Provincial lost a massive £473 million on turnover of £247 million, i.e. the Provincial costs are more than three times its income.

The Property Board continues to be a healthy contributor to the Board's finances. Last year an operating surplus of £61 million was achieved from property sales of £81 million and lettings income of £82 million.

2.3 Passenger Transport Executives

The board also receives compensation from Passenger Transport Executives, established under the 1968 Transport Act, from whom it runs local services under contract. This allows the PTE to set fares which prevent local competition, e.g. the train fare from Glasgow Queen Street to Bishopbriggs is the same as the bus fare from Buchan Street Bus Station to the bus stop adjacent to Bishopbriggs train station. The local authority control prevents competition even if the bus service is tendered out. This prevents rational resource allocation based on consumer choice as price is ruled out of the equation. Trains may be used to cross subsidise buses.

It is time the PTEs were abolished and real competition and choice introduced.

3. SALES OF SUBSIDIARIES

Since the publication of 'The Right Lines' British Transport Advertising was sold to a group of its managers. The new company has a five year contract with the BR Board for the advertising rights on BR Property. The management of the Doncaster Wagon Works bought the works (now RFS Industries).

The Board are now inviting offers for TravellersFare, now restricted to station catering, and a group of works (York, Derby and Crewe) — BREL (1988) Ltd. British Rail believe that the best interests of the businesses and the workforce will be served by sale to new owners due to the potential of diversification outside the railway environment.

The rest of BREL has been formed into two business groups. The New Construction Group is described in the BR Annual Report as being responsible for the design, engineering, manufacture, project management and sales of BREL's range of BR's vehicles and rolling stock. The Manufacture and Repair Group is responsible for the heavy maintenance and repair of BR's vehicles and the manufacture and repair of component parts to support the BR National Supply Centre and the New Construction Group. It competes for business outside the railway environment.

These developments will reduce British Rail's activities considerably to operating sectors and regional infrastructure management organisations. One should not forget that some of BR's subsidiaries have already been privatized. Sealink, its former ferry operation was sold to Sea containers Limited. British Transport Hotels were sold individually and the hovercraft business was virtually given away to its employees. The Property Board is now disposing of its non-operational land and developing valuable sites in town centres.

The sale brochure for the sale of the scenic Settle to Carlisle has been recently issued. There are serious deficiencies in the brochure which will be detailed later.

4. FURTHER SCOPE FOR PRIVATIZATION

There is plenty of scope for tendering out like local authority services much of which is even taking place now.

4.1 Competitive tendering

TravellersFare, BR's catering division, successfully tendered against private competition on 68 of 89 occasions for the lucrative station catering sites. However, as mentioned earlier, on-train catering has now been transferred to the passenger sectors. Grand Metropolitan have been given the contract for catering between Euston and Manchester, an important precedent, Scottish & Newcastle breweries have declared their willingness to sponsor the branding of a restaurant of buffet car on the Settle to Carlisle, after sale of course.

British Rail adopted competitive tendering in 1983 for locomotive and coach manufacture and repairs. This business has been worth around 800 million pounds; of which about half has gone to the private sector. It would be interesting what the proportion would have been if British Rail's subsidiaries had been in the private sector at the time.

Exclusive Cleaning Plc run the sanitary services at Kings Cross and this could be extended much more widely. Compulsory competitive tendering should be adopted in these areas, just as in local authorities and extended to the following:

- maintenance of track and signalling
- station and carriage cleaning
- ticket inspection
- architectural services
- design of locomotives, wagons and coaches
- laundry services for buffet cars and sleeper cars

If you have a Barclaycard you can use a special ticket machine at Euston. Allied-Lyons contributed towards refurbishing the Waterloo and City line in exchange for displaying the company logo on the carriages. This type of scheme can be extended to more lines and other aspects of the business.

4.2 Further sales of subsidiaries

An interesting development is the merger of Railfreight's distribution activities with BR's container subsidiary, Freightliners. Freightliners would be private now if it had remained in the National Freight Corporation (now Consortium).

The NFC shows quite dramatically how a loss making state industry can be transformed into profitability when the employees have a real stake in its future. The new distribution company would, experience the same benefits anticipated for BREL and Travellers Fare if it too was offered to the private sector. The same argument applies for the Railfreight sector, which this year declared an operating surplus of 44 million pounds, and the newly created British Rail Maintenance Ltd.

The British Rail Property Board has been contributing positively to BR's finances for some years. There is considerable further development potential through sale and lease back of sites which British Rail cannot afford to develop themselves.

5. THE CASE FOR PRIVATIZATION OF THE NETWORK

One of the main criticisms of 'The Right Lines' has been that the report failed to address the issue of whether it is desirable to privatize the railway in the first place. This section is designed to remedy this apparent omission.

Before examining whether the railways are suited to privatization it is worthwhile examining the advantages of privatization in its own right. Although privatization was not even mentioned as a word in the 1979 Conservative Manifesto (it did propose the sale of the shipbuilding and aerospace industry) it has formed the major plank on the Thatcher Administration industrial, and now social, policy. Many different techniques have been innovated in implementing privatization. Dr Madsen Pirie, President of the Adam Smith Institute, has identified no fewer than twenty-one different methods.

5.1 Denationalization versus privatization

For reasons that will become apparent later, it is vital to differentiate privatization from denationalization. Denationalization, implemented in small measures by Winston Churchill's 1950's government, was a response to Morrisonian nationalization and involved returning them to their previous owners. Privatization is the transference of goods and services from the public to the private sector in a form which is best suited to the industry or sector concerned. It also can relate to functions which historically have been the preserve of the state.

5.2 Exerting economic discipline

The central theme to privatization is that private firms perform better than their public sector counterparts. Consumer choice exerts economic discipline. Only organisations which enjoy a legislated monopoly can pass on the costs of inefficiency and financial laxity to the consumer. Even the largest companies who, on the face of it, enjoy a monopoly can become complacent and new entrants will come in to challenge them. This was evident in the recent postal dispute when utilities paid their own staff to deliver customer bills to secure their cash flow. Companies like DHL are desperate to be able to challenge the monopoly, enforced by a minimum charge of £1 for a letter carried privately.

5.3 Opportunities to diversify

Privatization is a form of liberation for the organisations involved. many public sector companies are constrained by law as to the activities they can pursue. Until its flotation in late 1986 British Gas was restricted to gas related activities. Many British Gas regions are now expanding their retail base into non-gas products. The BR Annual Report puts this as its main case for selling its subsidiaries.

5.4 Worker participation

Privatization also makes the best use of naked self-interest. In the private sector one improves one's lot by satisfying the needs of the customer, otherwise the competition will step in and bankruptcy or take-over will result. Private employees are rewarded through positive contribution to profits.

This was evident when the National Freight corporation was sold to its employees, some even mortgaged their houses to buy shares. Eventually the shares become worth over fifty times their initial value as this stake encouraged the workers to work for improved profits. One driver is now a paper millionaire and is still with the company.

