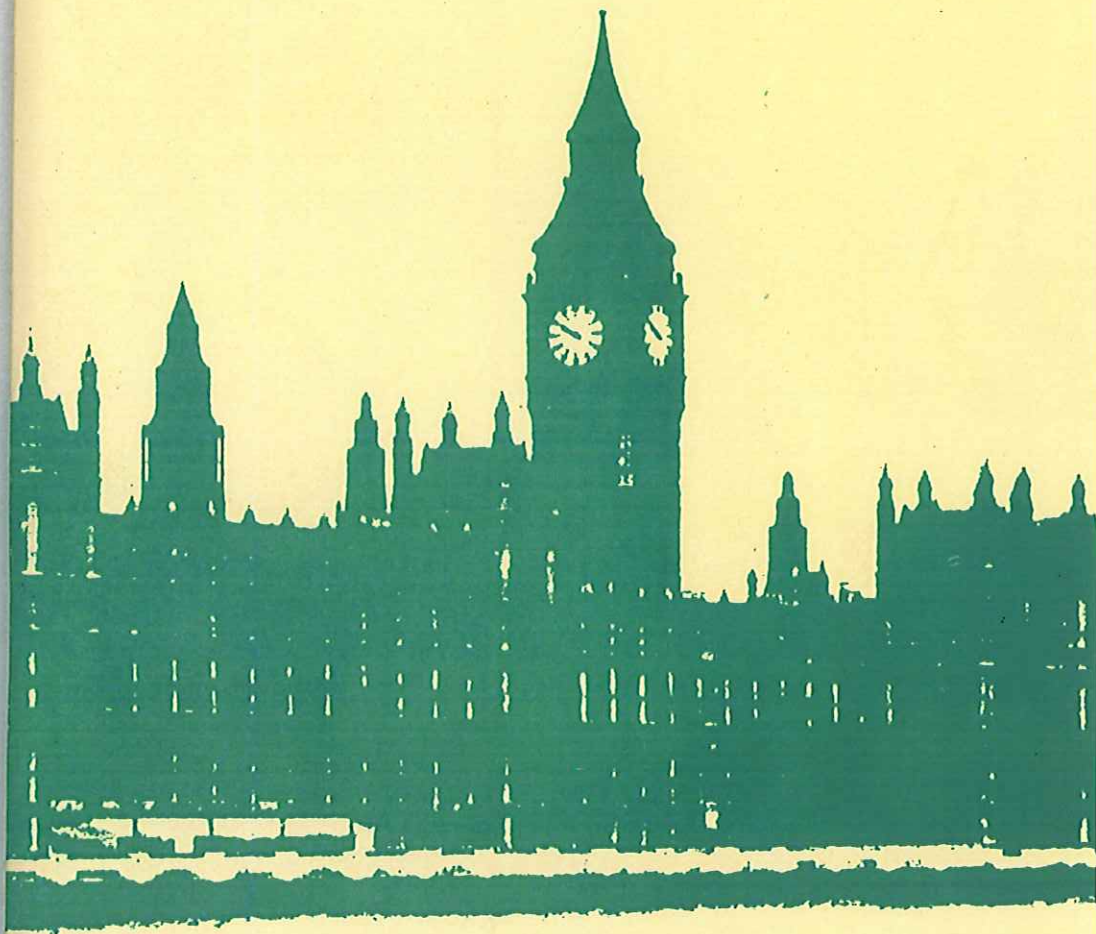


Policy Study No. 97

Reviving the Railways

a Victorian future?

Andrew Gritten



CENTRE FOR POLICY STUDIES



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Introduction

It is time to challenge the railway industry. If policy is not changed, it could degenerate. It is too comfortable, constricted and confused. Alternatively, but seemingly so much more laborious, it could be reborn. It has the best prospect on offer in nearly a century.

The decision over direction is urgent. In only five years time the Channel Tunnel opens. The railways will then be international and will provide a vital link to a unified European market. The Tunnel, a great railway enterprise, could transform the financial position of much of the rest of the industry: but only if those with vision and resources are allowed to rebuild Britain's network where opportunities dictate.

The pressure to change course and the advantages of doing so are increased by the improvements being made to rail systems on the Continent whilst, in Britain, transport policy has to change. The roads are ever more congested with freight and traffic moves ever more slowly. Additions to the motorways are mooted and yet will be very expensive. Air corridors are crowded and airports strained to the limits of their capacity. Commuter railways have become unreliable and overcrowded.

If railways were not shackled by financial constraints to the markets of a century ago, by defensive attitudes in both management and unions, by structures imposed by government and inappropriate for a commercial enterprise, they could take advantage of this demand to seize a far greater share of traffic from their competitors.

Ultimately, the railways should be removed from the public sector. To put this policy into practice, the railways should be divided into routes which follow traffic flows and existing facilities. Very broadly, the division is made simple by returning to the structure first established by the railway companies which built today's routes. Within the overall constraints of geography and social and economic activity, these routes are not regional. Thus the railway would have a base from which to grow again. Free enterprise and private capital must be allowed to develop existing railways, create new systems and offer a variety of train services, addressing modern markets. To do so they must be allowed, whenever necessary, to build, manage and operate

each system as they see fit.

BR's monopoly must, then, be ended. With liberalisation, railways could compete more effectively both for investment and for customers, seeking to maximise returns by being more responsive. New entrepreneurial ideas could permeate the industry; exploiting assets and capturing for the railways the wider commercial benefits they bring. Suppliers would no longer be beholden to a central purchaser. New opportunities could be opened up for engineering concerns, for goods and passenger handlers and all the many small businesses which successful service industries generate. The taxpayer, too, would benefit. A much more vigorous railway industry would need less subsidy and the opportunity could be taken to clarify the extent and location of losses could be clarified.

It is not only that a great national asset must be used more effectively. Railway management and staff surely wish to fulfil their potential, serve their customers and enjoy good rewards. But the truth is that this will come about only by breaking up BR into more manageable business units, using the best of the past to future advantage.

Point of departure

In 1947 the railways were nationalised. The corporate structure of railway companies, although left in private hands, had already been interfered with by government only twenty five years earlier under the terms of the 1921 Railways Act. This grouped most of the existing one hundred and forty railway companies into four: three new ones, the LMS, LNER and Southern and an enlarged GWR.

There had been four hundred railway companies in 1880. So, before 1921, the process of merger and acquisition, of growth or decline, had been continuing of its own accord. Enforced merger was not always advantageous and delayed the rationalisation that would become inevitable. Even so, not every railway company was losing money in 1947. Then, with nationalisation and the formation of British Rail, a cosseted, centralised bureaucracy was superimposed which gradually lost the flexibility to compete effectively in the transport market.

