

# How Should Our Railways Be Run?

Policy Provocation



Written by

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Railway ownership in the UK needs to be radically reformed. It is unacceptable that our current system allows publicly subsidised profits to be extracted from our local economies in the form of dividends to shareholders, and at the same time minimising the risk and responsibility for train operating companies.

The current model is an affront to public values, reducing service quality through lack of investment in staff and infrastructure and complying with bare minimal standards. This cannot continue.

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# 1. Introduction

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With the majority of Britons in support of the nationalisation of our railways<sup>1</sup>, the call for public ownership is now the dominant mainstream view. Underlying public opinion is the sense that train operating companies ought to be accountable to tax payers as opposed to shareholders<sup>2</sup>. This has been fuelled by a spate of news stories about the financial and operational mismanagement of various rail franchises across the country.

In January this year, Southern rail hit the headlines after being condemned by parliament's spending watchdog for its failure to deliver value for money, with passengers experiencing the worst service performance on the national rail network<sup>3</sup>. In June, it was the turn of the Northern rail franchise, where the introduction of a new timetable has caused weeks of disruption for commuters. This sparked criticism from UK Secretary of State for Transport Chris Grayling and Greater Manchester mayor, Andy Burnham, who called the breakdown "nothing short of a scandal"<sup>4</sup>.

These two recent cases are part of a wider pattern of mismanagement which, in 2003, resulted in the Government terminating the Connex South East franchise after the company had covered up a shortfall arising from a failure to meet cost reduction targets<sup>5</sup>.

Most infamously, the East Coast Mainline service has been dogged with controversy since its privatisation in 1997. Despite paying out shareholder dividends of £197 million between 1997 and 2007, the Great North Eastern rail company was forced to give up its franchise in 2006 due to financial problems faced by its parent company, Sea Containers. The contract was then awarded to National Express in 2007, only to be handed back to the government in 2009 after it failed to meet its ambitious financial projections<sup>6</sup>. The state then took over the line and returned the service to profitability, handing back £209 million to the tax payer in its final year of operation. Despite this, the service was privatised again in 2015, with the franchise being awarded to Virgin and Stage Coach. However, in May 2018, Chris Grayling announced that the service is to be renationalised once more, again due to the failure of the Virgin Stage Coach franchise to meet its financial projections<sup>7</sup>.

The other main controversy with the current privatised system is that rail fares are expensive. UK passengers spend up to six times as much of their salaries on rail fares compared to European passengers using publicly owned railways<sup>8</sup>. On average, UK passengers will spend 14% of their income on a monthly season ticket from Luton to London (£387), or 11% from Liverpool to Manchester (£292). By contrast, similar commutes would cost passengers only 2% of their incomes in France, 3% in Germany and Italy, and 4% in Spain<sup>9</sup>.

In what follows, this policy provocation provides an outline of the current UK franchise system and considers arguments both for and against public ownership. It then sketches out a series of alternative ownership models, before concluding with CLES's own view on how our railways should be run.

## 2. The UK franchise system

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*"Privatisation is one of the great success stories of this Government. It has taken different forms in different industries. But common to all privatisations has been the harnessing of the management skills, flair and entrepreneurial spirit of the private sector to provide better services for the public.*

*The time has come to extend these benefits to the railways. This calls for a new approach... Our objective is to improve the quality of railway services by creating many new opportunities for private sector involvement. This will mean more competition, greater efficiency and a wider choice of services more closely tailored to what customers want."*

**John MacGregor, Former Secretary of State for Transport, 1992<sup>10</sup>**

Contrary to John MacGregor's ambition, the current state of our railways is somewhat at odds with the vision set out back in 1992, prior to privatisation taking place. The government's belief at the time was that the introduction of competition, innovation and the flexibility of private sector management would enable the railways to flourish. This has not happened, even if you take the most positive of interpretations.

What is most obviously absent from the current privatised system is the element of competition needed to incentivise train operating companies to improve. On many routes, rail passengers frequently have no choice about which service operator to use.

To make matters worse, our rail fares are not going back into the system to fund improvement, as rail industry leaders argue each year to justify annual increases. Instead, this money is being extracted out in the form of shareholder dividends and excess pay, irrespective of how a particular company is performing<sup>11</sup>. This system is deeply flawed. Having won the right to operate a service, the successful franchisee is not required to invest significant capital back into the service. This is because rolling stock (which includes trains, equipment and associated plant machinery) is not owned by the franchisee but rented from a leasing company, and rail infrastructure (which includes track, stations, bridges, level crossings etc.) is provided by nationally owned Network Rail in return for track access charges. These track access charges are paid by the franchisee to Network Rail at an artificially low rate. Consequently, as the franchisee does not typically own any major assets, there is no incentive and limited requirement to invest.

