Planning Commission/Indian Railways/World Bank

European Railway Reform and Performance

Jeremy DREW
Senior Policy Adviser, Economics

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CER – representing the railway sector in Brussels

- 72 **Railway Operators** and **Infrastructure Managers**

- From **entire European area** (including Switzerland, Norway, EU accession states, and aspirant EU members)

MEMBERS PROFILE: Private / State-owned • **Small /** Big
East / West • **Separated /** Integrated • **Freight /** Passenger
Crossborder / National **/** • **Non-EU /** EU

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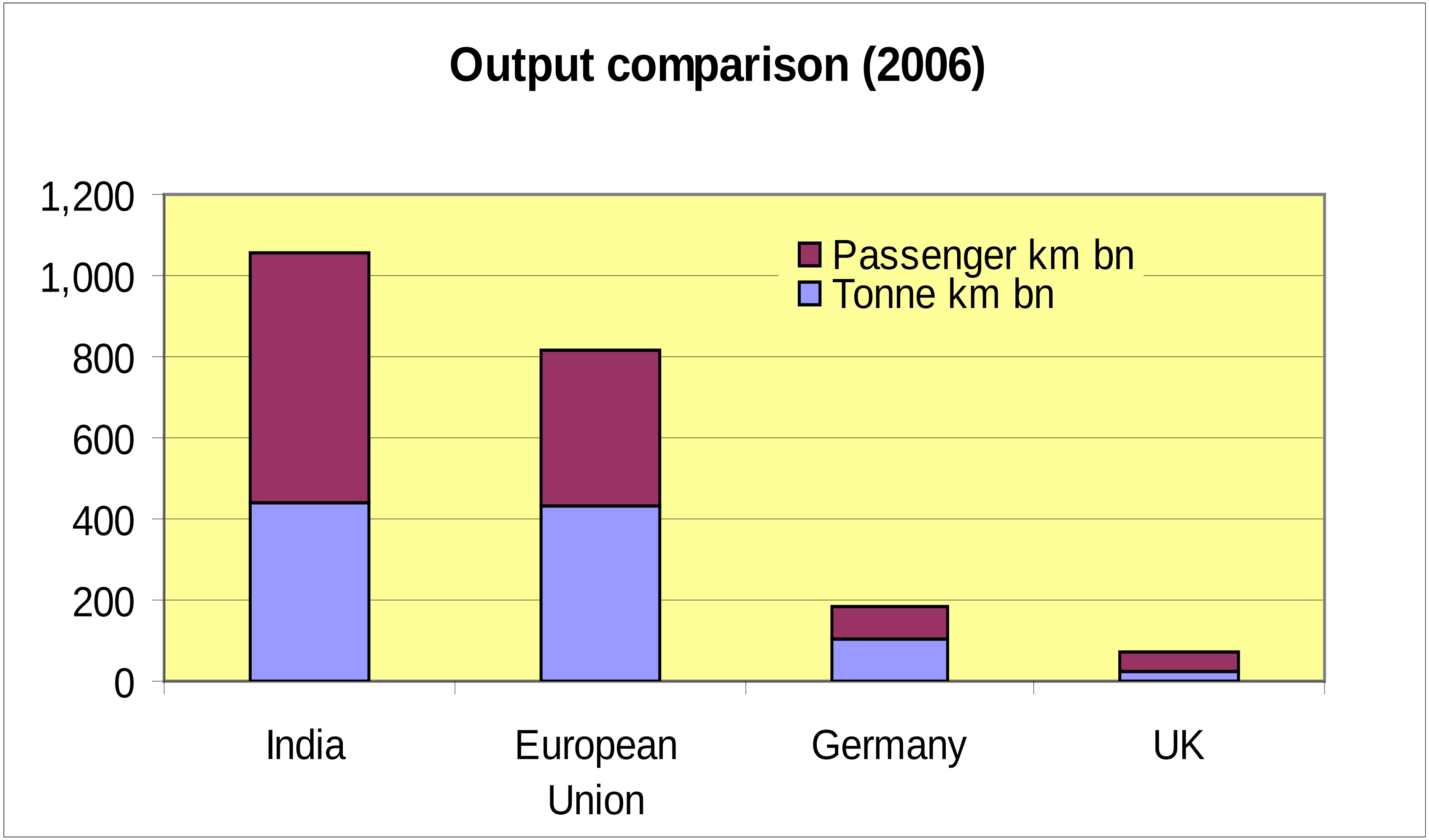
The European Union – general

- The European Union (EU) consists of 27 member states with a total population of about 500 million.
- The member states include most countries in Western Europe and some newer members from Central and Eastern Europe.
- Policies are proposed by the European Commission, the body based in Brussels that represents the common interests of the EU.
- Policy changes must however be agreed to by member states and the EU Parliament.
- One of the EU's key roles is the creation of a single market by reducing barriers to trade between members.