The railways, being strategically vital, had been under State control during both World Wars. By 1945 their assets were severely run down and they suffered with the rest of Britain which was virtually bankrupt. In the years that followed, increasing competition from less capital intensive means of transport on the roads exacerbated the problem. Left to the market, the vast bulk of the railway system might have shut down. Government financial support for railways was therefore necessary in order to sustain the industrial and social structure of the time.

State control and public subsidy need not have been entwined. As the discipline of private ownership receded, BR became steadily less commercial in its attitudes. The taxpayer carried the cost.

Today, with the increasing amount of transport congestion in Britain, it is becoming evident that the railway system might again be better exploited. But is the State-owned railway able to expand and meet the needs of its present and potential customers?

The financial constraints

The outstanding feature of the nationalised railway is that it loses money. Because of this an 'overdraft' is required, which BR gets from the State. After considering public spending as a whole, government then sets its transport investment priorities.

Under the terms of the Transport Act of 1974, BR is required to run 'socially necessary', 'non-commercial', loss making services for which a Public Service Obligation subsidy, the 'PSO', is given. BR also has requirements for capital – renewing assets merely to keep the railways running is very expensive. In order to control BR's total borrowing, the Treasury sets an 'External Financing Limit', or EFL, on BR's net cash flow. The EFL is calculated by offsetting all subsidies and all sources of capital originating from outside BR against the income and asset sales which can be generated internally. All capital from outside BR is counted towards the EFL because, under Treasury rules, it is neither the nature of the lender nor the terms that matter but the identity of the borrower; and BR is in the public sector.

The higher the subsidies, (of which the PSO grant is by far the main component – see Appendix 4), and the capital requirements for asset replacement creep up to the level of the EFL, the less room for new development or expansion. Even though the EFL is negotiated, there is no purpose in the BR Board proposing investments (or leasing arrangements) which would take it over the EFL or over its likely future levels as suggested by Treasury guidelines.

There may be commercial merits in new capital projects, with even higher returns than the Department of Transport looks for (e.g. the Channel Tunnel), but BR cannot consider them. As competition with BR is precluded, neither can others. So, an environment for true commercial decision-making over investment is largely absent. Instead, rival groups lobby for public funds for their pet scheme, elaborate debates take place about whether or not there can be wider 'cost benefits' to the economy; and in any case BR has a vested interest in justifying the status quo and thus in disparaging new ideas.

The way to achieve greater and more effective capital investment in railways does not lie merely in disputing Treasury rules, however arcane, but rather in re-examining the structure and culture of the railway industry.

The nature of the losses

Some of BR's difficulties in achieving profitability can, then, be attributed to State control over its finances: restricting as it does BR's ability both to generate income and to spend enough to realise the full benefits of business ideas.

The extravagant maintenance of costly infrastructure or outdated equipment becomes necessary with the shortage of investment capital. With better access to or arrangements for raising capital, which would be possible in the private sector (especially where equity could be offered) the ageing piece of civil engineering or rolling stock might be replaced and refinanced, eliminating the cause of the loss.

Insufficient investment in new routes, particularly since nationalisation, has certainly reduced turnover. BR has had difficulty merely in modernising the system it inherited. Routes and services still reflect the transport markets, the social and economic patterns, of nearly a century ago. For example, there is still no railway line to Heathrow even though one is at last being considered years after the need was identified. Other potential opportunities are considered in the next chapter.

Government rules for the public sector narrow BR's business activity, confining it to the 'railway' and inhibiting the development of 'peripheral businesses'. Thus BR cannot capture the wider economic benefits that railways can create. This is a sensible policy for the public sector and it applies even to small 'non rail' operations with potential, such as Casey Jones hamburgers on stations which cannot expand to other sites. Property prices can obviously rise after a local railway is improved, but BR cannot reap any of the rewards itself unless it already owns nearby land since purchase is not allowed. Moreover, although more passengers can be attracted, as they were after the improvements to the Bedford line, regulation of fares minimises the gain to the railway despite maximising the value of their customer's houses. (Thus taxpayers, money often benefits already well placed groups: especially in the South East.)

Lack of traffic is, of course, one reason for losses. But the cause needs to be analysed. The large number of underused but 'socially necessary' services, which need to be subsidised, are easily separated from a supposedly 'commercial' railway. The

salvation of the railways does not lie in closing loss making peripheral lines. The above average costs are actually at the core of the system. Despite evident improvement in cost control and performance by BR with its train services, the financial status of many routes largely remains guesswork: inevitable, as the subsidy is delivered close to BR's 'bottom line' and the costs are then allocated from this. Thus there is neither the incentive nor the information for the fine judgements that an enterprising organisation would make to improve the financial performance of a particular route: by enhancing both its infrastructure and its train services where possible – to the benefit of customers.

Moreover, the political framework within which BR operates, the drive to reduce the dependence on the public purse, dictates that closure or inaction is an easier option for BR than the effort, management skill and investment that might be required to generate more income. Consequently, it is difficult to evaluate BR's judgements over possible remedies, improvements or closures.

Marketing

Maximising income by effective marketing would be the priority of a commercial organisation.

Although some improvements to BR's services have been market-led recently, BR carries out too little market research adequately to assess opportunities. For example, according to evidence given to the Monopolies and Mergers Commission on Network South East, the principal market survey (an analysis of journeys) is carried out only every ten years. BR does not know what a customer would pay for better quality or style. Without constant market research it is difficult to estimate how requirements might be changing. It has sometimes been necessary to raise fares to suppress demand for services which become unexpectedly successful since no option to enhance them had been considered.

Operational convenience can still take precedence over customer satisfaction. For example, the public has increasingly high expectations of catering. But on many services this remains second rate, despite the demise of the curled sandwich. Sometimes buffets close long before the end of journeys or never open. Even now, attempts are being made by BR to restrict full

restaurant services to first class passengers only. No commercial organisation would proscribe potential customers in this way. It is as though restaurants in the best hotels were open only to the residents of the best rooms. Yet here is an excellent opportunity to extract revenue from willing customers.

BR's accountancy system makes it difficult for management to see what services add value to the railway by encouraging its use. Catering is a good example. By insisting that each outlet must be profitable or not exist at all, the ability to attract travellers on the basis of an overall level of service is often overlooked.

The impact of State control on management and employees

Decisions about the railways are a matter for government as much as for BR. Responsibility for implementing policy is therefore divided, creating a fundamental structural fault in management.

Government departments and BR continually debate the conditions necessary to improve efficiency. Cost cutting has shrunk activity: closing lines, selling assets and hiving off services. The definition of 'railway activity' is becoming ever more narrow in the pursuit of financial control.

So the private sector is being considered for a role in what have been vertically integrated functions in BR such as railway civil engineering, track maintenance and carriage cleaning. Contracting out may seem wise given BR's record in handling 'non railway' operations (such as hotels). Yet BR is not given flexibility: often being obliged to sell or contract out: never (or very seldom) allowed to acquire, or branch out anew.