If substantial operating losses are in prospect, the franchisee can either receive revenue support from the government or walk away after paying a modest penalty, leaving the state to run the trains<sup>12</sup>. In addition, companies are usually wholly owned by a large corporate parent where the standard practice is for them to receive all company surplus whilst taking limited responsibility for any losses and distributing the profits in the form of shareholder dividends.

Furthermore, most franchises are formed and operated via what are known as a *special purpose vehicle* (SPVs) which provides substantial financial and legal protection to the parent company, thereby also mitigating against the risk of any substantial loss<sup>13</sup>.

In short, the current UK franchise system is calibrated in favour of the operator, over the passenger or the taxpayer. It allows the private extraction of wealth to be maximised whilst subjecting train operating companies to minimal risk. As a result, the government's aim to create a reliable, efficient railway system that offers a high-quality service to its users has failed to materialise.

# 3. The public ownership stereotype

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Public ownership is often negatively stereotyped with privatisation hailed as the panacea. This framing does not hold up to scrutiny.

Speaking on the BBC's This Week programme on 7th June 2018, Michael Portillo characterised the privatisation of Britain's railways as a broad success. The rationale for this being that under privatisation passenger numbers have increased from approximately 700 million per year pre-privatisation to approximately 1.7 billion passengers per year today. Conversely, he described public ownership as a failure, mentioning safety and the fact that whilst he was Minister of State of Railways between 1988-1990, he presided over a number of fatal rail crashes such as Clapham Junction in 1988 and Purley station in 1989. In addition, in terms of our rail infrastructure, his claim was that it is the publicly owned Network Rail - responsible for the track, signalling, bridges, tunnels and most stations - who are the worst performer. Both of these factors, he said, constitute proof of how poorly equipped publicly owned rail companies are to run our railways<sup>14</sup>.

Similarly, Martin Griffiths, Chief Executive Officer of Stagecoach Group, provides a damning portrait of public ownership. Under British Rail, trains were old, he says, passenger revenue was the lowest in real terms since the late 1960s and costs were out of control. He claims that Britain requires private sector finance and expertise to deliver the massive investment needed to tackle the combined challenges of increased capacity, fleet modernisation and infrastructure enhancement to meet passenger expectations. Meeting the challenge of growth and the need to add significant capacity will only be possible with private sector investment, cost-control and innovation. Rail company profits, he says, "reflects the key role the private sector plays in the financing of today's railway"<sup>15</sup>.

## How do these arguments stack up to scrutiny?

### 1. Passenger Numbers

First, there is the claim that passenger numbers have increased under privatisation and the implication that this increase is due to some unique feature of a privatised system. Whilst the increase in numbers is not disputed, the notion that privatisation has facilitated this shift can be called into question. The reason being that the nature of our work and commuting, as well as the nature of our wider economy, has shifted dramatically over the last 30 years. According to the latest rail transportation survey, commuting now accounts for 56% of all journeys with leisure at 23%<sup>16</sup>. Therefore, this shift could have more to do with broader economic growth and residential patterns, as opposed to some unique feature of a privatised system that makes rail travel more attractive. Moreover, this implication gains further traction if we triangulate these statistics with accounts of commuter dissatisfaction. The majority of commuters believe their journeys do not represent good value for money and they are dissatisfied with the way delays are handled<sup>17</sup>.

## **2. Safety**

Second, the claim above – particularly from Michael Portillo – is that the old nationalised system was inherently unsafe. Whilst there were indeed a number of fatal crashes under British Rail's tenure, so too have there been fatal crashes under a privatised system. In 1998, the Hatfield rail crash on the East Coast Main Line saw 4 people killed and over 70 injured.<sup>18</sup> In 1999, the Ladbroke Grove crash on the Great Western Mainline saw 31 killed and 523 people injured<sup>19</sup>. Do these facts render a privatised system inherently unsafe too? Merely linking the occurrence of accidents to the fact that they were presided over by either a public or a privately owned company is not sufficient to attribute causation.

## **3. Performance**

Third is the claim that the worst performer in our railway system is the publicly owned Network Rail and, by extension, that this proves how inadequate public ownership is. In response, poor performance alone is not sufficient to condemn a particular macro-economic structure: again, correlation is not causation. To make this argument stick would require a much more pointed analysis of Network Rail's financial and operational management. If we do lift the lid, what immediately becomes apparent is that, as a publicly owned company, Network Rail has sacrificed its own financial sustainability to make things much more comfortable for the privately-owned franchises. Despite sitting on £30 billion of accumulating debt, charges to train operating companies for the use of Network Rail's track have, at the behest of the Department for Transport, been held down. This in effect makes them an undisclosed public subsidy, which is being used to dramatically improve the private train companies' profitability<sup>20</sup>. The result is that these companies are able to create an illusion of themselves as self-reliant profit earners, where in actuality, this is being claimed at the expense of the public purse.