Railways in Europe – weaknesses in the 1980s

- Railways in Europe were all in public ownership by the middle of the 20th century
- Until the 1980s all railways in Europe were vertically integrated public sector bodies – often not corporatised
- However, rolling stock and other manufacturing in most countries was carried out by the private sector
- Competition from road meant that traffic stagnated or grew only slowly
- Financial performance was deteriorating - many railways were covering less than half their costs from revenue.

Railway output in Europe is similar to India for freight, smaller for passenger



Railways in Europe – early reforms

- By the 1980s, some national railways had sold off to the private sector their non-core businesses, e.g. rolling stock maintenance, hotels.
- Some began to re-organise along market lines and to pull out of certain markets (e.g., wagonload freight)
- Major reforms to the core business also began to be considered
- In 1989, Sweden was the first country to separate infrastructure from operations in order to:
  - put rail on a level playing field with road
  - allow state support without distorting the market .

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Railways in Europe –1991 legislation

- The EU normally passes directives which require countries to pass legislation
- The 1991 railway directive was aimed at promoting the development of the railways:
  - management independence from government
  - reducing railway debt
  - separating partially accounts for infrastructure from those for operations
- This represented the first tentative steps to creating a single market in railway services.
- However, reforms were carried out in only a few countries – and the impact was limited.

2001 White Paper on Transport

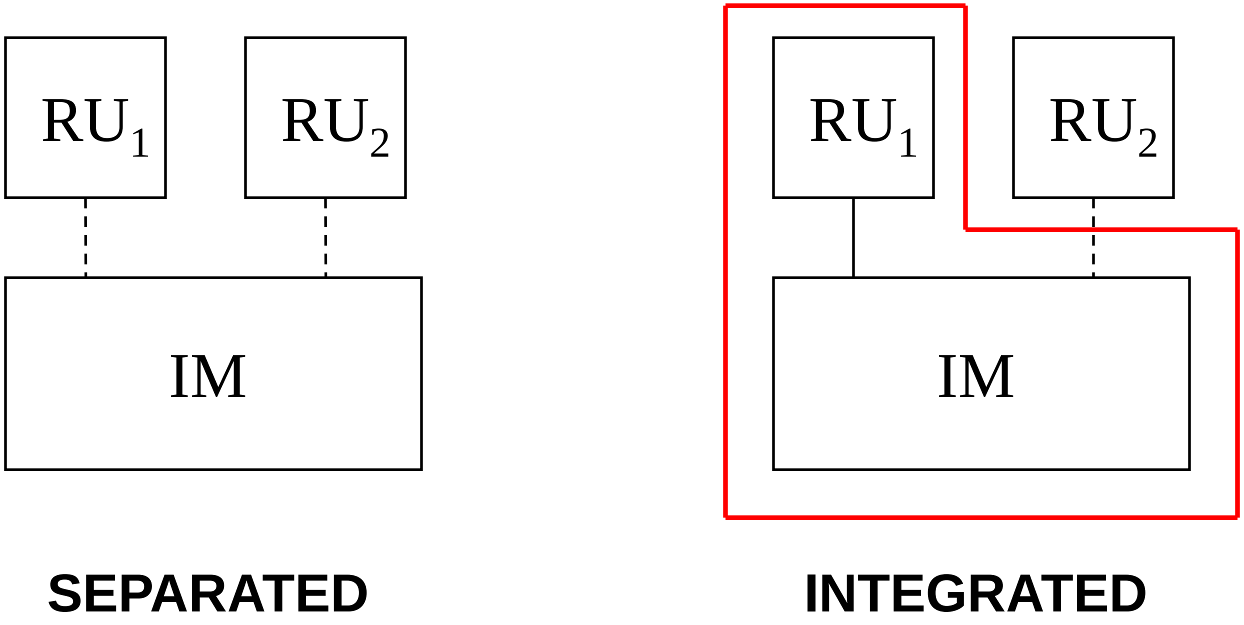
1. Revitalising the railways:
   - Rail regarded as strategic sector for improving sustainability
   - Competition seen as key to revitalisation
   - Internal market in rail – fuller separation of infrastructure
   - Proposed dedicated network for freight
2. Development of infrastructure:
   - Need to eliminating bottlenecks especially for international traffic
   - Completing the Trans European transport network
   - 20 (now 30) priorities projects – mainly rail
   - Some funding from EU and European Investment Bank (EIB) – but most from national governments

EU legislation- the First Railway Package (2001)