In business terms the impact is to drive BR towards non-commercial attitudes. Such changes as there have to be are often resisted or take too long to implement. Without the freedom to decide on direction, there is no experience of risk taking. Those with new ideas feel hampered. Dynamic management has few opportunities; innovation is driven out.

Everyone suffers: the customer; the taxpayer; the 140,000 employees whose morale is an urgent problem. Leadership is too remote. No corporate image can be clear enough to build team spirit throughout the organisation as it stands.

Employee share ownership might be promoted as a means of linking enjoyment of the job and customer service to financial

results. The privatisation of the National Freight Consortium was a good example of success in business rejuvenation. Likewise, compare the service now offered by the private coach services with their nationalised predecessors. Employment opportunities do not need to decline at a time when service industries everywhere else are growing. Over half a million people have lost employment on the railways since nationalisation; yet with imaginative new services many new jobs could be created.

Summary

Forty years after nationalisation, bureaucratic control of the railways can be seen to be a failure. Until enterprise is given its head, the railways cannot be said to have been given a real chance. It is vital for the economy as a whole as well as for the railway industry, that the present structure be liberalised. Opportunities there may be, in plenty.

The opportunities . . .

The recent history of the railway is one of decline. But the Channel Tunnel, a classic private railway company, suggests that the case for railways can still be a very powerful one: both commercially and technologically.

International opportunities – The Channel Tunnel

The Channel Tunnel will effectively expand Britain's railway network at least fivefold since European railways generally have the same track gauge (width between rails) as we do. However, the loading gauge (the size of the trains that can run through tunnels and platforms etc.) is larger through the Tunnel and on the Continent where new high speed lines are being built. So, if trains and their loads are to be fully integrated throughout Europe, new or improved lines, routes and loading gauges are urgently required in Britain.

Passenger travel

Considerable gains in railway income are to be had from fast passenger trains to the Continent, mainly from in and around London where most of the passenger traffic will probably start.

In part, rail travel could supplement or replace some short distance air routes to Europe. Speed, convenience and punctuality are needed. These factors enabled the French high speed train system, the TGV, to capture the air traffic from Paris to Lyon. New TGV lines are now spreading elsewhere in Europe and will be branching to Calais.

Speed may be one requirement. But passengers will also need easy access to international trains from central London. Waterloo is one site for the construction of a new international station capable of dealing with up to 15 million passengers a year. But there is little space for expansion. Other interchange points may therefore be needed to tap passenger traffic, say from Heathrow. Kensington Olympia could also be expanded to cater for Tunnel trains some of which could travel North.

Cars also need to be catered for. Will car users want to drive all the way to Kent to use the Tunnel or would they take

advantage of car-carrying trains if well marketed? Given that drivers will have to get on a train anyway to go through the Tunnel, they might well wish to do this earlier, at say motorway/rail interchange points around London. By disembarking at strategic points well into France, hours of tedious driving would be saved.

Congestion

The lines from Kent to London are already crowded so that domestic trains are too often delayed. On top of this problem, the Channel Tunnel is projected to add 16.5 million passengers and 7 million tons of freight per annum.

Congestion in the South East will be compounded by the inadequate infrastructure that is a feature of the rail system between Kent and London both structurally and technologically. Without improvements, trains travelling at up to 180 mph and averaging 125 mph in France on a tight timetable will be using a system on this side of the Channel which will inevitably produce delays and will enable average speeds of 60 mph at most to be achieved. In structural terms, routes are narrow and twisting. In technological terms, the method of electric traction (a third rail) is slow and incompatible with the (25kv AC overhead) system which is common on the Continent and on the rest of British railways. Some solution to these problems is urgent.

International freight

The commercial case for better lines will be strengthened by considering freight traffic. Freight has often been the most profitable activity for railways. Indeed it is the mainstay of American long distance railroads. The Channel Tunnel will open up a pan European system of freight routes. Up to two thirds of cross channel freight traffic has destinations in the Midlands and points North. The routes taken by most traffic do not need to branch out until well inland on either side of the Channel. The Tunnel will therefore put many freight journeys over the 250 mile mark at which, it is generally accepted, rail becomes increasingly cost effective compared with road. As with cars, the earlier on to a train, the more efficient it would be: to the benefit, incidentally, of the motorways and the environment.

Freight alone, then, could transform railway prospects. Some estimate a sevenfold growth in Britain's rail freight traffic. But the better attuned the facilities are to the market, the more any demand is likely to rise.

A possibility

The map on page XX suggests a possible North South freight route: which for part of the way might take advantage of disused and underused infrastructure. It would have to be able to carry Continental size loads for the whole of its length and it could also offer interchange points with motorways.

There could be an extension from the Midlands to Liverpool. The North West coast of Britain is, as the crow flies, on the direct shipping route from the Continental North Sea ports to America. A railway reaching Liverpool from the continent might save one day's sailing time each way across the Atlantic which might have considerable commercial benefits.

National opportunities

Rail is in competition with other means of transport. However, in terms of business strategy, this does not mean that it cannot collaborate with them. People who travel to railway stations in cars would benefit if there were stations close to main roads, in particular to motorways, with ease of access, decent parking and good services. For example, facilities for catching trains on the main lines passing across the M25 must be worth examining for journeys both out of and into London. The railway itself must be able to profit from car parking and other facilities to compensate for the small fares taken for short rail journeys. There are a large number of sites in and around London, many already owned by the railway and often under-used, where such park-and-ride schemes might be worthwhile.

Railways would also benefit from more integration with road freight: with better handling and road/rail transfer arrangements. Smaller freight-handling and business units may also yield benefits. They might enable rail to diversify away from bulk commodity traffic like coal.

New urban transport systems are already being developed, helping to transform the inner city. The potential of underused rail links needs to be fully explored. New routes could be

reopened and integrated with road movements and other rail systems in a variety of ways (for example bus and light rail routes).

The railway supply industry

Much of the railway supply industry has been in decline for many years. BR's centralised procurement policy has narrowed the industry's base. 'Economies of scale' in purchasing have often locked British suppliers into the home market and have restricted their opportunity to sell alternative designs. They can then become uncompetitive in some technologies even for BR's own use. For example, BR has considered using locomotives supplied by foreign companies because of their lower maintenance costs. Contrast this with the bus industry where deregulation has led to the emergence of many new designs for different operators.

Summary

BR's proposed investment budget of £3,000 million over the next five years, although considerable, will not be able to fund all of the investment possibilities outlined here. The use of taxpayers' money for these purposes would dull the incentive needed to make them a success.

. . . and how to seize them

New routes

As a first step towards a change of policy, the Government should allow new railways to be built and declare that it will end BR's monopoly.

The private sector should be allowed to conceive new railway schemes on whatever scale may be necessary for commercial success. Market demand should be analysed, construction allowed to proceed and railways managed with the minimum government intervention.