Railway employees should also consider the case of British Rail's former hovercraft division, Seaspeed. Seaspeed had merged with Hoverlloyd, a service owned by a private Swedish firm, Bronson's. In 1984 British Rail and Bronson's the new firm, sold Hoverspeed to five directors and another staff member for the princely sum of £1 i.e. it was virtually given away. The improvement was staggering. A £3.3 million loss in 1982/83 was transformed into a £625,000 profit in 1985/86. In June 1986 the business was sold to British Ferries, a subsidiary of Sea containers who had previously acquired BR's Sealink subsidiary. The price however was not a £1 but £4.3 million !!

5.5 No meritocracy in the public sector

In the public sector one improves one's lot by empire building and exploiting the bureaucracy. All too often grades are decided by meaningless ratios like the number of staff reporting to the post concerned. Very few are motivated by a sense of altruistic public duty having seen the success of the exploiters. Those who do, like the nurses, soon get trampled upon by the middle class bureaucrats who are able to exploit the bureaucracy to their own advantage. Those who do work hard out of a sense of duty are often shunned by the bureaucrats who think the country owes them a living.

A good rail example is that assistant drivers are promoted to full driver according to length of service rather than ability. Therefore the person with the poor disciplinary record with five years service is promoted before his colleague with a clean record and four years experience.

5.6 Producer oriented

Another public sector characteristic is that their activities are often oriented towards the needs of the producer rather than the customer. How often has one gone to the train buffet car half an hour prior to arrival to be told it is closed for accountancy reasons? Why must first class passengers paying, in many cases well over £50 for their journey, put up with hard toilet paper? This was asked by one participant at an ASI seminar. One should ask why should anyone? These seemingly trivial matters are extremely important.

The fact that industries are state owned means that no one really owns them and their property is not treated with the care and attention of private property.

5.7 Government intervention

Since the enforced amalgamation of the railway in 1923 the railways have been subjected to continual government interference in the running of its affairs, most notably nationalization in 1947. There have been numerous acts of Parliament which have altered the railway's source of finances, its organisational structure, the size of the network and its investment such as electrification. It is worthwhile to examine some examples.

In the early 1963 the British Rail chairman of the time, the famous (some might say notorious) Dr Richard Beeching, was instructed to conduct an investigation into the viability of local lines. The result was a succession of line closures which demoralized the railway industry. John Hibbs, in 'Transport with Politics ...?', comments that: 'the degree of emotion which marked the so called 'Beeching closures' illustrates the depth of emotion which transport can evoke. (The closures procedures was blatantly rigged so as to discourage rational and informed debate.)

It was taken to be a sign of governmental lack of confidence in railways and that roads were to be the future. Indeed the growth in publicly financed construction of motorways can be viewed as a demonstration of successive government commitment to road transport. One should add that motorways have never been subject to the scrutiny of their performance in the manner to which the railways have. The records of successive governments in running the road network have been lamentable. Traffic forecasts have been grossly inaccurate and revenues from taxes have not covered construction and maintenance costs. It was such problems which led to the Adam Smith Institute to call for the introduction of motorway tolls and private road construction.

Another example of governmental excess is exemplified in the famous story of a Labour administration that had decided to close a rural line which was losing fifteen times its revenue. The proposal had to be ratified by the cabinet and was about to be approved when one member noticed that the line ran through several marginal constituencies. Needless to say that political expediency triumphed at the expense of the taxpayer.

5.8 The external financing limit

The External Financing Limit, a legacy from the last Labour government's introduction of cash limits to restrict public sector borrowing, is set by the Treasury to limit British Rail's cash flow from external sources. The EFL is the difference between British Rail's net income and its- external income, whether it be in the form of government subsidy of private investment (to be examined in the next chapter). Therefore the EFL acts as a virtual straightjacket which limits the ability of the railway to invest more resources to meet market demand, even if the investment comes via private institutions in the City or from private companies.

This straight-jacket effectively acts as a method of intervention in favour of road transport as road hauliers and private coach operators, never mind private vehicle owners, are free to attract investment and loans from any available source.

There is no doubt that the EFL has distorted the transport market and that a private railway network is required to be able to respond positively to market demand and redress the resource imbalance.

With Paul Channon's Party Conference commitment to private sector track competition and competing services, there is a need for the Treasury to re-examine the definition of external financing. Otherwise the private sector may not be able to respond fully to the Channel Tunnel opportunities.

6. THE EXISTING ROLE OF PRIVATE CAPITAL

Most people are unaware of the increased role of private sector capital in today's railway. This has been due to pressure from central government to reduce the level of public subsidy after the Serpell Report into the finances of BR. This approach has been welcomed in certain circles within BR who see great advantages in using private capital. Private capital is invested according to its ability to yield a return rather than its ability to appease vested interests.

6.1 Freight

There are nearly 180 private freight terminals in Britain. These have been funded with the help of grants awarded under Section 8 of the Railway Act of 1974. This act gives the Secretary of State discretionary power for the payments of grants towards the capital cost of providing facilities for the movement of freight where there was identifiable environmental benefit to be gained from transferring the traffic from road to rail. Section 8 grants cannot be awarded in cases where the traffic would have been forwarded by rail anyway. The Department of Transport has defined quite clearly the categories of facility which are eligible for a grant. These categories are outlined below.

- Infrastructure
- Loading and unloading equipment
- Access roads
- Loading bays
- Rail haulage equipment
- Land purchase
- Environmental protection equipment
- Design costs

Most of British Rail's large freight customers either have their own wagons or lease them from private companies such as Tiphook Rail, Procor or VTG. This type of investment together with the private sector contribution to the construction of freight terminals represents an investment by customers of £2.4 billion (at current prices in terminals and rolling stock and demonstrates the private sector's commitment to the railway.

Foster Yeoman Plc has purchased its own fleet of locomotives from General Motors, USA. It is now virtually a private operator on BR track, paying for the use of the track and train crew. It is estimated that Foster Yeoman's initial investment of four million pounds will pay for itself in under five years.

6.2 Passenger

The famous Venice-Simplon-Orient Express pays BR thirteen pounds per mile for the use of British Rail's locomotives, track and train crew — similar to Foster Yeoman. The Orient Express is a good example of a private operator exploiting a market niche which BR cannot itself enter due to either problems in raising finance or being seen as promoting an upmarket service while receiving vast amounts of taxpayers' money to provide a 'social' service. The Orient Express is owned by Sea Containers Ltd who bought BR's ferry subsidiary Sealink.

The Great Scottish and Western Railway company now operates a luxury train service to the north of Scotland. However British Rail's refusal to grant a long-term contract to run over their tracks limits the company's ability to attract capital to expand its operations, a case for the Monopolies and Mergers Commission!

6.3 Terminals

There are now many successful retail operations on station concourses, (Tie Rack and Sock Shop spring immediately to mind). Last year the private sector invested 720 million pounds on British Rail property.

Keith Mans MP has suggested selling the stations themselves. However any sale would need a contractual requirement for the railway's continued access to the station area. Otherwise a developer might evict the railway, concreting over the tracks. This option may have to be precluded by law.