- Open access for all international operators to an extensive trans-European rail freight network by 2008
- Infrastructure, passenger operations and freight operations must have separate accounts
- Separation of powers for path allocation and the setting of charges
- Independent regulation
- Charges for infrastructure based on direct costs plus mark ups

Vertical separation is not necessary for competition

Organisational reforms – allowing competition on rail



Neither solution is perfect

Railway structures and ownership of infrastructure

Structure	Ownership of infrastructure	
	PUBLIC	PRIVATE
INTEGRATED	Austria, Belgium, Germany, Estonia, Greece, Ireland, Italy, Luxembourg, Latvia, Lithuania, Hungary, Poland, Switzerland	Formerly Estonia
PARTIALLY SEPARATED	Czech Rep., Finland, France, Slovenia	
FULLY SEPARATED	Bulgaria, Denmark, Norway, Netherlands, Portugal, Romania, Spain, Slovakia, Sweden	(UK)

EU legislation- Second & Third Packages

- Second Railway Package (2004)
  - Establishment of European Rail Agency under European Commission
  - Complete opening of the rail network for international freight services 2006
  - Open access for domestic freight 2007

Third Railway Package (2007)
  - Will extend open access to international rail passenger services in 2010

EU legislation- public service obligations

- Problem of governments imposing services and not paying for them
- Regulations 1969 and 1991:
  - ➢ Compensation should be paid for meeting public service obligations
- Regulation 2007
  - ➢ Improves transparency about what government buying
- Compensation provides all involved with the correct economic incentives:
  - ➢ operators have a clear mandate to pursue commercial objectives within a defined framework
  - ➢ transport authorities have an incentive to require only services they are willing to pay for
- Public procurement directives in the award of contracts
  - ➢ Non discrimination & transparency

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Germany and the UK - different models of reform

Germany – reforming legislation passed in 1993

- Legislation went further than EU requirements
- Response to bad financial situation, particularly in East German railways
- Established a German Railways (DB) Holding Company - daughter companies for infrastructure, freight, long distance passenger, short distance passenger, stations
- Provided for write off of debt
- Required removal of subsidies for operating long distance passenger services – to be run commercially or not at all
- Open access for passenger and freight in 1996
- Government funds most infrastructure investment

Germany – regionalisation

Another law in 1993 “regionalised” local rail transport:

- Responsibility for specifying and funding local rail transport was transferred to regions
- Funding to allow this was provided by Federal Government
- Regions can negotiate contracts for provision of these services with German Railways (DB) or use competitive tenders
- Most contracts still negotiated with DB – and, where tendered, DB usually wins
- DB’s strategy is to operate 70-75% of local rail passenger services - more profitable than intercity as they are supported by regions.

Germany – DB's strategy

- The key feature of DB's strategy has been to make major acquisitions of:
  - foreign rail freight companies – both national and new - to take advantage of EU legislation and the growth of international traffic
  - logistics companies to provide full service to customers
- No other railway in Europe has done this
- DB has withdrawn from some wagonload and inter-regional passenger services - where these lose money
- Current strategy built around concept of 'mobility chain' for passengers – e.g. providing bicycles, buses, taxis for onward journeys
- Strategy is therefore mainly driven by the business – but EU Directives have enabled some elements

Germany – impact of the reforms and DB's strategy

- Major traffic growth in overall passenger and freight market – reversed declining modal share
- International freight growing particularly rapidly
- Despite recent rapid growth in competition, DB's traffic continues to grow
- Growth in open access operations - mainly run by private sector – but also other national operators.

UK – “privatisation” of railways

Reforming legislation for “privatisation” passed in 1993:

- Went far further than EU requirements
- Involved fragmented structure in order to introduce competition
- Infrastructure separated – company privatised in 1996 but failed in 2001
- Infrastructure maintenance and renewals contracted out – contracts badly designed and brought back in house
- Passenger operations split in 25 (now 19) companies and franchised (concessioned)
- Passenger rolling stock leasing companies or ROSCOs (3) were established and sold
- Freight operations sold and subject to open access

UK – “privatisation” of railways

- “Privatisation” left some control under central government and this control has since been increased:
  - government sets out what it requires of Network Rail (the infrastructure manager) and specifies passenger service requirements in franchise contracts
  - the regulator determines efficiency targets for Network Rail and decides on competition issues
- The industry is now subject to more external control than under British Rail!
- Funding was to be provided almost entirely by the private sector:
  - The ROSCOs and freight operating companies have made major investments
  - But most infrastructure investment is now being paid for by the government