Fair competition

Fair competition with BR from newly built railway infrastructure is difficult to envisage. In financial terms, new railways would have to pay back their investment capital as well as make an operating profit and provide for replacement costs. BR does not face the same financial hurdle. Its land assets and most civil engineering costs have been written off and any investments it might make would be on non-commercial terms (at public sector interest rates). So, however well new lines were managed and marketed, they would find difficulty in competing with BR's inherently lower cost structure.

Furthermore, BR would continue to have a monopoly over the rest of the rail system. Regulation would certainly be needed to ensure fair access to BR's system. But this would not be enough. New lines would need to ensure that they could generate their own traffic by operating their own trains if necessary. But, to maximise capacity, they would have to be given the opportunity to compete for traffic from elsewhere on the system. Most of this would be controlled by BR, who could use its monopoly position to prevent traffic draining away on to lines it did not control. (Regulation to prevent this would be almost impossible to devise.)

BR's infrastructure will be needed

Buying land to build new routes would be expensive. But, perhaps more important, it would be unpopular (and unlikely

for environmental reasons) on any significant scale in the South East, where it is most needed.

It might be easier and more effective to allow the private sector to buy into BR's existing system. At the same time this would better exploit some of BR's underused routes or land assets (where, for example, tracks could be added).

Dismantling the BR structure

To attract private investors the railway needs to be in separately owned sections. Unless this takes place any return would be diluted by a very large accounting unit which would also include within it activities over which an investor would have little control. Uncertainty would be compounded by the unpredictability of governments' attitudes to the amounts of subsidies and their location.

Separate accounting units are needed to identify the costs and income of particular routes or lines. They should be able to operate independently of State controls as soon as practicable. Each unit could be as vertically integrated as it considered necessary and would define its own 'core business' and strategy.

It would be tempting to revert to the pre-nationalisation position with the four large companies formed in 1923. But when the railways were nationalised, the regional nature of the railway's route structure was reinforced. Recently, and rightly, BR has begun to break down the unnecessary management layer that had been inherited. It would be only too easy to slip back into it. More than four companies are necessary from the start of any reorganisation and the more units created, the less their monopolistic power and the more flexible their response to market demand.

The original structure

A better starting point for division of the railway into separate units is to look at the system as it was before the 1921 Railways Act: before government began to interfere with corporate structure by forcing amalgamation.

Until 1923 nearly one hundred and fifty railway companies existed, forming an intricate web of services throughout the country. Most of these were very small operators or Joint Companies formed to extend or improve route structures to

mutual advantage. Some were only nominal owners of track systems, leasing their lines to the most professional management or leaving the operation to them. Many lines (or at least the most speculative parts of them) or the entire systems of former companies have disappeared during the rationalisations of the last sixty years.

But the smaller number of bigger operators had extensive systems, often linked to different parts of the country. They were not necessarily 'regional'; growth had after all come through varied business strategies. In general they owned routes that (still) reflect common traffic flows. For example, the LNWR owned the line from Euston to Carlisle via Crewe and the description 'regional' hardly describes the routes owned by the Midland Railway that went from St. Pancras to Carlisle via Leeds and from Peterborough to Bristol. Of those whose lines reached London, each built its own terminus: every one still serves its original routes. Even today's underlying management structure is based on that of the former companies. For example the South Central division of Network SouthEast was originally the London, Brighton and South Coast Railway Co. And NSE's newly created Eastern division is similar to the original Great Eastern Railway Company.

Around a dozen smaller companies, returning to something like the original structure, would make commercial sense and provide efficiency and financial clarity. More accurate and more concentrated marketing would be possible as it would enable local managers to respond to local customer needs without interference. It would uncover the original structure of assets and routes. (For a more detailed outline see Appendix 2.)

The resurrection of names such as the Great Western Railway (the only railway company to keep its original identity from foundation to nationalisation) or the Great Eastern, could build on the advantages of historical sentiment and loyalty shared by public and railway staff alike. It could be an important factor in marketing. It could greatly improve morale.

Competition at a local level

BR's management has found it worth giving more responsibility to smaller divisions so that local needs can be more readily addressed. But it does not go far enough. If there was no longer

a unitary corporation - no longer a BR - all the planning, financing and marketing could be the responsibility of the new companies alone.

The map of Britain's railway system shows that, if such a route based division were chosen, there would be several places served by more than one railway line: customers would thus enjoy services competing on price, speed and quality. Examples from London are: Cambridge from Liverpool Street or King's Cross, Exeter from Waterloo or Paddington, and Birmingham from Paddington or Euston. Such a division needs to be examined in a detailed study to decide the most effective division of routes between companies.

Apart from managing the railway itself, companies would be free to grow their business in any direction they saw fit. The old railway companies moved into a variety of businesses: shipping, road and air transport, hotels and property. In so doing, they found ways to capture commercial benefits for a transport system.

Perhaps the best example was when the promoters of the London Metropolitan lines in the 1920s developed local housing in Metroland. Privately owned railways could look for similar ways both of acquiring assets and using the ones which they already have, the more effectively to balance their capital investment programmes. Each railway company, then, needs to own its assets, even if it might decide to sub-contract some of the services.

The temptation to plan for particular management policies in advance should be resisted. New centres of responsibility would create badly needed new initiatives at different points in the system. With different management approaches towards marketing and engineering and in the use of existing assets, the best ideas on running railways would permeate through the whole network, becoming modified and improved in the process. So if a different approach to train design or to services on trains increased traffic it would soon be imitated elsewhere. Or original and beneficial schemes in property development might come from professional advisors.

The key is to be found in the idea of variety; in diverse management styles, in diverse marketing, investment and

procurement.

Competing trains on the competing tracks

A free market should allow any competition in train services. There should be no reason why a train operator concerned with, for example, specialised or cross company traffic should not seek to provide and market its services without owning any track at all.

This would be of advantage to all parties. Owners of track would wish to maximise its use and they would encourage any kind of service over their lines; collecting tolls, say, in the process. They would compete to attract 'foreign' trains on to their system; they would evaluate the profitability of their line by the extent to which it might be used by other train operators. Track owners would have an incentive to offer train owners new and different services throughout the network. Thus customers would have a greater range of services from which to choose. Demand could be ascertained and met with the investment and risk diversified. The business prospects of both new and existing railways would be improved.