7. THE OPTIONS FOR PRIVATIZING THE NETWORK

Following the success of the use of the private capital and the transfer of old subsidiaries into the private sector it is logical to privatize the railway itself. As intimated in the introduction, following the publication of 'The Right Lines' there have been some alternative approaches contributed to the debate. It is vital that these approaches are fully appraised in order that the final proposals are adopted and the steps towards implementation begin immediately.

However any scheme must satisfy some basic objectives:

1. Widen competition and consumer choice
2. Simple to legislate for
3. Simple and quick to implement
4. Reduce the level of public support
5. Compatibility with demand patterns

7.1 The infrastructure company

This is the approach outlined in 'The Right Lines' and one which is in keeping with the micro-political solutions already successfully developed by the institute to promote previous privatization schemes to the government and industry. The basic premise is develop a plan which is easy to implement, which will not alienate the interest groups but which will bring about the desired aim of private sector competition, new investment and market growth.

The plan is based on the organisational division which BR has undergone since nationalization. The logic of privatizing the sectors as separate operating companies and forming the regions into an infrastructure company requires little imagination. Legislation would be simple. Established demand patterns would remain, keeping customers happy. Employees would simply stay in the same jobs but in private companies. Productivity would be boosted by employee share schemes. Safety would be enforced by existing or new legislation.

Pricing the Infrastructure.

The infrastructure company would tender rights of way to the privatized sectors and new private entrants to the market. Stations could be like airports with several check-ins similar to the one the Orient Express has on Victoria station. Therefore there would be more opportunities for competition under this scheme than with either of the options currently being canvassed.

The infrastructure company's customers, the privatized sectors and new entrants would pay for the use of the track and stations in a similar manner to that currently used for charging Foster Yeoman and the Orient Express.

Abolish Prime User Charging

British Rail currently charge the sectors on a "prime user" basis. The prime user pays for all the costs of managing and maintaining the lines of which it is deemed to be the prime user. The other sectors are charged on an avoidable cost basis. This has the effect of encouraging the sectors to withdraw services from lines in marginal cases. In some cases the InterCity has reduced its commitment to some lines leaving them to other sectors who do not have a financial remit to make. This will likely be more prevalent from now on as the InterCity sector is no longer eligible for PSO grant. The sector will reduce its services in marginal cases and leave them to the Provincial and Network SouthEast to be subsidised by the PSO grant. The PSO grant bulk subsidy along with the prime user charging arrangement is a joint license to indulge in creative accountancy.

A tendering system of charging will result in the optimizing of revenue from the track. Peak slots will be more expensive than off-peak slots. Eventually the market choices will lead to rate cards or their equivalent being established for certain lines and their feeder lines.

To prepare for this system the Secretary of State should instruct British Rail to establish an infrastructure-marketing set-up to move away from the prime user basis towards such a market based alternative. This could be centralised or have regional outposts. The organisational set-up should be responsive to the market and not be based on the post-nationalization regional structure. British Rail's creation of the Anglia region proves that they are moving away from the old structure.

Such a marketing organisation would have a specific financial remit from the Secretary of State and would form the basis for the creation of the infrastructure company. This remit would become an incentive to improve resource allocation and widen access to the track to new entrants. It would enable financial scrutiny for future flotation of the infrastructure company and the privatized sectors.

The Provincial sector's main requirement for PSO grant lies in its infrastructure cost burden. Relieved of its burden via the abolition of prime user charging it could soon be profitable.

Therefore the infrastructure subsidiary company will be the sole recipient prior to privatization.

Contracting Out The 'Social' Services

Competitive tendering out the contracts to provide the 'social' services, on the cost centre basis, could reduce levels of public subsidy. The tender would go to the company best meeting the tender specifications. Specifications could cover such quality of service criteria as:

- frequency of service
- punctuality
- cleanliness of stations and trains
- passenger information
- queuing times at ticket offices
- cost of providing the service.

Tenders would be sought by the Department of Transport, the relevant Passenger Transport Executive or local authority. The Department must consider substitution of loss making lines by local bus services. There has been debate within BR and in the Provincial sector in particular on this course of action to meet PSO targets. However the Windsor to Slough and Settle to Carlisle case studies show that private enterprise must be given the opportunity to improve on BR's efforts before line closure commences. Penalty clauses would be imposed on the franchisee for failure to meet contractual standards, just like Railfreight has to pay to its industrial and commercial customers when vital trains do not run to schedule.

It is likely that local groups of rail personnel will form companies to tender for this service. When tendering was adopted in Welwyn Garden City a group of drivers from the previous company got together and bought a fleet of small buses. They now provide a more frequent service with a higher percentage of filled seats. Residents prefer the new services especially as they do not have to put up with large buses on the roads.

Local Competition

The potential to improve services by competitive tendering is apparent but there is growing interest in the potential for competing services in local areas, especially in the South-East. Competition could be fostered by awarding local franchises to more than one franchisee.

A form of local travelcard could be issued valid on the all of the franchisees services. There are many potential methods available to enable allocation to the franchisees. British Rail, London Underground and London Transport have used market research to allocate Capitalcard revenues. The Capitalcard has encouraged off-peak travel and is available on many routes where there is competition between all modes. Wimbledon to London is a good example.

There are many other methods of enabling revenue allocation such as electric token, travel tokens and driver payment. The Leyland Railbus was designed for such operation.

Expanding Local Capacity

There is growing concern, especially in the South East, as to whether scope for local concern as to whether there is scope for new competitors to enter the market due to the limits of existing capacity. If new entrants are to enter the market, it will be in their interests to contribute to research and development to improve signalling and track technology to accommodate more trains in the timetable.

It has always been assumed that railways are expensive to improve. This is because it has been in the hands of the state. British Rail have always gone for expensive solutions and have been able to pass on the costs to the customer and taxpayer. Matters have improved since the sectors have pressurised the engineers to be more cost conscious. (This has been especially true in the case of the InterCity and Freight sectors who have a financial remit from the Secretary of State to meet. These sectors are under additional competition from the deregulated coach and haulage sectors.)

A private basis for track ownership will enable R & D funding to come from a variety of sources and encourage efficiency and R & D in capacity expansion. It would be wishful thinking to imagine that there will be many new entrants into the commuting market overnight on deregulation. Therefore the main operator will continue to be the privatized sector, Network SouthEast or Provincial. This will allow lead time to develop new operator management systems to be developed. An analogy can be drawn with the need for the Civil Aviation Authority to update their traffic management system to allow air traffic to expand in response to market demand. This problem is inhibiting the growth of the new London Airport on the Docklands.

The other option to expand is to move towards double-decker trains which are popular abroad. These would be an option when tunnels were able to accommodate them. Otherwise the new entrants would have to pay for the cost of re-boring the tunnels which is quite feasible.

The real potential for expansion for this market depends on these options being exploited and is therefore more long-term than the other market opportunities.

Potential Markets For New Entrants

(a) InterCity

One only has to look at the success of the deregulation of the long-distance coach market to realise the potential of a similar market developing on the rails. The

coach fares came tumbling down, offering consumers a wide choice of services. New entrants came into the market, after a settling down period customers' choices took effect with some entrants losing out and leaving the market to those firms which had clearly established themselves as the customers' choice. A similar effect can be expected when access to the rails are opened up.

