Transport Committee

Inquiry Into: *The Future of the Railways*

Memorandum of Evidence

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1. The government set out a new direction for transport policy in its integrated transport strategy White Paper, ‘A New Deal for Transport: Better for Everyone’, published in July 1998. This was followed by the ‘Ten Year Plan’. A new era for the railways expansion was envisaged, which would be justified on economic and environmental grounds. Road building was severely curtailed, and a policy in roads of ‘predict and provide’ abandoned.

2. By 2003, this ambitious project was in tatters. After a series of accidents and significant financial and managerial problems, Railtrack was placed in administration, and in due course replaced by Network Rail, a not-for-dividend company, financed in large parts by the Treasury, but controlled by a set of members. Its track access charges, however, remained under the control of the Rail Regulator. Performance, both financial and operational, has been widely acknowledged as lamentable, while the apparent costs of operating the existing network have risen sharply. The West Coast Main Line upgrade has become one of the worst examples of cost overrun in recent British history.

3. In consequence, the railways have failed to attract the growth in passengers and rail freight envisaged in the 1998 White Paper, existing users remain poorly served, and the problems of road congestion have increased, notwithstanding the general economic difficulties after the stock-market crash.

4. The policy response has been muted and confused: on the one hand, the Treasury has questioned whether more money should be spent on a failing service; on the other hand, the Department for Transport has begun to position itself as more road-friendly. Plans to replace railway lines with buses, to close

some lines, and to reduce the number of services have gained greater profile, and in some cases begun to be implemented.

5. Although there is a strong case for a substantial reappraisal of the road versus railway policy options, it is important to ensure that what is compared is put on a level playing field. The economics of roads is opaque because there is no proper asset valuation of the roads (what might be called 'roadtrack'); and an imperfect valuation of the environmental and social damage caused by road traffic and congestion. The relationship between petrol taxes, road tax and the externalities is at best a tenuous one.

6. Of considerable importance in the comparison are the costs of the railways. Rather than take the existing estimates of future costs from the SRA, the ORR and Network Rail as the basis for such policy evaluations, it would be better first to establish what an efficient railway would cost, and what its social, environmental and general economic benefits would be. The actual costs represent the inefficient, complex and poorly managed system currently in place.

7. The gap between the actual railway and an efficient one arises in large measure because there is a confusion and duplication of roles and responsibilities, and very weak incentives on Network Rail and the train operating companies (TOCs). This should be a primary focus of the analysis of future options.

8. The confusion of role arises because:

- the Department for Transport's role in subsidiary to that of the Treasury and its spending review, leaving the status of the 10 Year Plan ambiguous;

- the SRA's role depends on the Department for Transport's priorities, and the guidance provided to it;

- the SRA's budget is notionally outside the main government borrowing calculations, but in reality is determined by the Treasury;

- the Rail Regulator decides the track access charges which, in practice, are paid by the SRA at the margin;

- thus, the Rail Regulator determined how much money the SRA pays Network Rail and the TOCs, and therefore how much money the Treasury pays the SRA via the Department for Transport;

- the outputs are, however, determined by the SRA, which effectively carries out the capital planning function (which Railtrack previously did);

- Network Rail therefore is largely responsible for the operations of the railways, and the SRA for its capital development, confusing the role of management and responsibility;

- the Rail Regulator and the SRA have a concordat which cements this confusion of roles between them.

9. As a result, it is not surprising that there are often sharp differences of opinion between all the main parties: the Treasury, the Department for Transport, the SRA, the ORR and Network Rail. Tom Winsor, Rail Regulator, sees himself as the ‘referee’, but one who has to take into account the aims of the SRA, and whose decisions ultimately determine public expenditure on the railways.

10. The incentives of the parties are blunted by the confusion of roles, but are also distorted by the ownership and separation of functions in the industry. Network Rail’s position is extraordinary in Britain: its members exercise little control, and its directors claim that its incentives are solved by the managerial contracts that tie pay to performance. Were it possible to achieve this, presumably much of the economy could do without shareholders, and, in practice, both the initial managerial contracts and the actual results indicate that this will fail. To date there is little evidence to suggest that Network Rail’s management is performing markedly better than their predecessors.

11. TOCs' incentives are also peculiar, in that the relationship between their costs, revenues and performance is not obviously aligned with customer interests. The SRA has compounded this problem with its approach to refranchising.

12. It is therefore recommended that the primary focus of transport policy in respect of the railways should be on sorting out the mess created though a combination of a failure to rationalise the institutional and regulatory structures, and the absence of appropriate incentives on the management of Network Rail and the TOCs. Although it is beyond the scope of this memorandum, the following reform should be urgently considered:

    i) abolition of the ORR (and the Rail Regulator's function);

    ii) clarification of the SRA/Network Rail interface (including consideration of the contracting out of the functions of Network Rail to the private sector under the SRA's control, *or* nationalisation of Network Rail);

    iii) changes to the TOCs' incentives and a review of the franchising approach by the SRA.

13. If such a package of reforms were to be implemented, the role of the SRA would be increased. Its corporate governance would therefore be even more important. Recent evidence of expenditures on PR, newspaper advertising and the handling of differences of opinion and staff matters indicate that it may need reform too.

14. Should the current policy nevertheless be continued, on the bases of 'muddling through', and the fundamental issues raised above remain unaddressed, then there is little reason to expect significant improvements in performance or much better control of costs. In such circumstances, the experience of passengers and freight operators will encourage a further relative decline in the railways, and the policy response will be to focus on roads. The costs to the government, to communities and to the economy are likely to be very considerable.