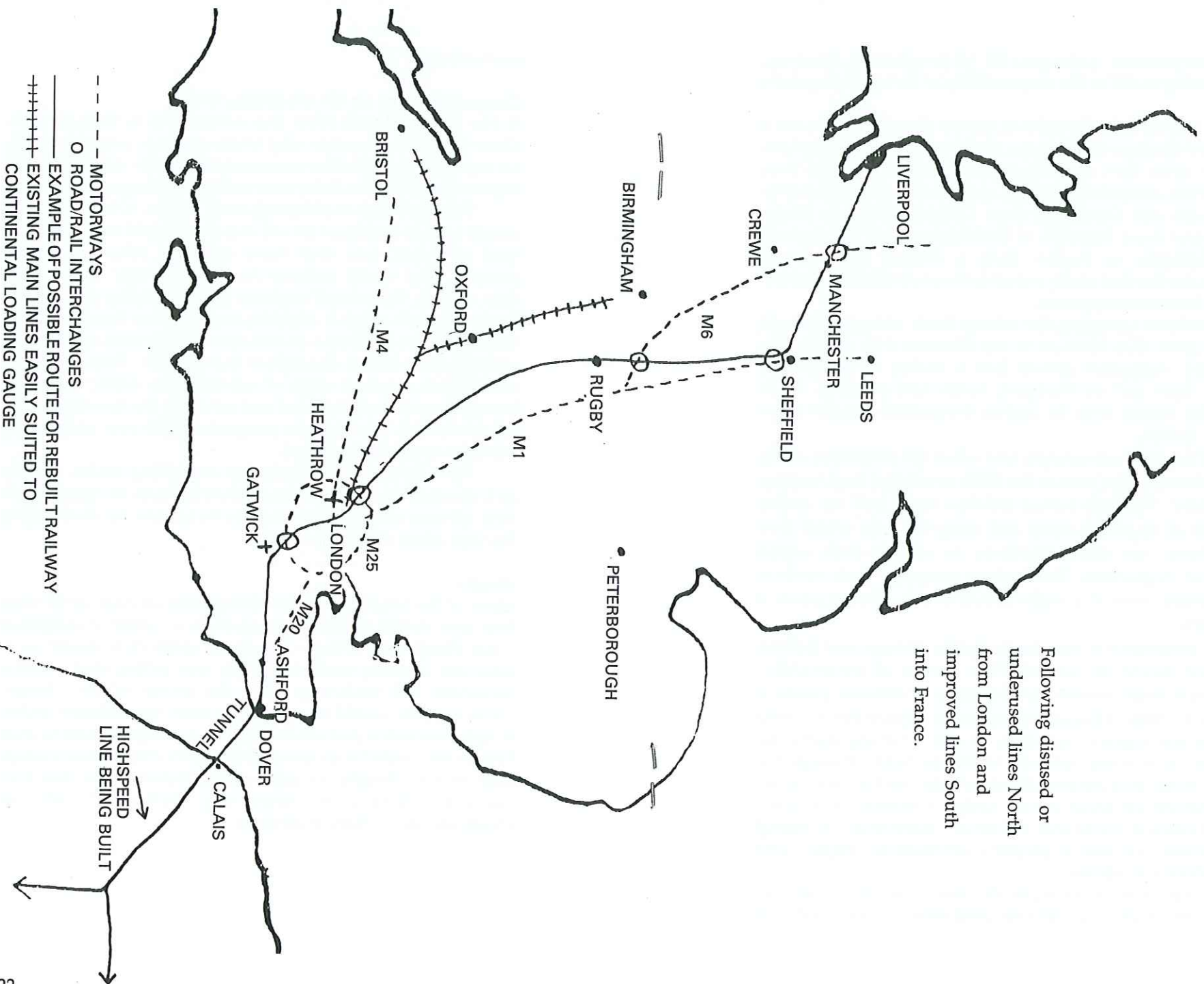
The Channel Tunnel offers an interesting model. It owns and operates the infrastructure, raises revenue by operating its own services and seeks to increase its income by encouraging through-trains owned by others.

Freight

Much of the benefit from liberalising train services could come from new freight traffic. There could be a variety of companies – like Freightliner today – in whose interests it would be to minimise handling costs, with their own rolling stock, sorting procedure and marketing. With the advent of the Channel Tunnel, many would be concerned with international traffic. Freight forwarders and many multi-site companies, such as retail businesses, might be tempted off the roads if they could manage their own rail freight, its costs and movement, more than they can today. There is no reason why "Railfreight" could not constitute one of these businesses.

A North-South Freight Route?

Following disused or underused lines North from London and improved lines South into France.



Regulation

A degree of regulation would be necessary. But with the system described above, the market would provide an inbuilt incentive to compete at many points. Travellers, investors and tax-payers would be comparing the performance of different managements.

The extent of any local or 'regional' monopoly would of course depend on the number of divisions made in the network. Regulation would have to ensure that monopoly positions – inevitable, for example, over unique routes at full capacity – were not abused and that basic service provision would be maintained at the lesser used parts of the system. (This latter point is perhaps best regulated by finding a suitable method of subsidy.)

In practical terms there would have to be, as there originally were, shared track and trains in several places, perhaps on a basis of percentage of cost. (Railway companies often clubbed together to build mutually useful routes.) But at the busiest places, in London for example, the track routes still reflect ownership divided in a way which minimised conflicts of interest. This is exemplified by the two halves of Victoria station, divided into the Kent Coast and Brighton line services which were once separately owned.

The statutory obligation to 'run a railway' could be maintained to make sure that they did not, to take an extreme case, turn lines into housing developments. Ultimately, perhaps, a 'golden share' could be used to achieve this – within the bounds of economic rationality. (See also Appendix 3.)

Safety, which has always been under State supervision, and other technical factors are considered in Appendix 3.

Long distance travel and ticketing

Through-ticketing was adequate in the days of the pre-nationalised railway and would have to be available under any system. Computers are already being installed by BR and there is no reason why ticketing and sharing receipts could not be done as easily as it is by the airlines.

The present standard fare structure could be deregulated. Prices should be set to meet the characteristics of particular routes. For example, fares charged could differentiate between

local or tourist passengers to the benefit of some rural routes.

It should be pointed out that the vast majority of passengers would travel on routes owned by one company. For the others, the movement of long distance trains would have to be assured so that there would be no inconvenience. Indeed, the owners of any track would anyway wish to see the maximum number of trains passing over their system, and the operators of those trains could only profit from offering the services that their customers wanted.

Summary

A transformation of the railways can be achieved by establishing a series of independent yet integrated railway companies, incorporating the management of trains, rail and the non rail businesses. They would be free to raise capital from their asset bases and plan their own strategies to exploit demand: to the benefit to all parties.

First steps towards the new railway

Commercial investors require detailed information. But they would find it difficult to assess the prospects of any part of British Rail at present. It is amorphous. Detailed financial information about particular sections of the railway system is lacking. As a first step, small, independently managed units need to be formed within the public sector and their financial status clarified.