(b) Freight

There are many private companies who wish to compete with BR's freight sector. The finance is there, all that is needed is the right of access to British Rail's track.

(c) The Channel Tunnel

The Channel Tunnel will secure the future of rail travel into the next century. Opportunities abound in all market sectors. The fast journey times will promote the passenger business and the freight market too. The airlines will find their cosy, EEC sponsored, European cartel threatened, especially those operating out of Heathrow with its long underground journey time to the centre of London. It is likely one will see the re-emergence of the motorail market which BR pulled out of a few years ago. The attraction of letting the train take the strain out of the journey through the Channel Tunnel will be most attractive. One would then be fresh for a drive on the continent.

It is unlikely that British Rail, constrained by the external financing limit will have the resources to make the most of the tunnel's new marketing opportunities. Only the private sector, with City backing, could respond.

(d) Long-distance Commuting

The considerable outcry following the recent announcement by BR of Their intention to impose major price increases on long distance season ticket holders has already been mentioned. These increases have been sparked by British Rail's underestimate of the attraction of the High Speed Train. The greatly improved journey times initiated passenger growth levels far in excess of forecasts. The inflexibility of the High Speed Train, in terms of its inability to be lengthened, has led to chronic overcrowding which BR is attempting to price away.

The customer should not be forced to pay for British Rail's inability to invest to meet demand. These fare increases, as much as 75% in some cases, will threaten the financial security of many who have moved out of London to escape rising house prices. The private sector must be allowed to compete and force down fares.

Sea containers' chairman, James Sherwood, has already intimated their interest in expanding their rail business. Spiralling London house prices will ensure that long-distance commuting remains a growth market for the foreseeable future.

Competition could come from privatized companies diversifying, entrepreneurial commuter groups or from companies new to the travel business. Virgin Atlantic Airways is a good example — could we see Virgin Rail trains speeding through the Channel tunnel in the nineties?

How the New Entrants Will Operate

The new private operators would purchase or lease locomotives and rolling stock from the private railway industry suppliers. In many BR depots there is a surplus of qualified train crew. The new operators must have the ability to recruit its own train crew from this surplus. The precedent is shown in the Settle to Carlisle case study. The young drivers, who suffer from the agreed BR/trade union policy of promotion through length of service, would jump at the chance to further their careers.

Train crew Policy

There are two other train crew alternatives available.

- a) BR and ASLEF to establish a train crew subsidiary which would sell train crew services to the sectors and new entrants.
- b) Establish driving schools and test centres which would issue licenses to drive on certain routes with which the applicant is familiar. This would allow private operators to recruit new train crew or for private train crew hirers to set up in business, thereby knocking down the ASLEF closed shop. The advantage is that drivers would be free to escape the BR/ASLEF length of service basis for promotion agreement.

Vertical Integration Versus Horizontal Split

There are two approaches to this idea, one based on the separation of infrastructure and operations along the lines stated earlier or on vertical integration of infrastructure and operations. There is no golden rule as to which approach should be adopted each case should be evaluated on its own merits, possibly geography will be an important factor.

Fenchurch Street to Southend

One example is the Fenchurch Street to Southend line which was suggested as an opportunity to be sold off as a single entity to a single buyer. This line would have been suitable for vertical integration since it is almost separate from the rest of the British Rail network. The crucial point is that there is potential competition for between London and Southend on the line between Liverpool Street and Southend. Therefore there is an incentive for the purchaser of the Fenchurch Street line to reduce costs and improve profitability by pruning

infrastructure costs, increasing potential for reducing fares. Alternatively the line could be leased from British Rail and maintained by the lessor. It would be up to the lessor to run services itself or act as a competing infrastructure company. Market conditions would dictate.

The Docklands Light Railway

The Docklands Light Railway was built to fill a large gap in the capital's public transport network. The railway is notable for its automatic system — the trains have no driver and are programmed to start and stop at stations by a sophisticated computer programme. However it is becoming apparent that it will not be big enough to accommodate the large demand which is forecast to result from the further development of the Docklands area and the extension to connect with the London Underground. Large amounts of private investment will be required if demand is to be met.

Dr Madsen Pirie has suggested that the underground should be privatized as a single entity due to its operational characteristics. The same approach should be taken with the Docklands Light Railway as operations and infrastructure are even more integrated. The same arguments apply to the Tyne & Wear Metro and the small Glasgow Underground.

There is now debate as to whether vertical integration should form part of any plan to privatize British Rail. This debate is tackled under "The Final Solution" after looking at some specific case studies.

Need For Private Investment in Infrastructure

Whilst the private sector may tender for infrastructure construction and maintenance on the British Rail network there is growing need for the private sector to initiate the provision of railway infrastructure. British Airways have been reported to be looking at funding a rail link between Heathrow and Paddington. Eurotunnel are setting an example through the funding and construction of the Channel Tunnel and have highlighted the need for the private sector to finance lines round London to shorten journey times between the North and Midlands and Europe when the Channel Tunnel is complete.

Linking New Lines to the Network

Mr Channon's announcement of private sector involvement in building new lines to link up to the Channel Tunnel opens up the question of how they will operate and charge for use of their track. It is likely that the private track owners would wish to link up to the national network to gain maximum revenue from trains travelling through their lines having set out from other parts of the network.

Construction companies could negotiate with the infrastructure company, set up prior to privatization, the rates to be charged for the use of the new lines. The infrastructure company could act as an operating or negotiating agent or both.

Alternatively the owners of the new track could run services themselves or act as an isolated competing infrastructure company. However it is unlikely that this will be the case due to limited market potential.

Since the new private infrastructure companies would receive no public subsidy there is no potential conflict of interest should they choose to operate their own services. There is the potential for such a situation to arise if British Rail were to be sold in a manner where the providers of infrastructure and services were linked within a single company — grants for maintaining social services could be used to cross-subsidise new market ventures. This problem is inherent to the retention of a prime user basis for infrastructure charging.

Pressures To Improve Performance

Opening the market will result in market growth and less need for subsidy of the track (where most of the subsidy currently goes). The private sector would exact commercial pressure on the infrastructure company to improve its efficiency. Additional pressure to improve costs and efficiency would come from the Treasury, the City, and new infrastructure companies.

The idea of splitting up track management from operations is not new. When the railways were nationalized in 1947 the London North Eastern Railway company pleaded with the Labour administration to nationalize the track only and to allow the LNER to continue to run its services. Further support for this concept has come from Dr David Starkie in *'Economic Affairs'* and Malcolm Gylee in the journal of the *Chartered Institute of Transport*. The idea of privatized sectors running on state track was first intimated in the short report in the *Financial Times* in 1983 of an address to the Manchester Statistical Society by Dr Richard Pryke of Liverpool University. However there is no need for the state to own the infrastructure as the government has grasped with its plans to privatize electricity.

