British Railways in 2019
Reform or Renationalise?

This note is written in anticipation of the Williams Review, to be published in the autumn. The Review will be the most comprehensive assessment of British railways in a generation, with the current UK Government having indicated it will look favourably at any proposals, though some recommendations may fall within the control of the devolved administrations in Wales and Scotland. This note considers the alternative cases for renationalisation and for reform within the current framework, largely in the context of the English system, and concludes in favour of reform and against the distraction of renationalisation.

Successes Since Privatisation; Contemporary Failures

The Centre for Policy Studies set out a note in December 2018[1] showing that on both satisfaction and efficiency measures British railways have made great progress since privatisation, and perform well by European comparison.

- Rail travel has grown as a means of transportation: responsible for only 4.6% of passenger kilometres in 1993, by 2016 that was 8.8%.
- Reported satisfaction grew more in the United Kingdom than any other European country between 1997 and 2012.
- In 2013 a Eurobarometer survey found us second most satisfied with our railways amongst European countries. Our railways are the safest in Europe excepting Ireland, which has a very small system.
- Our track and trains are intensively used, labour productivity more than doubled between 1993 and 2008, and between 2000 and 2008 the efficiency of our subsidies grew faster than in any other European country.

[1] https://www.cps.org.uk/files/reports/original/181228082055-RailwayBriefingDec2018.pdf

- Last year recorded the greatest amount of private investment in the railways since the record began more than a decade ago.

However, the story is really one of overall progress since the 1990s stalling in recent years. A corollary of our intense infrastructure usage is overcrowding, and we scored very low in satisfaction with seat availability in a 2018 Eurobarometer survey. On punctuality, Office of Rail and Road (ORR) analysis showed recently that 85.4% of trains are hitting their targets, the lowest rate since 2005. A 2016 European Union report ranked us 20th of 26 on the measure. Finally, annual price rises are in excess of consumer price inflation, and prices are amongst the highest in Europe, though this is partly due to lower taxpayer subsidies.

In addition, there have been some high-profile industry failures in the last few years. Several franchises have bankrupted, having overbid for the contract. In 2016 we witnessed the Southern Rail fiasco: trains delayed or cancelled day after day for months on end, making commuting all but impossible in that part of the country. In the summer of 2018, there were problems across the network as a new timetable was implemented.

The 2018 Eurobarometer survey found we had slipped from second to sixth in the overall satisfaction ranking since the 2013 survey. While this shows that privatisation continues to deliver more than most nationalised European systems, there is room for progress.

The Williams Review

Acknowledging those successes, but in the context of new problems, the Transport Secretary announced a review in September 2018 to report in Autumn 2019, led by Keith Williams, former British Airways chief executive and deputy chairman of John Lewis Partnership.

The panel aimed to "consider all parts of the rail industry, from the current franchising system and industry structures, accountability, and value for money for passengers and taxpayers"[2].

[2] https://www.gov.uk/government/news/government-announces-root-and-branch-review-of-rail

In an interim paper, the following problems were identified[3]:

- The rail sector too often loses sight of its customers – both passengers and freight.
- Over recent years it has come to lack a single strategic direction.
- It has become fragmented and accountabilities are not always clear.
- The sector needs to be more productive and tackle its long-term costs.
- The sector is struggling to innovate and adapt.

Delivering the George Bradshaw address in February 2019[4], Williams said:

"Put bluntly, franchising cannot continue the way it is today. It is no longer delivering clear benefits for either taxpayers and farepayers."

What Do Passengers Want?

Transport Focus asked exactly this question in a report submitted to the Williams Review in January 2019[5], drawing on the wealth of research they have accumulated from passenger surveys in recent years to answer it. Unsurprisingly, their results emphasise the importance of the 'core product':

"The results of Transport Focus's research on priorities and passenger satisfaction continually emphasises the importance of an affordable, punctual, reliable, frequent service on which you can get a seat or, at the very least, stand in comfort."