## **4. Cost and Efficiency**

Fourth, we have the contention that it is only a privatised system that is capable of providing an efficient, cost-effective system that is able to meet growing demand. Conveniently, the recent nationalisation of the East Coast Mainline provides us with a test case to ascertain whether private sector profit motive is a necessary condition for successful operation. Taken back into public ownership in November 2009, the state owned Directly Operated Rail (DOR) began work in the middle of a recession, with some of the oldest rolling stock on the network and without the usual benefit of years' worth of planning that has been typical of other recent franchise take-overs. Nevertheless, the last set of performance measures taken before the line was re-privatised highlight that the service had the third highest customer satisfaction ratings out of all operators and that it matched or outperformed all other private franchises with respect to punctuality and reliability. Moreover, profits rose by 7% within a context of serving some of the areas of the UK that were hit hardest by the financial crash and despite the disruption caused by a significant overhaul of timetabling<sup>21</sup>. Contrary to the view that an efficient, well-managed rail company requires private ownership, the example of DOR shows that state employed railway managers, without profit incentive, can run a train operating company that delivers exemplarily efficiency and cost management.

## 4. The alternative – Regional Public Ownership?

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The arguments above, which attempt to portray a publicly owned rail system as inherently inferior to one that is privately owned, do not stack up to scrutiny.

On the contrary, given the recent spate of news stories about the financial and operational mismanagement of various rail franchises across the country, it is the privatised system that looks increasingly flawed. In light of the evident failings of rail privatisation, what form of ownership could instead be pursued?

The case of the East Coast Mainline, outlined above, which was taken back into public ownership in November 2009 and run by the state owned DOR, shows that the state can indeed run the railways, and in a manner that is more efficient and cost effective than the privately-owned companies. Moreover, despite the negative stereotype associated with British Rail, close reading of the evidence shows that by the 1980s, British rail management was delivering exemplary operating efficiency despite being starved of investment<sup>22</sup>. Thus, full national ownership could be considered as a viable option.

Nevertheless, with the present Westminster dominated system, where London based ministers take decisions on behalf of the rest of the country<sup>23</sup>, is national ownership the best way to ensure local accountability? With the appetite for more local and combined authority control growing in areas up and down the country, there is a case for city regions and local authorities to play a more prominent role, bridging the link between service, communities and local democracy. Although central government needs to retain a role for standardising equipment and procedures and a responsibility for tracks that run through numerous regions, could regional public ownership be a feasible option?

In support of this model of ownership, there are a number of encouraging examples from around the UK which serve as alternatives to the dominant franchise model. For example, the publicly owned Translink in Northern Ireland provides an integrated and efficient transport system which continues to report successful growth, continued investment and positive customer satisfaction<sup>24</sup>. The Department for Infrastructure, a devolved Northern Ireland government department in the Northern Ireland Executive, provides a capital grant to Translink to operate rail services. The funding helps maintain and develop the rail infrastructure and rolling stock. The past few years have seen significant investment in the railways. From the year 2004/05 to 2014/15, the Department has funded over £400m of capital works, including the acquisition of 20 new trains, track and safety improvements, as well as the upgrades at a number of stations<sup>25</sup>.

With respect to how regional public ownership could be funded, some of the regional requirement for subsidy and investment could be provided by locally raised taxes with the rest provided centrally. The £235 million Scottish Borders project for building 30 miles of new line is illustrative here. Following a locally based campaign, the three local authorities of Edinburgh, Midlothian and Scottish Borders began developing a business case for the reopening of the Borders Railway. Through their combined efforts they managed to secure significant support from Scottish Government to supplement their own contribution. Opened in 2015, the new line also has 7 new

stations and enables a train to run every hour along a route which had been previously abandoned<sup>26</sup>.

At a city region level, the powers that have been devolved to the Greater Manchester suggest a potential way forward. Following the passage of the 2017 Bus Services Act, Transport for Greater Manchester, in conjunction with the Mayoral authorities, have been given the power to improve bus services by reforming the current bus market, with Mayor Andy Burnham making a commitment to use these new powers to make local bus services more affordable, more reliable and more accessible<sup>27</sup>. Could a similar arrangement not be made for the region's trains?

# 5. The CLES View

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Railway ownership in the UK needs to be radically reformed.

## **The extraction of tax payer subsidised profits by shareholders must end.**

It is unacceptable that our current system allows publicly subsidised profits to be extracted from our local economies in the form of dividends to shareholders, whilst simultaneously minimising the risk and responsibility of private train operating companies. This private, extractive model, characterised most recently by the spate of news stories about the financial and operational mismanagement of various rail franchises across the country, must be abandoned if we are to realise an effective public transportation system.