UK – impact of railway reform

- Some aspects of reform have been successful:
  - the sale of freight operators
  - on balance, the sale of passenger rolling stock leasing companies
- There has been a major increase in both passenger and freight traffic since privatisation – this is in line with EU and UK government objectives and reform contributed to this growth
- However, costs have increased and the government is bearing higher costs than before, especially on infrastructure
- Managing the interface between infrastructure and operations has been difficult, both for investment decision making and operations

UK – private sector financing of infrastructure

- Early attempts at private sector financing of very large rail infrastructure projects were problematic:
  - The UK share of the Channel Tunnel was constructed with private money but the returns were so poor that investors have been put off such projects
  - The consortium building the Channel Tunnel Rail Link, which connects London to the Channel Tunnel, had to be rescued by the government
- Rail projects have also been more difficult to build as public private partnerships than road projects
- However, there have been some successes with medium sized projects, especially where the project is separate from the existing network

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- Competition has been introduced with good results in:
  - Manufacturing and maintenance of rolling stock and other inputs
  - Wagon ownership
  - Third party logistics
  - Some freight services
- Vertical separation of infrastructure has been introduced in a few countries - but it is complex and has cost, service reliability and safety risks
- Compensation for meeting public sector obligations has:
  - helped separate policy making from management
  - removed a financial burden from railways and allowed more investment
- Giving railway management more autonomy from government has been key to improvements in Europe

Thank you very much for your attention!

For more information please contact Jeremy Drew at jeremy.drew@cer.be
or visit CER’s website at www.cer.be

BACK UP

- BACK UP

Lessons from European experience – financing infrastructure

- Governments are the main sources of finance for infrastructure in most European countries – this is justified because:
  - Rail transport experiences economies of scale, so tariffs designed to cover total cost reduce traffic levels below optimum levels
  - Rail generally imposes lower external costs than other modes of transport
  - Rail services may provide social or economic benefits that are not fully reflected in revenue
  - The large indivisible nature of rail assets means that, even if a project is expected to be financially viable, the returns may take a long time to accrue. Commercial borrowing is therefore not always an option.
- For these reasons many infrastructure projects do not provide a financial return and cannot be financed by debt
- Private equity financing is also difficult to introduce in rail infrastructure although there are niche opportunities

The European Union – transport

- A stated objective: to ensure sustainable development through an integrated approach to transport.
- EU gives priority to sustainable modes such as rail.
- The EU considers that investment in transport infrastructure has a key role to play in lowering barriers to trade – to help create a single market.
- The EU has two roles vis a vis investment:
  - As an influence on national rail investment through policy.
  - As a separate channel of funds and facilitator/promoter of investment in rail.

Public service obligations in individual countries

France	• Government and *régions* provide PSO compensation for groups of local and regional services • Now introducing contracts with clearer definition of what services being bought • Contracts for rail services all with national operator
Germany	• States (regional governments) provide PSO compensation for services within the State • Compensation sometimes determined by tendering
UK	• Governments – central and regional/city - provide PSO compensation to franchised operators • Compensation determined by tendering

Central Government contributions – reasons

- EU - investment in transport infrastructure has a key role in:
  - lowering barriers to trade
  - giving priority to sustainable modes
- Germany: favours the sustainable development of the transport sector and emphasises that rail makes an important contribution to this
- UK: support to the railways reflects "the social, environmental and economic benefits that cannot be paid for through fares". It also supports rail to reduce global warming.

Central Government contributions are large

- In all the countries we reviewed, central governments are major contributors to railway investment, particularly in rail infrastructure
- In 2001, total public sector contributions to railways for the 15 members of the EU at that time amounted to €38 billion (RMB 278 billion) – 74% of total operating revenue
- Of this €10 billion or 25% was for capital investment, mainly in infrastructure - most of this was funded by central government
- Governments - both central and sub-national - also support rail services
  - operators of these services then pay track access charges to infrastructure companies
  - Governments are therefore also contributing indirectly to infrastructure investment

Trans European Networks

- Projects identified by member states
- EU provides funds for studies (50%) and towards construction (10%; 20% exceptionally)
- Regional and cohesion funds provide up to 80%
- Also favourable lending from European Investment Bank
- 30 priority projects (21 rail)
- Many high speed passenger
- Freight priority networks
- Are projects adequately appraised?
- Are the priorities right?

Freight Priority Networks

- 6 corridors identified for European Rail Traffic Management System
- Lack of priority for freight on the network
- Substantial investment needed (145b euros according to CER) to improve productivity (longer trains) and provide capacity for predicted 61% growth
- All countries to designate 1,2 or 3 freight corridors and set up new institutional arrangements
- Implementation plan to achieve objectives required
- Lack of progress with motorways of the sea – could a similar approach work?