7.2 The Pre1923 Structure

This is the approach favoured by the Centre for Policy Studies(CPS) paper, *'Reviving the Railways'* by Andrew Gritten, which advocates complete abolition of the BR Board and to split the network into twelve companies a la 1923. The institute has looked at the proposals in detail and believe that it has several disadvantages.

This approach harks back to the Churchillian approach of denationalization rather than privatization in that it attempts to return to the structure prior to

nationalization. It fails to take account of structural changes which have taken place within the industry or changes in demand patterns.

Employee concern

There is potential for employee opposition. Both management and staff could perceive their job security to be threatened, possibly resulting in an organised and vocal pressure group of employees and their families fighting privatization. Staff with valuable expertise could leave the industry resulting in the viability of the plan being threatened.

There is also possible customer resistance. Splitting the network would result in certain routes no longer being available as the new operators may not form reciprocal ticketing arrangements. Vocal interest groups to publicize their fears that their lines would be closed, their journey patterns altered, fares raised and the inconvenience of a company change.

Complex Negotiating Procedures

Freight customers could be required to negotiate with several companies instead of one and would be concerned that the new firms might not be able to deliver a quality of service comparable with existing levels. The alternative scenario is that the new companies would have to introduce reciprocal arrangements. These complications take place in today's European market but are unnecessary and avoided under the infrastructure company approach with a one to one relationship. This is vital when an extra train is required at short notice and slots in the network have to be found quickly. Competing companies are not going to divulge this vital market intelligence.

The allocation of British Rail's resources to the new companies could present major difficulties. Even if tendering took place it could result in some passengers receiving an inferior service. Expertise would go to the highest bidder, if at all, leaving the least attractive companies floundering. Some of the new firms could be bankrupt shortly after commencing trading with the effect of reducing the network.

Vertical Integration

It is not clear whether the CPS plan favours competition over the lines owned by the new companies. In one section the paper suggests 'there should be no reason why a train operator... should not seek to provide and market its services without any track at all' whilst arguing against a track company because 'separation of track and trains would mean there would be no unitary point in the management structure which would be accountable'. Therefore the CPS plan is ambiguous on this crucial issue of the need for vertical integration.

This ambiguity will be of particular concern to potential new private operators, like the Venice-Simplon Orient Express and Foster Yeoman, who have no interest in owning track. Such companies will be disturbed at the prospect of negotiating with a multitude of track companies. If the plan does favour vertical integration the potential for competition will be reduced, especially in the long-distance passenger and freight markets.

This paper shows that vertical integration is not a solution for the British Rail network as a whole. It is suitable for certain situations, especially when new technology inextricably links operations and infrastructure, i.e. it is 'horses for courses' — micropolitics in action.

Centralized Solution for Decentralized Objective

The CPS believes a study is needed to establish the precise structure of the new industry, capital requirements, market sizes and growth estimates to enable the new firms to be set up. This seems a strange centralist approach, reminiscent of Marxist constructivism, i.e. a central authority trying to plan a decentralized rail market. Hayek and the economists of the Austrian School have demonstrated that market dislocations occur when a central planning authority tries to allocate resources with imperfect data. A much better approach is to let the current market develop spontaneously and freely through increased competition and let the entrepreneurs allocate the resources according to the consumer signals of a decentralized market.

The CPS believes that the resurrection of such names as the Great Western Railway company could build upon sentiment and loyalty shared by the public and staff. However it is now more than forty years since nationalization and only a small proportion of the population will have any real recollection of the old railway companies. It is this sentiment which attracted the sympathy of Julian Critchley, self-style arch critic of the Prime Minister. The magazine described this notion as 'whimsical'.

Abolish the PSO Grant

However the CPS report does suggest replacement of the PSO grant by a system of local line grants. This is similar to the tendering approach favoured by the Adam Smith Institute.

Not Relevant to Today's Markets

There is no logic in pursuing this type of structure as markets are national and international. Prior to 1923 journeys and freight traffic flows were over shorter distances. Therefore the smaller companies met the market requirements. With 1992 on the horizon one needs to think internationally rather than locally.

It may seem merely churlish to criticize a rival think-tank's scheme but it is important that it is not used by privatization opponents to 'rubbish' the idea of privatization when there is a practical solution which is gaining increasing support amongst private firms anxious to move into railways. The CPS paper did concentrate the mind on the need for vertical integration against a purely horizontal approach. Competition yields benefits even in the market for ideas; Mr Gritten's paper has rekindled interest in the rail privatization issue and for that one is grateful. However a successful policy needs more depth than a simple turning back of the clock. It is therefore left to John Manley of the magazine *'Financial Weekly'* for a final comment:

"There is a crying need for a comprehensive study of Britain's transport needs, and of the options for privatization, break-up or retention of BR. But Gritten's paper is not that study. BR's criticism of the study is quite understated. It is superficial and backward looking ... is unlikely to be the model chosen".

7.3 BR Plc

This is the label given to proposals to privatize BR as a single entity, the option regarded as the least of evils by BR's chairman Sir Robert Reid. It is supported by the railway enthusiasts' magazine *'Modern Railways'*, which has a remarkable propensity to toe the BR Board's line (perhaps it fears its cosy relationship is under threat) and is reported to be an option supported by one or two merchant banks but there is little enthusiasm elsewhere for this scheme.

Under this scheme BR's subsidy, the Public Service Obligation grant (PSO), would be paid to the private BR under contract. The main advantage is that there would be little reorganization required and legislation would be relatively simple.

This scheme is unlikely to stimulate private competition. Even if BR was forced to allow competition access to the track to compete with its services it could make life difficult for the competition, e.g. giving priority to its own services in times of operational difficulties.

The Public Service Obligation grant might be used for cross-subsidization, lowering fares on competitive routes. To account for situations such as this, complex legislation and a regulatory body like Oftel, British Telecom's 'watchdog', would be required to rule in cases when British Rail was in dispute with competitors. There is no guarantee that BR would co-operate with the new body in providing the vital information required to arbitrate fairly in disputes between BR and the new private competitors.

The incentives to cut bureaucracy, remove restrictive practices, improve the use of resources and reduce union domination are low compared with the other

alternatives available. The new shareholders would present a formidable interest group to oppose the competitive tendering of local services.

It is unlikely that the public would favour this approach. Privatization of monopolies as single entities, like British Telecom, has proved unpopular as the quality of service failed to live up to immediate expectations. The method chosen by the government in selling the electricity industry shows that competition must be an integral part of any privatization scheme. Market research shows that the public has retained a poor image of British Rail and its management. An unchanged structure is unlikely to inspire the public to purchase shares in BR Plc.

8. RAIL PRIVATIZATION IN THEORY AND PRACTICE

8.1 Case Study 1: The sale of Windsor to Slough

In January 1983 the British Railway Board was approached by Rail Limited with a proposal that the company take over the running of the Windsor to Slough line, a branch line two and a half miles long between Windsor and Eton Central and Slough. Meetings with high-ranking BR officials followed with BR emphasizing that the venture would be required to be financially viable, reduce the level of public support and provide additional benefit to the customer. A joint working party comprising representatives of British Rail and Rail Limited was formed to evaluate the possible transfer of ownership or management to Rail Limited. The report which arose out of the working party's discussions was submitted to the British Railways Board who were responsible for making the final decision.