A study is needed to establish:-

- how many separate companies it would be practicable to set up. In any division of the system, loss of economies of scale needs to be traded against gain from the flexibility of small market orientated units. Management incentives, use of resources, market orientation and financial independence are among the essential criteria;
- possible share structures, providing a basis for independence. The aim should be to establish a series of companies, under the Companies Act, able to operate independently from State controls as soon as practicable. Considerable steps towards a liberalised railway could be made within the present nationalised framework. Initially, each company's shares might be held by a holding company. They could gradually sell shares off to raise capital – subject to negotiations with the Treasury over what constitutes public ownership.

A detailed business analysis will be needed for each unit. This would include:-

- capital requirements. A study, company by company, in what new or improved infrastructure, facilities and rolling stock would be justifiable;
- market estimates and growth prospects.

Subsidies

At present, BR's subsidy is about £700 million p.a. BR has given an undertaking to the Government that it will reduce this figure to just over £500 million within the next three years. Acceptance of this target implies that a saving of this order is possible within

the present system (before the changes advocated in this paper).

A market led operation should reduce the level of subsidy needed and in some cases render it unnecessary, if only because:-

- centralised bureaucracy (and administration costs) would go;
- wages and conditions would be determined by local circumstances;
- assets could be used more efficiently;
- capital reconstruction might reinvigorate the system with new and improved routes – an equity element could lower costs in exchange for risk;
- more income is possible from more trains, better services.

There will remain routes or services which make a loss. Losing money is not, in itself, a justification for subsidy. The lack of clarity at present is partly caused by the political concept of a 'social railway'. Change need not threaten loss making services. Grants should be given only where they are indisputably needed and according to a set, explicit, formula.

Here are some steps:-

- PSO type grants should go. They are too generalised and impose a static service obligation which has nothing to do with market demand (the only kind of interest to customers).
- Line by line grants (thought to be unnecessarily complicated in the past) should be considered favourably.
- Foreign experience should be studied. Various new ideas are being considered in Europe.
- Examination of a grant system which would pay towards the upkeep of the infrastructure might be considered. The infrastructure could include use of stations and power supplies – or just track and signalling. Several variations are possible to suit the costs of particular lines. Tolls could be collected from or paid to a passing train on the basis of its use or the need for its services.
- Local grants: in the case of scantily used rural routes Local Authorities could play a more active role (though some form of central government support would be necessary where lines crossed local authority boundaries). Accountability at a local level may create a more accurate view of the use for a service than at present.

Other ideas already in circulation in this country include endowments, tapered grants, time limits on subsidies, franchises and 'abatements': rents paid by the operator which go down as use goes up so the more successful the operator is the more profit is made. (The latter scheme tries to reflect the benefits to other parts of the public sector of reducing road congestion).

Some of the schemes that are suggested, however, imply that ultimate ownership of the railway, and therefore its assets, would not lie with the operating company. This may adversely affect investment prospects. The ordinary process of share trading is more likely to ensure effective management.

Other proposals on the table

Extending 'sectorisation'

Only in the 1980s did BR begin to search for a greater degree of financial control than had previously been thought possible. Some steps had already been taken. Non railway units, such as Property had already been separated from the railway operations. British Rail Engineering Ltd. was removed from direct BR control. But financially identifiable management units were needed; so the structure was reorganised. Five business sector managers became responsible for types of train service: Inter City, Freight, Provincial, Network SouthEast and Parcels.

The new Sector structure was not an attempt to create independent businesses which could become a basis for privatisation. The aim of sectorisation was to achieve greater financial control within the nationalised railway. Division allows costs to be attributed to 'prime users' of any particular railway line; and for profit targets to be set for each Sector by the Department of Transport. For example, Inter City is not eligible for any subsidy after 1988/1989. Subsidies are still necessary for the 'non commercial' operations in other Sectors.

The Sectors depend on each other for passenger traffic and, of course, on the infrastructure which they share. Since, inevitably, the accounting and costing principles used include an arbitrary element in the allocation of 'prime user' of a line, conflicts can arise. The customer does not necessarily come first. Loss making services can be allocated to already loss making Sectors. A glance at the routes allocated to Inter City suggest that better routes are creamed off in the search to meet its financial targets. So Inter City's performance may improve but not necessarily to the benefit of BR's overall financial position. Such improvement comes from each sector being forced to concentrate on its own management. Indeed, most of the benefits of sectorisation may already have been achieved.

A 'Track Authority'

It has been suggested that sterile conflict between the Sectors should be replaced with competition by separating the

ownership of trains from that of the track: drawing an analogy with aeroplanes' use of airports.

The State would continue to own the national rail infrastructure through a 'Track Authority'. The infrastructure can be defined in various ways. In a recent paper by the Adam Smith Institute, *'The Right Lines'*, which advocated this scheme, it embraced track, power supplies, signalling, stations and non-operational land. By allowing private companies to run trains, any train, over the system, unrestricted competition is hoped-for in the provision of services.

The present sectorised businesses (albeit privatised as independent companies) could be kept to compete with others in running trains. The public subsidy could be cut by having a bidding process for the right to run trains over the system. Slots might be auctioned in the way used at some airports. The subsidy would either not be paid to a train operator or be reduced by competitive tender. Another suggestion is to charge for use of the infrastructure by, for example, type of train and time of day.

Controlling the costs of the 'Authority' remains unlikely

The infrastructure represents a high proportion of the railway's fixed costs. To keep this in the public sector could make the private operation of the trains themselves attractive because of the level of subsidy which would be possible for their running costs. But the commitment of the taxpayer would be likely to be open-ended.

Despite recent improvements in BR's management accounting, costing the infrastructure (principally of track and signalling) still presents difficulties. These would continue. A 'Track Authority' would, in practice, be administered by an organisation which was a relict of the present structure. This would not augur well.

Competition and liberalisation would be confined to trains, and would not extend to the rest of the railway system. Regulation would be needed to ensure that any savings which were made by the Authority were passed on to customers via the train operators. Incentives to become efficient would be slight. It would be hard to find a formula which prevented the Authority from letting its assets degenerate (a tendency which would always be in its short term interest; its long term interest

being guaranteed by the State).

No means to develop the 'Authority's' infrastructure

If the infrastructure remains in State hands what mechanism would there be for investment in new routes? Government would presumably continue to exercise financial constraints. Many opportunities would not be exploited.

Land assets, because they would belong to the Track 'Authority', would not be available as security against which capital could be raised on the market. This may also mean that the property disposal programme of the Authority may be inefficient. If the precedent of the bus companies holds for the railways, much of the value of railway property remains hidden and is likely to be exploited well only by locally based management: not through central control. A large part of the net asset value of railways also lies within their operational boundaries: comprising stations, car parks, sidings, depots etc.

The 'Track Authority' could itself be privatised; but only as a monopoly with all the attendant regulatory problems. To counter these, the Authority would need to be split up. But would not the track companies or owners of new track then wish to run trains in order to ensure its use . . .

