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FORMS OF PRIVATE SECTOR PARTICIPATION IN RAILWAYS

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Many railway activities traditionally reserved for monolithic public railways can be performed more effectively by the private sector. During the 1980s, the large budgetary demands and failure to achieve improved performance led many governments to consider "privatization" or, more appropriately, an increase in the role of the private sector and enhanced competition in railways. This note discusses the use of different institutional arrangements to facilitate private participation in rail activities.

GOVERNMENT DEPARTMENT OR ENTERPRISE

Many developing railways (e.g. Bangladesh, India, China, Egypt, and many of the CEE economies) have been owned and managed directly as government ministries. While such a structure has occasionally functioned well, it is usually severely handicapped by lack of transparency, accountability or incentives for efficient customer orientation. This is especially severe where the railway must cross-subsidize some services (typically passenger, especially suburban) with others (freight), but also competes with private sector carriers, particularly trucks and buses.

Though not a ministry, the "public enterprise" is another common approach to public ownership and operation of railways; even these generally have far less managerial or financial autonomy in practice than on paper. The Polish State Railways, for example, were transformed from a ministry to a state-owned "enterprise" in 1987, but traditionally strong ties with the government have limited the actual change in management style.

The need for greater management responsibility and autonomy led to the development of more or less formal performance agreements ("contracts") between government and enterprise which specify the objectives, authority and obligations of each. While sometimes successful in developed economies, these agreements have generally proven less effective in many developing countries, such as Senegal, Mexico and Kenya, often because they lack clarity and the commitment and understanding of all parties. The real value of performance agreements lies in the process of reaching agreement, and the information and understanding that result, rather than in the details of the agreement. Success depends on to the degree to which the railway is expected to act like a commercial entity.

Public enterprise railways almost always lack useful information on the profitability of specific activities and the magnitude of cross-subsidies. They are often production-oriented, with little concern for market requirements. Most require large subsidies. In some cases, the "reformed" public enterprise has been corporatized (made into a shareholding company), commercialized (made financially and managerially autonomous), and subjected to normal company law. It may have only limited access to budgetary financing (e.g. to compensate for non-commercial public service obligations), but its investment and pricing policies are often still largely determined by the state as majority owner. One important feature is that regulation (if any) is put at "arm's length," and carried out by an independent agency. Examples are Amtrak (U.S.), British Rail, Japanese National Railways (JNR), RENFE

(Spain), Colombian Railways and Uruguayan Railways.

The reformed public enterprise is a useful option when privatization is not being considered. Recommendations for railway reform in the CEE economies focus on the development of a strategic plan; creation of a government owned joint stock or limited liability company subject to commercial laws and practices; explicit acknowledgement of the railways' commercial orientation; acceptance of the need for only minimal regulation; limiting government support to equity investment and loans (commercial terms) to the railway along with Public Service Obligation (PSO) payments; establishment of a settlements agency to take responsibility for redundant labor, retraining needs, excessive existing debt, and non-rail activities and assets; organization according to lines of business and cost centers and implementation of a reporting system for allocating costs and revenues among the lines of business; and divestiture of non-rail activities.

UNBUNDLING AND DECENTRALIZATION

A key to private sector participation (PSP) in railways is separating or "unbundling" rail transport activities. One example is the separation of the ownership of fixed facilities (rails) from operations, as was done in Sweden. While such separation does not require privatization--it can also be an effective way to make public operations more transparent and efficient--it does facilitate PSP. It relieves the railway of its base of fixed assets and long term debt, freeing it to function commercially; permits the establishment of profit and cost centers for improved financial information and accountability; makes the railway structurally more like competing modes; and enhances the opportunities for intramodal or intermodal competition.

Decentralization is another way to break up the railway monolith. This is particularly appropriate for localized passenger (i.e. suburban or rural) services, which rarely cover costs, but which local governments may wish to subsidize. Where the transport need is essentially local, decentralization promotes greater accountability and sensitivity and provides opportunities for PSP via contract operation. Examples can be found in Brazil, where the Rio and São Paulo rail commuter services are being transferred from the federal to the state governments, and Argentina, where the remaining intercity passenger lines are being transferred to the states.

SERVICE CONTRACTS

Even if still publicly owned, the railway can contract for almost any activity with the private sector. This is often done for janitorial services, food catering, and medical services. Also open to contracting, though less common, are infrastructure, wagon, and locomotive maintenance. Such contracts, properly designed, can be made competitive and can incorporate incentives for good performance.