That said, consumers also expect the railways to keep up with changing times: free Wi-Fi came one ahead of train maintenance and cleanliness as a priority.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/786962/rail-review-cfe-objectives-assessment-criteria.pdf
[4] https://www.gov.uk/government/news/rail-review-chair-says-franchising-cannot-continue-in-its-current-form
[5] http://d3cez36w5wymxj.cloudfront.net/wp-content/uploads/2019/02/01160753/Williams-Rail-Review-what-do-passengers-want.pdf

Another emphasis in the Transport Focus report was on the importance of the effective management of disruption, specifically the communication of information during disruption. Finally, consumers want best-value fares, and a 'sense that there is 'someone' in charge when it comes to service delivery'. Williams has said[6] that the industry needs to become consumer-centric:

"There needs to be a much stronger focus on passengers. This has been common ground from everyone we have spoken with. Passengers must be at the heart of the future of the railway."

Solutions: Nationalisation

Renationalisation is current Labour Party policy, intended to be a solution to the problems identified, though the Party has made no detailed proposals other than to set out it will do this as franchises expire, or "*with franchise reviews or break clauses*"[7]. Of course, the way nationalisation is undertaken will be crucial – appropriation of assets (such as rolling stock) below market value would have a huge impact on private investment, both domestic and overseas. But regardless of how it is undertaken, it is worth considering why nationalisation is being proposed as a solution.

Jeff Tan, writing for the Progressive Economics Group, a group of economists favourable to the Corbyn agenda, wrote a short piece on the subject in 2017[8]. In arguing for renationalisation, it noted:

"*Railway systems are unable to pay for themselves given the very large disparities between infrastructure costs and socially acceptable rail fares. Railway financing will need to be based on the wider benefits of rail linked to reducing road congestion, pollution and carbon emissions.*"

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[6] https://www.gov.uk/government/news/keith-williams-a-railway-with-todays-and-tomorrows-passengers-at-its-heart-is-the-future
[7] https://labour.org.uk/wp-content/uploads/2017/10/labour-manifesto-2017.pdf
[8] https://static1.squarespace.com/static/5991db18e4fcb524946fb639/t/5a26fdb853450aec8f824ac1/1512504761435/PB_Rail+Renationalization.pdf

In other words, under this nationalisation proposal, railways would continue to receive a net subsidy from the Exchequer as a matter of policy.

A TUC paper from 2015[9] also makes the case for renationalisation. It supposes that a public company acquire the franchises that were due to expire in the five years from the date of publication. The figures in the analysis are specific to this five-year plan from 2015, and so are only included here indicatively, but the mechanisms by which these savings were to be made would be relied upon by any renationalisation plan.

The paper estimates that one-off administrative savings of £349m could have been made by ending franchise competitions. It argues that the £154m paid annually in dividends to train company shareholders could be returned to government. This assumes that a public company would operate with the same costs and revenues as the incumbent private firms.

The paper argues that, if anything, the public company would operate at lower costs due to efficiencies from monopolisation of the operating company, vertical integration, and replacing subcontractors with in-house capacity. These efficiencies are: de-duplication of train company senior management and marketing (estimated £37.6m annually); reduction of costs incurred as a result of frictions between train companies (estimated £145m annually) and between train companies and Network Rail (estimated £70 annually); non-payment of profit to train company and Network Rail subcontractors (estimated £125m annually). Altogether, these reductions in costs would be sufficient to reduce all fares by 8%.

However, the history of public ownership gives us cause to doubt that a public monopoly would operate at lower costs than the current entities. Though there may be *potential* for cost reductions from monopolisation and integration, public monopolies tend to be productively inefficient due to the absence of competition or, even where competition is lacking, the profit motive.