The report considered three main options:

- a) outright sale of all the line's assets to Rail Limited
- b) the long-term lease of the assets to Rail Limited
- c) for Rail Limited to act as an operating agent, British Rail retaining ownership of the lines assets.

The report concluded in favour of the first option for the following reasons.

1. Under the other options British Rail would not have been fully relieved of its liabilities and Rail Limited would not have full control of its own destiny. another advantage perceived was that if Rail Limited needed to raise further finance in the future the freehold ownership could be used as security against loans.
2. The option c) was considered to have safety drawbacks due to dual operating responsibility. This was deemed to be undesirable at the time. Therefore vertical integration was assumed to be necessary for safety reasons. However the examples described in this paper have shown that this is not the case. Further evidence will appear in the Settle to Carlisle case study.

Under Section 1 of the 1981 Transport Act British Rail could form a subsidiary company and under Section 7 of the same Act transfer the assets to the subsidiary company. With ministerial consent British Rail could sell shares in the new company to Rail Limited. All liabilities, statutory or otherwise, would be transferred to the new company, including the contracts of staff who were employed for the purpose of operating the line and its services.

The report pointed out other potential areas of dispute would be resolved through clauses to be drawn up under a formal contract. Rail Limited would maintain the timetable and agree changes with British Rail. British Rail would

retain the right to repossess the line if 80% of the scheduled services failed to run within a 28-day period. Bus services were acceptable as alternatives for cases like when essential repairs to the line forced temporary closure.

Obligations

Rail Limited were required to undertake further obligations such as insurance of bridges and indemnity against structural failure of assets during the first ten years of operation. British Rail were to be allowed access to the line and Windsor station when required for special purposes.

Ticketing Arrangements

There was to be an arrangement for through ticketing from BR stations but no joint season ticket arrangements, i.e. one season ticket would be required for Rail Limited services and one for further travel on British Rail and London Underground services. This was a strange request by British Rail's it would be possible to estimate the necessary revenue split. Rail Limited fares had to be set at a similar level to those previously set by BR. Travellers Fare would no longer be able to run the buffet on Windsor and Eton Central. This operation would have be contracted out to a private caterer with anticipated profit sharing with Rail Limited.

Security

It was considered undesirable that Rail Limited's property should be policed by the British Transport police. Rail Limited would need to make their own security arrangements. Some might argue that this is a case for transferring the resources of the British Transport Police to the normal police and for British Rail to tender out security to the likes of Group 4 or Securicor. The advantage is that the police would have more resources without having to train new personnel. There is no reason why transport property should have its own police force than, for example, banking property.

Rail Limited was formed to operate railways. Its four directors contributed and arranged considerable financial resources. Financial projections were drawn up by a reputable firm of accountants with railway experience. These projections showed that profitability was readily attainable.

BR Pulls Out

The scheme received a favourable reception at the Department of Transport who considered it to be a worthwhile pilot scheme. It was decided to proceed with the project. British Rail got cold feet at the eleventh hour and pulled out fearing another ASLEF dispute. If there was to be another ASLEF dispute then it was

considered that it should be over a strategic issue of perceived greater importance. The embarrassed officials at the Department of Transport paid compensation to the directors of Rail Limited for the cost of the wasted time spent on the aborted project.

This is an excellent example of how private enterprise can profitably take over the running of the smallest line, improving on the performance of British Rail, with positive benefits to the public purse and consumer. If British Rail had really wanted the scheme to go ahead they could have moved towards option c) rather than pull out altogether. Rail Limited could have acted like a franchised private operator and hired the train crew from BR or have bought the line as in option a) and reached an agreement to recruit train crew from BR who had been passed out to BR standards and who knew the route. Rail Limited were badly let down. A pilot scheme like this would have been extremely valuable.

8.2 Case Study 2: The Sale of the Settle to Carlisle line

The Windsor to Slough example is 'small beer' compared to the offer for sale of the Settle to Carlisle line. Lazard Brothers, the merchant bank, have been appointed by the British Railways Board to assist them in finding a suitable purchaser. This decision followed the furore which greeted British Rail's announcement of its intention to commence closure procedures. In fact British Rail have already completed the necessary procedures to seek closure from the Secretary of State who, to his great credit, has decided to await further developments.

The sale brochure prepared by Lazard Brothers gives details of the line's history, its development, operational arrangements and details of the obligations and liabilities to be undertaken by new owners.

The Line's History

The 71-mile line was built in 1870s by the Midland Railway Company to compete with the London & North Western Railway Company's route between London and Scotland (now British Rail's West Coast Main Line). In the 1970s British Rail concentrated resources on the modernisation of the West Coast Main Line resulting in the Settle-Carlisle line becoming less competitive, especially as advancing technology in freight wagons made it possible for them to use West Coast Main Line.

The decision to concentrate investment on the West Coast Main line led to the neglect and deterioration of the Settle-Carlisle line, the famous Ribbleshead viaduct being reduced to a single line in 1985. The line's contribution to railway finances dwindled with steady erosion of freight traffic and the running down of the passenger service, including the closure of intermediate stations.

Ironically the furore which greeted closure announcements forced British Rail to improve the marketing of the line. New pricing packages were developed, new publicity material distributed, train services improved and some of the stations were reopened. BR encouraged the specialist train charter business, steam trains to recreate the nostalgia of the line's heyday.

Operational Restrictions

British Rail are now seeking to dispose of the line's assets to a single purchaser who, hopefully, will be able to exact a positive return. However, the future operational arrangements included in the line's sale brochure are so restrictive they make the line an extremely unattractive proposition to potential purchasers. Presumably this is the reason why the deadline for bids has been extended from the 30th September to 31st October 1988. The really contentious item is the requirement laid out under the section concerning connecting and supplementary services. To fully understand the problem it is necessary to quote the entire section.

'Although at the southern end of the line, the purchaser will, subject to the conclusion of satisfactory operating arrangements, be able to operate his trains over BRB tracks as far as Hellifield, he will be able to charter trains to convey his passengers from Leeds to Hellifield, where they will change trains. These charter trains will not stop at intermediate stations. BRB will endeavour to ensure that there normally be sufficient rolling stock available for such charters, as long as they are arranged on a regular basis. The terms on which such charters will run will be a matter for negotiation between the purchaser and BRB; the purchaser will retain the whole of the income from fares for this portion of the journey. In addition, the normal train service which BRB run between Leeds and Morecambe via Carnforth will be able to pick up passengers at intermediate stops between Leeds and Hellifield. These trains consist of two cars only and therefore are not capable of taking large numbers of people to Hellifield.'

Machiavellian Plot?

The message is quite clear, the BRB want to 'have their cake and eat it'. They wish to dispose of a troublesome line in such a manner that they have no real commitments to the purchaser. The arrangements have been fixed to present no real threat to the BRB existing services. Indeed the arrangements give the impression that the BRB see the potential limited to infrequent excursion traffic. It would appear that regular services would be considered a nuisance by the BRB. If one is to be uncharitable to their motives, one could suggest it is a Machiavellian plot to undermine moves towards full privatization of the network. The plot would be to sell the line with such restrictive operational arrangements as to make the line unprofitable thereby showing the privatization is a failure.