Pakistan Railways contracts out ticket sales and inspection and on-board services for two lines out of Lahore. The contractor pays a fixed rate to the railway and therefore has an incentive to collect as much as possible. This arrangement has reduced the previously high level of ticketless travel. Other contracted services in Pakistan include luggage handling and parcel service.

In Japan, the Shinkansen (bullet train) right-of-way has been entirely maintained under contract with the private sector, and the maintenance is done more efficiently than on JNR's conventional lines. In several U.S. railways, locomotives are maintained by private contractors at a lower cost than by the railway itself. British Rail privatized British Rail Engineering (BREL Ltd.), which manufactures and maintains rolling stock in full competition with other companies.

Developing country examples include Senegal, where the suburban railway contracts with a locomotive builder (Alsthom) to maintain locomotives for its "Petit Train Bleu"; the proposed Nigerian and Kenyan reforms, which call for locomotive maintenance under contract; the Bolivian Red Oriental railway, for which heavy locomotive repairs are performed in Brazil by the locomotive builder; and Kenya and Sudan, which have contracted with BREL Ltd. to oversee the rehabilitation of locomotives. The arrangement in Senegal, although said to be relatively expensive, has been so successful in raising reliability and availability of locomotives that the government is considering extending it to the entire national fleet.

MANAGEMENT CONTRACTS

Management contracts range from what is essentially a form of technical assistance, where the management contractor takes no financial risk, to more significant cases where compensation is based at least partly on results, including performance incentives. The contractor assumes responsibility for operations and maintenance of a particular activity, or even an entire railway. Competition arises from the possibility of several firms bidding for the contract. One drawback is that although it is often an explicit goal to turn over management to local staff at the end of the contract, it has proven difficult to incorporate incentives and mechanisms for local staff development.

Several U.S. companies provide short line railway management services for industrial clients or local governments. Amtrak provides commuter services in Boston, Los Angeles and elsewhere, under contracts that provide for full cost reimbursement plus profit.

LEASING TO THE PRIVATE SECTOR

Leasing can be similar to contracting, but in this case the contractor pays a fee for the use of the fixed assets. The lease contractor assumes more risk than a management contractor because it must typically finance working capital and replacement of some assets while the owner may remain responsible for a share of investment and debt service. In return for assuming more risk, the lease contractor has more autonomy, in particular, control over working capital and all aspects of staffing and management.

Amtrak, VIA (Canada) and the Japan Freight Railway Co. all operate their services over the tracks of another entity in return for a fee. The parcel and baggage traffic on Cameroon Railways is operated by a private domestic enterprise that was established by former railway employees and which pays a fee to the railway for the use of its traffic routing equipment; this service, which ran at a heavy loss when operated by the railway, is now earning a modest profit while providing an improved quality of service.

In 1985, the State Railways of Thailand (SRT) contracted through a lease agreement to private operators the provision of long-distance express passenger services on three lines, which were previously unprofitable. The new operators emphasized service quality (e.g. air conditioning) as well as efficiency, and were able to attract former road users, mainly high income customers traveling long distances. After two years under lease contract, all three lines were able to cover operating costs and earn substantial profits. All were subsequently canceled because SRT wanted to regain the profits for itself.

LEASING FROM THE PRIVATE SECTOR

In the U.S. most railway wagons and locomotives are mortgaged to non-railway lenders. In many cases, a private company, often specialized in leasing, buys a piece of equipment and leases it to the railway. For the Burlington Northern and Santa Fe Railroads, the locomotive lessor also provides maintenance, and the railway pays by usage (unit of tractive effort or distance). Such opportunities are particularly favorable for specialized or limited use equipment. Indian Railways recently created a subsidiary, the Indian Railways Finance Corp., which is intended to issue bonds to private individuals and entities, buy equipment, and lease it to the railway. Leasing arrangements are also common in francophone Africa, where private French companies own, maintain and lease rolling stock to the railways.

CONCESSIONS

Concessions are a form of lease in which the contractor agrees to make certain fixed investments and retains the use of the assets for a longer contract period. A recent example is Ferrocarriles Argentinos, which was broken up into six cargo lines, as well as separate suburban and metro passenger lines. Concessions of 30 years have been granted to the cargo line operators, who will be responsible for all maintenance and investment. Concessions (actually hybrid management contracts) for the Buenos Aires commuter system were offered for 10 years (20 years for the segment which includes the underground system), with interested consortia bidding for the lowest subsidy on operations and investment. The government is creating a regional authority to set policy and regulate the transport companies. Only two of the new private freight railways has been operating for any length of time, and the results so far are encouraging but unclear.