[9] https://www.tuc.org.uk/sites/default/files/TUC%20summary%20TfQL%20analysis%20March%202015_0.pdf

A change of ownership would not, in itself, necessarily do anything to improve the core product: punctual, frequent and comfortable trains. And a public monopoly would be even less likely to deliver on the demands for innovation outside of the core product. Nationalised industries are particularly slow to change: it would likely have taken a public monopoly much longer to install free Wi-Fi on its trains, and would likely take it a lot longer for it to develop the communications technology consumers are demanding for disruption management. Altogether, there is good reason to doubt that nationalisation would deliver the consumer-centric industry Williams has said we must: the incentives are lacking, and our historical experience with nationalised industries is that they are rarely characterised as such.

The theory of nationalisation is often very different from the practice. Throughout the decades leading up to privatisation, rail's share of passenger kilometres consistently fell as people moved to other forms of travel, particularly the road network. Renationalisation might prove a distraction from other reforms that are targeted more directly at consumer demands.

Solutions: The RDG Proposals

The Rail Delivery Group (RDG), on behalf of all the producers, private and public, in the network have produced an eight-part reform proposal[10]:

1.) Fare Reform

This is perhaps the most crucial area for reform. The system is riddled with anomalies: there are 55 million fares, and the consumer has no easy way of calculating the cheapest fare. The RDG have developed a proposal in which consumers only pay for what they need and are guaranteed the best value. Fares would be 'unbundled' and single fares would be the basic unit of pricing. Regulation would then require the most efficient packaging for returns and multi-ticket journeys. Train companies would be able to create discounted or

[10] https://www.raildeliverygroup.com/about-us/publications.html?task=file.download&id=469775655

premium tickets, e.g. to encourage travel at off-peak hours. There would be a price cap for commuter fares.

All of this is similar to how fares are structured in London and indeed, those commuting into cities would benefit from the cap, and from a pay-as-you-go, tap-in tap-out system, allowing more flexibility than season tickets do. Long-distance and leisure travellers would benefit from pricing which encourages a better spreading of demand, and this could reduce overcrowding by up to a third on the busiest services.

2.) Organisational Reform

The industry is not sufficiently joined up and accountability is poor. A new, independent organising body should be created to focus on the consumer. It would be responsible for implementing policy and monitoring standards, with a focus on the medium to long run. It would penalise those responsible for delivery where necessary. The roles of existing regulatory and industry bodies should be reviewed and some of them combined in the new organisation.

3.) Public Service Contracts

Two types of contract are proposed. Firstly, a gross cost 'concession' contract, where the operator just receives a price to provide the service and revenue goes to the commissioning authority. This is the Transport for London model of a single integrated brand, and is suitable for commuter routes where demand and revenue are mostly due to factors outside the operator's control.

Secondly, a net cost 'outcome' contract, in which the operator bears some risk and is rewarded based on given outcome measures, rather than input-measures as now, so that they can innovate in the mechanisms to meet those measures. This is more suitable in markets in which there is a greater choice of when and where to travel, and more competition with other forms of transport, so that demand and revenue is partly in the control of the operator.

4.) Open Access

The RDG agree that the open access arrangement on the East Coast Main Line has been a success and propose two models for this to be rolled out across long-distance routes. Firstly, competing outcome-based contracts, in which operators provide substantially different services on the same route, for example fast trains and slow trains. Secondly, a structured open access competition model, in which access rights are provided to maybe two or three operators with no specific obligations on the type of service provided, but for them to compete for consumers.

5.) Track and Train Incentives

A single set of incentives, which concern those things consumers value most highly, should unite providers, 'from CEOs to frontline teams and between the track and the train'. They should ensure that Network Rail and the train companies are pulling in the same direction.

6.) Localised Decision-Making

In cities where there is a city-wide governing authority, particularly a mayoralty, devolution to it can be especially beneficial in the design of commuter markets, and of concessions designed for economic development. TfL is the obvious successful example. There is a risk of fragmentation, so this would be coordinated via the independent organising body.