Publicly owned or not, train operators could not respond to the market without the means to enforce commercial direction on the Track Authority. The latter would by nature be averse to risk; and would have little incentive to look for opportunities to develop new routes, since the only commercial rationale would be to maximise returns from existing train operators (and taxpayers).

Technical considerations

The mechanism for controlling a large number of separately owned (private) trains would be very complex. Allocating costs and umpiring between types of trains with many different owners at heavily congested parts of the system would present continual difficulty. Bidding for popular slots in the timetable would be possible and even lucrative (although some slots are only good one way) but would tickets be transferable between trains if a passenger missed one or had to change? What would happen if the train failed? Perhaps most important, how could

a large number of operators provide a reliable service on the very busy commuter routes. (Twice as many trains pass through Clapham Junction on an ordinary day as do planes using Heathrow at its peak periods.)

For the obvious sake of both safety and efficiency, track construction, maintenance, signalling and many other operations must be matched to railway vehicles. Effective discipline is needed between all these interests. Separation of track and trains would mean that there would be no unitary point in the management structure which would be accountable.

One of the most impressive achievements of BR in the last few years has been to involve engineers of all disciplines in containing the costs of their operations. The pursuit of engineering excellence for its own sake is now kept within proper limits because the managers of the train services have control. With a 'Track Authority' this market restraint would be lacking; excessive safety demands and engineering perfectionism might again misuse resources, and indeed inhibit innovation in rolling stock and locomotives. Even maintenance of the infrastructure would pose difficulties. Railways cannot be shut down as easily as motorway lanes. Even bridge renewals must usually be completed in one weekend. Most railway engineering has to be carefully planned into the timetable and synchronised with train operations as much as two years ahead.

Summary

Separation of responsibility between two groups of managers with different objectives would prejudice the success of the plan for a 'Track Authority'. Railways are an integrated engineering and business concept and there needs to be a commercial relationship between train operators and the owners of track.

Another suggestion: Separating one section from BR as a trial BR would still hold a monopoly over the rest of the system; and would not find it in its interest to use the separated lines; thus one way to make train services more profitable would be closed. Nor could the separated services be integrated with those on the rest of BR as BR would not wish them to succeed.

Then there is the question of which section to chose for the trial. Discrete sections are difficult to find. Small units would prove very little. BR would certainly argue against having its best routes picked off.

It has sometimes been suggested that Network South East could be a candidate for privatisation. The Southern area of NSE is quite separate from the rest of the system at present (the Tunnel will change this) and even its traction system is unique. However, all the other parts of NSE feature other Sectors' traffic prominently: especially Inter City. To provide better services, Inter City arguably needs better integration with more local services, not less.

Moreover, competition in the Southern commuter area is badly needed to ensure better services and keep costs down. This is especially so if a more liberal price regime is to be allowed which could otherwise penalise commuters through the monopoly that rail holds over rush hour travel. Thus the Southern area needs to be split up as much as possible.

Summary

It would seem that the political decision to break up BR must come first.

Conclusions

This paper proposes major changes in the structure and management of the railways.

- 1 The opportunities presented by the Channel Tunnel, a classic commercial railway company, and the increasing inadequacy of other transport systems in Britain means that new or renewed tracks and train services must be permitted. To implement this within the next five years, political decisions are urgently needed.
- 2 To revive the industry, to minimise environmental disruption and use railway assets effectively some of BR's track system will be need improvement. Splitting BR into smaller units will make investment possible, provide units in proportion to the investment, give management better cost control and make marketing more effective.
- 3 The common suggestions for privatising railways, a BR plc. and the 'Track Authority', advocate the retention of a monopoly, either over trains and track or over the track alone. Quite apart from the many other difficulties, both schemes would inhibit investment in infrastructure – routes and facilities.
- 4 If monopoly is retained over tracks, the only new or improved lines developed will be those the monopolist deems worthwhile. Others should be at liberty to take a different commercial view.
- 5 Potential new owners of lines could not ensure their income without having the right to operate their own trains and market their own services. The right to attract trains onto their system is also attractive and operators of independent train services would also provide enterprising services.

The policy should therefore be to:-

- divide BR into major route/traffic segments. This would create around a dozen companies;
- end any monopoly over train services or types of traffic. The passenger 'Sectors' would be dispersed and their

trains operated by the new companies. The freight 'Sectors' would be independent where practical. Other train operators, although unlikely to run most services, should be encouraged;

- take each railway out of the public sector as soon as possible.

This policy would:-

- improve the morale of railway employees and thus customer service. The dissolution of a central organisation means greater individual responsibility and smaller units with which to identify. Traditional names would add to pride. Employee share ownership should be considered;
- create greater variety and quality of services for customers with the possibility of competition, comparison and locally directed marketing (traditional names may help again).
- open up the railway industry on the supply side throughout, providing diversity in the range of engineering and services being offered.
- enable subsidies to be given only where needed, after fully commercial decisions by each railway company are made: good marketing, competitive services and capital investment will reduce the subsidy.

Appendix I

How a company of the future might work

The Midland Railway

With a headquarters at Derby, the Midland would own the route from Carlisle down through Leeds to Sheffield and to London, St Pancras. It could also have a number of cross country routes: from Liverpool to Hull and from the East side of East Anglia through Birmingham to Bristol.

At first . . .

the company sought to develop a new London Scottish market. Through trains were integrated with links from South London and Birmingham which, although offering a slower service than that obtainable on the routes from Euston or King's Cross to the North, nevertheless were cheaper. Most Scottish sleeper operators chose the Midland because its tolls were less and speed was not relevant overnight. Service on board trains aimed at quality rather than price, with coffee and newspapers for all travellers on main trains. Catering offered a range of meals throughout the journey and a variety of catering companies which were part owned by the Midland provided the service. A new supplier built an observation car for the scenic interest which also doubled up as a cinema at night. A 'train manager' on board the better trains had responsibility for ensuring that high standards of service were effectively sold to customers providing important marketing feedback. A similar system also applied with 'station masters'.

New interchange points at the end of the M1 were constructed which offered services to car travellers and also provided fast trains to the City and to the West of London. Trains also stopped at the M25 and on the M1 in the North near Leeds. St Pancras station was redeveloped in combination with a well known hotel group and success in this enterprise led to the development of leisure and hotel facilities in the Pennines. An old bridge had to be replaced at the northern end of the line and a construction company was offered equity in the Midland in return for this contract and for the other

infrastructure projects along the route. A number of office developments took place on land adjacent to the line near London but which were still only 20 minutes from the City.

A new freight terminal was put together on an old marshalling yard outside Sheffield. After negotiations with the Customs, it developed into an important inland clearance depot for goods moving across Europe. Competitive pricing encouraged initial use.

Turnover increased and a business plan revealed that a new line could be reconstructed to Continental loading gauge on the track of a disused route which would save time between . . .