Another interesting proposal for introducing the private sector into railway operations can be found in Côte d'Ivoire and Burkina Faso for the former Régie des chemins de fer Abidjan/Niger (RAN). In Brazil, a private group has been granted a license for the construction and operation of several discrete lines for the transport of agricultural products to the nearest ports. Similarly, the national railway of Honduras has licensed a private company to operate 305 km of line. In Mali freight forwarders have created a company to manage and operate a container terminal, which they are now building under a 15 year concession.

JOINT VENTURES

Union Station in Washington, D.C. is a typical joint venture, in which a private (or mixed) partner contributes development capital, planning, and management expertise to develop land or other real estate owned by a railway. Similarly, British Rail created a Property Board to develop station space in concert with the private sector, and the Canadian National Railway (CN) created CN Real Estate to manage and develop the railway's large landholdings with private participation.

Another kind of joint venture is the use of a railway right-of-way by a utility for placing telecommunications cables. The simplest form of this, the "pipe and wire" lease, lets a utility take advantage of the rail right-of-way for access to a strip of land to lay its pipes or wires between major population centers, in return for a fee. In its more elaborate form, found in the U.S., Europe, and Japan, communications companies have used the right-of-way for fiber optic cables in a joint venture with the railway. The railway gets its return through a fee for installation of the cable, better communications services from its use, and revenue or profit-sharing arrangements.

PRIVATE OWNERSHIP

A few examples can be found of private ownership in railways (which may include some public participation, as long as it is not a controlling interest). Both Canada and the United States have fully private freight service. Also in the U.S., the more than 500 privately owned short line railroads have demonstrated that smaller entrepreneurs, unburdened by restrictive labor conditions, can succeed by cutting costs and through aggressive marketing. In Senegal, a private sector railway company, the Société d'Exploitation Ferroviaire des ICS (SEFICS), was established to transport the inputs and outputs of a fertilizer manufacturing plant; in comparison with the state-owned railway, SEFICS has maintained higher technical and financial standards of operation and maintenance, lower costs of transport, higher staff discipline and accountability and a better safety record.

Examples can also be found of privately owned services on publicly owned railways, for example, food catering on Indian Railways. In Poland, various subsidiaries of the railways, such as manufacturing and repairs, are being transformed into private, joint stock, or independent state-owned enterprises.

PSP IN RAILWAYS

There is no single recipe for promoting PSP in railways. There are, however, different circumstances which will tend to push a solution in one way or the other. First, there has to be an effective private sector outside the railway; where this is not the case (as in the formerly socialist countries, or China) the role for joint ventures will be limited until a private sector does develop. In many countries, though, there is a large enough private sector to begin looking for potential partners or investors, and it will almost always be advantageous to begin to enlarge the role of the private sector. In Africa, for example, most railways have failed to maintain their locomotives at a level which permits efficient use; contracts with the private sector have proven to be a productive way to attack the problem.

Second, there must be at least a reasonable expectation of competition among partners or suppliers in the private sector. Where the private sector consists of a number of effective monopolies, it is questionable what PSP will actually accomplish, other than bringing a better profit orientation to the railway.

Third, the real driving force will be the market and the competition within it. For example, the commuter rail role is often left to the public railway; in this case, the answer may well be decentralization to the local level rather than private sector development although, of course, the local operator may actually be able to go farther in its own PSP initiatives than a national railway would. On the other hand, where the service is highly competitive with the private sector, as is the case with rail freight or intercity passenger traffic, concessioning or outright sale to the private sector may be the only sustainable solution because public enterprises do not compete well with private enterprises.

Finally, the choice between concessioning or sale is also subject to degrees. In the case of a railway that carries essentially one product (e.g., mineral ore) which is produced by the private sector, or even a railway which carries predominantly freight, outright sale may well be possible and desirable. Where the railway has a mix of passenger and freight traffic, or where the prevailing political ethos forbids sale, then concessioning is probably preferable. One of the advantages of concessioning in this respect is that there can be several of them, some in private hands, others in public hands (national as well as local). The Northeast Corridor in the U.S. (the rail line from Washington, D.C. to Boston) is publicly owned and concessioned to Amtrak for intercity passenger, but has private sector operations under concession from Conrail (along with two other smaller private freight railways), as well as having six local, suburban passenger operators. The result is not simple, but it works quite well, and it assigns responsibility at the proper level.

TO LEARN MORE

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Additional references and more information on the examples can be found in Galenson, Alice and Louis S. Thompson. 1993. "Forms of Private Sector Participation in Railways." Transport Division, Transportation, Water and Urban Development Department, The World Bank. Washington, D.C. (February.) Processed.