Problem of Assumed Vertical Integration

Vertical integration seems to be the BRB's favoured approach to individual line sales. It has already been shown that it may have been inappropriate to the Windsor-Slough example and it is possibly equally inappropriate now. This will become apparent as one examines the line's market potential.

There is a small local market for travel within the boundaries of the line itself, i.e. into Carlisle and between stations. The real market potential lies in the ability to run into Leeds station itself, precluded by the operational arrangements. The purchaser must have the right to run from Carlisle to Leeds as customers will be against the idea of a company change, as outlined against the CPS paper. BR's commitment is only 'to endeavour to provide' connecting charter trains. The purchaser ideally will have the opportunity to pick up and lay down passengers between Leeds and Hellifield to avoid the need to go into Leeds and back out again if the Morecambe service connections were unsuitable. The purchaser could enter contractual arrangement to supplement BR's local service with an agreed method of splitting revenue, e.g. market research, between the both parties. The new operator would pay for rent of the track like the Orient Express. Passengers would be offered real choice.

The Long-distance Market

The line's most lucrative potential market lies not in local traffic flows but in making the most of the areas natural scenic beauty. The market splits into two distinct segments.

1. The tourist market for those wishing to visit the area itself, i.e. travel to the area and alight at one of the stations, either for a long or short stay.
2. The market for operators who wish to add value to a journey by using the line as an alternative to using the West Coast Main Line or even the East Coast Main Line.

These markets are particularly attractive to the likes of the Great Scottish & Western Railway Company who runs the country's most expensive train from London Kings Cross to the north of Scotland. The latter's market lies in rich American and Japanese tourists.

The line's market potential can be best realized by taking the infrastructure approach whereby a firm with infrastructure engineering and management expertise would purchase the line and tender out rights of way to the likes of the Great Scottish & Western Railway Company. Alternatively the latter could purchase the line itself and tender out the infrastructure management and the running of local services. The permutations are endless. However the market must decide. A long-term contractual arrangement with BR would be necessary to ensure that timetabling delays did not occur. A prototype agreement is set out in the sale brochure. British Rail must be directed by the Secretary of State to

allow private access to its tracks and stations. This is crucial to optimising the line's potential.

However, it is easy to appreciate the problems if this approach was taken in splitting up the network. A complex 'mishmash' of arrangements and negotiating procedures would result with the potential of state intervention and the misallocation of resources associated with central direction. Remember the post 1923 state enforced amalgamations.

Train Crew

The sale brochure also sets out an important precedent over the issue of train crew. This is the first case where British Rail have publicly spelled out the precise arrangements under which a private company can recruit its own train crew to drive over British Rail lines. Section B4 of the operational arrangements states quite clearly:

" if the purchaser wishes to take the option of running trains over BRB tracks into Hellifield or Carlisle ... it will be necessary for him to ensure that his train crews are permanent employees trained and passed out to BRB standards both generally and in respect of the relevant sections of the route'. This will be a useful precedent to establishing the train crew organisation outlined in the proposal to take the infrastructure approach.

There is no doubt that there must be radical alterations to the operational arrangements laid out in the sale brochure for the line to appeal to a purchaser or group of purchasers. The whole approach demonstrates the BRB narrow 'point-to-point' approach to marketing. Perhaps BR do wish to prevent any precedent for simulating competition.

The market opportunities are clearly evident. Potential bidders should be aware that there is financial support worth over 31.3 million pledged to help a potential purchaser. The details are included in the appendix with a list of firms offering discounted terms in areas such as supply of steel, aggregates, cement, funding of restaurant or exhibition car, and various engineering and contracting services. This demonstrates the desperation of the private sector to enter the railway supply market.

8.3 Case Study 4: The Japanese and American examples

The Japanese National Railways Privatization

The Japanese National Railways were re-organized and prepared for privatization on 1st April 1987. As was stated in 'The Right Lines' the Japanese were no April fools! For years the nationalized railways had been consuming ever increasing amounts of public money, far greater than their European

counterparts. The railways were the lepers of a successful manufacturing and service economy. Characteristically, the Japanese government decided that immediate action was required. Noting the success of the eighty or so private railway companies, privatization was the obvious solution.

British Disease

Like British Rail, the JNR had been suffering from the problems experienced by state-owned corporations all over the world — overmanning, restrictive practices, industrial relations problems, bureaucracy and a management structure which did not lend itself to rational resource allocation and business decision making. Until 1979 these were symptoms of the internationally recognized 'British disease'.

Political Interference

The JNR also suffered from vested interest groups from politicians to civil servants and political lobbyists. The JNR was subject to even more rigorous government control than their British counterparts. Stringent regulations covered issues such as fares levels, salaries and wages, revenue budget, and investment programmes. British Rail does suffer from interference in those areas too.

The New Structure

The JNR was split into six regional passenger companies, a freight company, a track holding company and several peripheral companies — all private. The structure is shown in the appendix.

The six passenger companies are a mix of the infrastructure company approach and vertical integration. There are three vertically integrated companies on the island of Honshu, East Japan, West Japan and Tokai. There is a company on each of the islands of Hokkaido, Shikoku and Kyushu. The Shinkansen Railway Holding company acts as an infrastructure company and leases the lines to the three passenger companies on the islands. It is unclear as to the extent to which new entrants will be allowed access to compete.

Freight

The JNR freight traffic more than halved in the ten years prior to privatization. The revenue did not even cover the wages bill. In order to achieve profitability in this sector the new company will be charged for use of the track on an avoidable cost basis, similar to BR's freight sector under the prime user charging system. This may be suitable in the short-term to secure market confidence but is unacceptable in the long-run, for the same reasons as BR, as the traffic volume grows to a larger proportion of total traffic. When the Channel Tunnel comes

into operation there will be a market for rapid transit freight. An avoidable cost basis for charging would not be appropriate. Some premium method of pricing is needed like slot tendering again proof that prime user charging is of no use in a growing freight market.

Settlement of Account Enterprise

Due to the excessive overmanning and restrictive practices the government thought that the workforce would have to be trimmed to achieve the targets set for the new companies. The SAE has sought to retrain and find alternative employment for the workers not required under the reorganization. The overall reduction was around 62,000-20,000 leaving through early retirement and voluntary severance, the rest becoming the responsibility of the SAE.

Although the ASI plan does not anticipate compulsory redundancies such a promise to form a similar body to find employment for displaced staff would take care of any fears of the British trade unions.

Liabilities and Targets

The Japanese government refused to write off all the liabilities of the old state railway. A significant proportion was transferred to the new companies. As a result of incurring these liabilities the new companies are required to produce profits of 1% of income and a 5% return on capital employed, the latter being the original targets of BR's InterCity and freight sectors (now reduced to 2.7%).