Appendix 2

A new route structure for the railways

To base the whole scheme on the shape of former companies does not take into account some of the changes that have been made to the railway system in the last fifty years. And, with the Channel Tunnel, opportunities for international traffic will become much more important. An analysis is urgently needed of the sections of the present parts of the railway system which could be used by continental trains and need upgrading to the best technological standards.

The services offered by train owning companies might include: passenger trains, bulk freight trains (similar to today's), special passenger trains (say Pullmans), trains originating from the Continent and certain rural services.

A division of companies based on the pre-1923 structure still seems a useful starting point.

Route based companies

Each company could operate any class of service that it wished; express trains (those going between cities), local trains or they may wish to contract out some operations.

Taking the names and routes of pre-1923 companies as a guide:

Great Western:

London (Paddington) – South West, West and Birmingham. Parts of Wales or Cornwall might be separated further. Parts of the system around London might be used in conjunction with the Channel Tunnel. The original Broad Gauge (7') lines could also be the basis for the wider loading gauge.

London North Western:

London (Euston) – Birmingham, Manchester, Glasgow.

London North Eastern:

London (King's Cross) and East Coast Mainline North to York, Newcastle, Edinburgh.

Midland:

London (St Pancras) – Leicester, Sheffield, Leeds. Incorporating some cross country routes, e.g. to Liverpool, Hull, Derby, Bristol, could create a system

large enough to give a backbone to these services.

Great Eastern:

London (Liverpool St) – East Anglia. East Anglia can also be reached from some other London stations and from the Midlands. And 'foreign' trains could provide a variations on present services.

The Fenchurch St to Southend services could also be distinct.

The Southern area is difficult because the balance must be struck between the interests of commuters and those of the Channel Tunnel users.

Southern:

London and the South East south of the Thames.

It could be split into a further two to four units. For commuters competition could be important especially for comparative purposes: Waterloo services (*London and South Western Railway*), Brighton line, Kent Coast etc.

The services out of Marylebone are fairly separate from the rest of the rail system and may be considered as one unit.

London urban routes:

the North London lines, Cricklewood Acton Ealing, Kensington, Clapham to East and West and to the City.

These links need study in the context of the Channel Tunnel and domestic travel.

Other urban areas:

local transport companies might be responsible for some urban networks in, say, the urban North West. Local authorities could become involved in these, as in Tyne Wear.

Scotland:

This might be two units: West and East Highlands (*The Highland Railway*) based on Glasgow and Edinburgh. Only long tentacles now exist to the remoter parts and route competition is not possible. Sleeper services and long distance trains could, however, be managed and marketed from Scotland as well as the South.

Appendix 3

Central Functions

Any scheme to break up the present structure would have to take some of the centrally controlled functions of the railway system into account:

Safety

This has been the responsibility of an independent Inspectorate for over a century. Whether railways are nationalised or not there is no reason for this to change. The assurance of safety is not the unique province of BR. The Channel Tunnel, independently operated and owned, has its safe operation regulated by the Inspectorate.

Manufacturers of rail equipment are likely to want to sell the best products possible anyway if they also want to sell to a world market. Running unsafe trains is also poor business practice.

Common engineering standards

The important ones are well established: track gauge, signalling, etc. Flexibility should be introduced to allow the railway manufacturing industry to call the tune as much as possible. New railways should come under improved (Continental) loading gauge requirements.

Research and Development

There is no reason why R&D should not be moved back into the private sector. This would be consistent with policy for other quasi-Government institutions in other areas of technology. Any R&D functions (TRRL) that might be needed in the public interest could perhaps come completely under the management of BREL or the DoT.

The statutory obligation to 'run a railway' and closure procedures

BR, as railway operator, has a statutory obligation to run a rail service and therefore cannot 'cut costs' by ceasing to do so. A private operator or a corporate predator might be tempted merely to asset strip and or prevent self inflicted losses by

refusing to run trains. Careful legislation could probably deal with this point with perhaps tightly drawn up articles of association or agreement to accept a service obligation defined by certain minimum standards through an operating licence which could be withdrawn on failure to perform.

Under present rules, railway routes may not be closed without a statutory procedure and the authorisation of the Secretary of State. Their ownership may not be transferred without this closure procedure taking place. However, reorganisation of the railways as it is envisaged here would not necessarily entail new ownership immediately. BR could be broken down into smaller units which would at first remain under public ownership.

Appendix 4

Summary Figures

<i>£ Millions</i>	1986/1987	
Turnover	2,397	
Grant (all sources)	786	PSO £720 EFL £784
Total	3,183	
Operating expenditure		
Staff costs	1,967	(1,725 'railway' staff pay)
Materials, services	1,284	(155 general management)
Other (not shown here)	_____	
Total	3,113	
Operating surplus	70	after interest 2.4
Fixed assets:		
Buildings, way and structures	673	
Rolling stock, plant etc	928	

Financial Management Structure

British Rail is divided into operating sectors as follows:

	<i>Gross income</i>	<i>Surplus/(loss)</i>	<i>Role</i>
Inter City	657	(99)	Fast trains on main routes
Network South East	709	(162)	Most services south east of a line from King's Lynn to Oxford to Bournemouth
Provincial	224	(473)	All other (often rural) passenger services
Freight	556	24	Freight, largely bulk movements (eg coal)
Parcels	118	(3)	Parcels etc

Property

BR has a separately run property division responsible for all managing, letting and selling, of property not required for railway operational purposes. A considerable amount of investment capital and income is derived from this source.

Sales	101
Income	75 net contribution: 131

Over the period 1987/88 to 1991/92 inclusive, a total of £435 million worth of sales and capital premiums is forecast which will be treated as extraordinary profits.

Investment plans

BR has invested £3 billion since 1981/82 and the corporate plan shows that £3 billion is forecast to be spent in the next five years to 1991/1992 among which passenger rolling stock and traction accounts for £925 million and infrastructure renewal £1020 million. Only £900 million of the forecast £3 billion has been authorised. BR expect their business output to increase by 3.5% in the next five years.

Numbers of staff employed

Total	170,000
Rail	141,000

British Rail Engineering Ltd (BREL) is no longer included in the staff count.

The staff count is due to go down to 127,000 over the period of the Plan.

Comparisons with group of eight Western European countries

BR compares its efficiency with that of other foreign railways:

Support from public funds as proportion of GDP %

	1985	1986
BR	0.30	0.26
The 8	0.76	0.75

NB Some adjustment is needed to take into account the much more extensive service provision in some countries than in Britain.

Source: *BR Annual Report and Accounts 1986/1987*
BR Corporate Plan 1987

Further reading

British Railways Pregrouping Atlas and Gazetteer: Ian Allan

Report of the Monopolies and Merger Commission on British Rail: Network South East, 1987

Report of the House of Commons Select Committee on Transport: *Financing Rail services 1986-87*

The Right Lines: Adam Smith Institute, 1987