7.) Industrial Relations

A fifth of the workforce is due to retire by 2033; the industry must ensure that a new generation are trained, including in the digital skills of the future. The railways can provide long and excellent careers and the industry should work with trade unions in pursuit of that.

The eighth proposal concerns freight, which is outside the scope of this paper.

These proposals are well targeted at the consumer demands identified in the Transport Focus report. The proposed changes to contracts, incentives, and competition will contribute to improving the delivery of the core product, and the demands for fare reform and an accountable overseer were emphasised in the report. In addition, private, competitive industry is more likely to be innovative and keep up with consumer demands outside of the core product, and most importantly, has the right incentives to be properly consumer-centric.

Solutions: Open Access as Proposed by the CPS

Open access involves different rail operators being granted access rights to run competing services on the same route.

In a 2013 report for the CPS[11], Tony Lodge set out the clear benefits that are apparent on the East Coast Main Line, which hosts the only two primary open access operators in the UK (Grand Central and First Hull Trains). Looking at data for stations on the line, Lodge found that over a given period of time: passenger journeys increased by 42% at those stations with on-rail competition, compared with 27% at those without; revenue increased by 57% at those stations with on-rail competition, compared with 48% at those without; average fares increased by only 11% at those stations with on-rail competition, compared to 17% at those without. In addition, Lodge associated open access with faster journey times, higher frequencies, less over-crowding, and innovation in ticketing and overall service.

In a 2019 article[12], Lodge further illustrated the benefits of open access in reduced fares. Examining two comparable journeys – London Euston to Manchester, and London King's Cross to York – he found a difference in price of £37.50 for walk-on standard single fares. Other research has found open access fares to be up to 55% cheaper than where a single monopoly franchise operates[13].

The scarcity of open access operators is in part due to the Not Primarily Abstractive (NPA) test, a regulation designed to determine whether a new service would only take passengers from existing services, or genuinely increase total passenger journeys. But since competition involves providers attempting to pinch consumers from one another, this is a flawed piece of regulation. In effect it implies that a monopoly is preferable to competition.

Conclusion – Reform Not Renationalisation

[11] https://www.cps.org.uk/files/reports/original/130321100013-railssecondchance.pdf.
[12] https://capx.co/true-competition-can-fix-britains-broken-rail-system/.
[13] https://static1.squarespace.com/static/56eddde762cd9413e151ac92/t/5c7bc1d2ee6eb044cf113f09/1551614434724/Open+access+paper+-+Adrian+Quine+with+Sophie+Jarvis.pdf.

Williams is looking past ownership for solutions to current problems:

"It is no longer helpful or relevant to see the industry purely in terms of ownership, being state run or privatised. Rather, my role is to realign the different parts of this fragmented industry so they face the same way with shared incentives, with risks (and rewards) sitting in the right places. Always with a singular focus on the customer."[14]

The argument for nationalisation rests on efficiencies being made through monopolisation and vertical integration. But public monopolies tend to suffer from productive inefficiency due to the absence of competition or the profit motive. Those problems are solved by privatisation, and as we have seen, in many ways great progress has been made since the 1990s. There is no reason to believe that renationalisation will improve the delivery of the core product, still less that it will innovate outside of the core product, or provide a truly consumer-centric service.

Instead, the challenge is to find reforms that retain the benefits of privatisation while making further progress. We believe that a combination of reforms including an independent organising body, better contracts, and incentive realignment along the lines proposed by the RDG can begin to do so. Further, fare reform will improve the availability of information for the consumer, on which all markets rely to function well. Most importantly, open access arrangements as proposed by the CPS will enhance competition on the railways. These reforms will build on gains already made, and not risk their reversal. Williams must be clear that reform, not renationalisation, is the right way forward for Britain's railways.

[14] https://www.railnews.co.uk/news/2019/02/27-williams-sets-the-stage-for.html

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