Conrail

President Reagan's 1986 State of the Union address proposed selling off Conrail, the old Penn State Railway. An initial selling attempt was simply to sell the company as a single entity to a new owner, the objective being simply to raise cash for the public coffers. The idea flopped.

The reason for the flop was that no one had been consulted — neither management, workers or the public. These groups were easy fodder for the lobbyists against the idea of the Sale. Congressmen listened to the interest groups and put political expediency before the financial interest of the company and taxpayer.

A second initiative was drawn up which after consulting some British banks with privatization experience. Each worker was allocated \$8,500 of free shares, amounting to about 20% of the total stock value of \$2 billion. This did not guarantee an unhindered passage through Congress but it helped. It definitely won over the support of the workforce.

This second successful approach demonstrates one of the most important techniques in privatization — the buying off of interest groups. This will prove

immensely valuable when the government seeks to enlist the co-operation of the British rail unions.

Air competition

The decision to sell Conrail as a whole should be considered along with the structure of the American transport market. There is a very small railway sector when one considers the size of the country, the decline has been due to the large and diverse competition from airlines. Americans think nothing of flying journeys as short as 100 miles, unthinkable in Britain except for the rich. If Britain can sort out its air traffic control problems, which restrict capacity, then railways could find themselves under real competition from the likes of British Aerospace's 146. This could be very interesting when the Docklands and Stansted airports are developed — real competition for the Channel Tunnel and the major airports.

9. TRACK TO THE FUTURE

These case studies have shown that vertical integration may be applicable in certain instances. However it is now necessary to determine its role in any future programme to privatize British Rail.

No Engineering Vertical Integration

One issue is abundantly clear. Vertical integration should only be used as a marketing concept and not an engineering concept. The Docklands Light Railway may find itself in a great deal of difficulty due to the linkage of computerised train operations to the infrastructure. The continued growth of Docklands together with the opening of the connection to the Underground will exert capacity pressure on the system. The computerised operations do not lend themselves to expanding train capacity and the stations are too short to allow train lengthening. New parallel lines will have to be constructed — an expensive consequence of engineered vertical integration.

The potential for marketing solutions based on vertical integration has to be balanced against the need to keep the network in tact. The case studies show that it may be suitable for cases like Settle-Carlisle or Windsor-Slough but the case studies also demonstrate that the lines can have more potential by allowing more than one operator to use the track.

Windsor-Slough could have been salvaged by such a solution. Equally lateral split expands the market for the Settle-Carlisle line. Vertical integration may be suitable for cases like Windsor-Slough and Fenchurch Street-Southend. In each case there is competition via other routes. Competition to provide services must remain the priority. If there are too many track companies operating in isolation market potential via the network will be lost. Equally market potential will be lost if there are a multitude of track companies with joint operating arrangements. Complex inter-company operating arrangements lengthen reaction time to respond to needs for a new service to be slotted in quickly. That is why a pre-1923 structure is inappropriate.

Regional Infrastructure Companies

One variant on the infrastructure company approach is to privatize the BR regions as separate infrastructure companies, with or without route reorganisation. It is argued that this will improve competition between routes such as the West Coast Main Line and the East Coast Main Line. That is a solution compatible with the basic approach advocated and could be easily implemented but it would be necessary to balance this against negotiating structures and the advantage of one track company. Intermodal competition and

inter-train company competition is more important. It should also be noted that once a few more track companies become established through franchising or linking to the network a complex structure emerges. A simplified structure to begin with becomes more important.

Railways are not a monopoly. They do compete with other modes of transport. In most cases that itself will act as an incentive to cut costs. Further pressure will come from governments wishing to cut public support, the City and shareholders alike as stated previously.

Track Company Trains

It is possible that the infrastructure company will wish to run services over its own track. A watchdog, like Oftel, or the Office of Fair Trading or the Monopolies and Mergers Commission would be needed to ensure fair competition. A legislative pre-condition is required to ensure that the present service structure is maintained for an initial settling down period. This would reassure customers that their travel patterns would not be disturbed overnight. This is similar to the requirement under the 1974 Railways Act.

Such an arrangement would link the needs of the end user closer to bear on the track company. It would have an interest in not passing inefficient practices on to the franchisees who might be forced to pass them onto the customer. Some view this to be a necessity in the South East where rail is beginning to enjoy something of a natural monopoly due to the inadequacies of the road system. These inadequacies are partly due to no effective system of road pricing — another issue too complex to be dealt effectively in this report.

Finally the approach must be to have a national track company, aided by the immediate establishment of an infrastructure marketing subsidiary under the BR Board. Regional track privatization is a possibility but need to be balanced against complex negotiating structures. Vertically integrated franchises may be granted but again must be counter-balanced by the desirability to keep the network in tact. The advantages of vertical integration are brought about by allowing the track companies to run services, monitored to ensure fair competition, and moves to extend further intermodal competition.

A national track authority is still the preferred option.

10. CONCLUSION

Paul Channon has now made clear his position on privatization of the last Conservative Party Conference on 11th October 1988. His words were:

"I want the private sector playing a part in any new high speed link from the Channel Tunnel to London. I am delighted to announce that BR will shortly be issuing an invitation to private companies to build, or even own, this vitally important link. There is even scope for private rail services to compete with BR'

"I want to look at the whole of BR's future to see whether privatization is the way ahead" "I have set work in hand to study the options because before we make any decision about whether to privatize, we need to be clear about how best to do it.'

Therefore Mr Channon has grasped the vital issue in rail privatization — that railways are not a vertically integrated engineering concept and that separate ownership of track and services is the way to progress. He has also grasped that railways are a right of way, just like roads, just like air routes. Vertical integration is only suitable for isolated cases, when market conditions dictate. It is necessary that in such cases, the requirement to keep the railway network in tact.

The author addressed the British Transport Officers Guild, the rail management union on the subject of privatization. The participants welcomed the infusion of private capital to expand not just the infrastructure but the range of services too, including private operators. A vote was taken on how privatization should proceed. The pre-1923 structure received no votes at all. The vote was split evenly between privatization of BR as a whole and the infrastructure company approach. Underpinning this vote was the desire to keep the network intact.

Mr Channon would do well to listen to this voice of the railway employees, as the Conrail experience has shown. He should also bear in mind the opposition of the International Railway Journal to geographical break-up.

This report reaffirms its support for a lateral approach to rail privatization, even with the opportunity for the infrastructure company to run services over its own track. This approach has the support of many in the railway industry, including the private sector firms wishing to enter and expand the market and some railway employees.

The Independent has suggested that ministers support privatization of the sectors combined with a prime user charging system. It is hoped that this structure has been approved. However it is vital that a more market based track charging system be adopted.

The Prime Minister has declared her wish to tackle the problem of fossil fuels' deleterious effect on the earth's atmosphere and environment. The positive environmental advantages which rail electrification has over road transport will present a sound basis for future investment in electrification. These environmental advantages will combine with the opportunities through the Channel Tunnel and the European Single Market to present railways as the transport mode of the 1990's and beyond. To meet this challenge the railways must be a sound network in the private sector.

This is the Track to the Future.

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