## **False stereotypes of public ownership must be challenged.**

The failure of our current private model notwithstanding - not to mention the success of the East Coast mainline under public ownership - it is all too easy for commentators to offer fallacious narratives of what public ownership has been like in the past or would be like again, despite strong evidence to the contrary. These interpretations must be challenged.

## **Greater devolution of power needs to be wielded ambitiously.**

In response to the failure of the current franchise system, there have been numerous calls for greater accountability and for more devolution of power<sup>28</sup>. Transport for the North, for example, have commissioned a review which will be expected to make far-reaching recommendations on how Northern rail can be better held to account by local people<sup>29</sup>. There have also been calls for a Northern "Crossrail" to provide more money for rail infrastructure and address underfunding<sup>30</sup>. Yet, while all of these elements are necessary for our railway system to be successful, they are insufficient. They tinker with a flawed system and market to make modest improvements whilst the underlying flaws remain.

## **A new model of ownership must restore public values and advance social justice.**

Sufficiency, we argue, can only be achieved via a different model of ownership; a model which ensues marketisation and private values and calls for the restoration of public values – values which promote the common good, democracy and public interest. Fundamental to this point of view is a question of the purpose of our railways and who they serve. Our view is that our railways are not just a means of promoting a narrow economic good. They are also a social right, and as such, a means of advancing social justice. Having access to an efficient and affordable transportation system is something that should be available to everyone.

## In Conclusion

Social connectivity can only be delivered if we are able to develop a more progressive social and political system, the likes of which have not previously been commonplace in the UK. In particular, we will need to change the distribution of financial resources, create alternative tax regimes, and continue to develop different, devolved understandings of political power. The kind of regional public ownership described in the previous section would be one way of achieving this goal.

Fundamentally though, we must put a stop to the extraction of resource from our railways. The current model is an affront to public values, reducing service quality through lack of investment in staff and infrastructure and complying with bare minimal standards. This cannot continue.

# Endnotes

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- <sup>1</sup> <https://yougov.co.uk/news/2015/08/06/support-radical-left-and-right/>
- <sup>2</sup> <https://yougov.co.uk/news/2014/05/11/why-do-people-support-rail-nationalisation/>
- <sup>3</sup> <http://www.cityam.com/278461/southern-rail-franchise-faces-spending-watchdog-criticism>
- <sup>4</sup> <http://www.wired.co.uk/article/northern-rail-emergency-timetable-cancellations>
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- <sup>7</sup> <https://www.theguardian.com/politics/2018/may/16/east-coast-rail-line-to-be-temporarily-renationalised-virgin-stagecoach>
- <sup>8</sup> <https://www.tuc.org.uk/news/uk-commuters-spend-6-times-much-their-salary-rail-fares-other-european-passengers>
- <sup>9</sup> Ibid
- <sup>10</sup> Department of Transport. (1992). *New Opportunities for the Railways*. Available at: [http://www.railwaysarchive.co.uk/documents/DoT\\_WP001.pdf](http://www.railwaysarchive.co.uk/documents/DoT_WP001.pdf)
- <sup>11</sup> For example, between 2012-2013 and 2015-2016, train-operating companies in the UK paid nearly all of their £868m operating profits as dividends. See <https://www.ft.com/content/d82848ca-f7ba-11e7-88f7-5465a6ce1a00>
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- <sup>13</sup> McCartney and Stittle. (2011). 'Carry on up the east coast'—a case study in railway franchising. *Public Money & Management*, 31(2).
- <sup>14</sup> <https://www.bbc.co.uk/programmes/b0b62910>
- <sup>15</sup> [https://www.huffingtonpost.co.uk/martin-griffiths/rail-nationalisation\\_b\\_3973007.html?guccounter=2](https://www.huffingtonpost.co.uk/martin-griffiths/rail-nationalisation_b_3973007.html?guccounter=2)
- <sup>16</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/663116/rail-factsheet-2017.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/663116/rail-factsheet-2017.pdf)
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- <sup>20</sup> Bowman et al. (2013). *The Great Train Robbery: rail privatisation and after*. CRESC public interest report. Available at: <http://www.cresc.ac.uk/publications/the-great-train-robbery-the-economic-and-political-consequences-of-rail-privatisation>
- <sup>21</sup> Ibid
- <sup>22</sup> Ibid
- <sup>23</sup> <https://cles.org.uk/blog/wealth-for-all-an-activist-local-government/>
- <sup>24</sup> <http://www.agendani.com/planning-future-translink-northern-ireland/>
- <sup>25</sup> <https://www.infrastructure-ni.gov.uk/articles/railway-transport-funding>
- <sup>26</sup> <https://www.transport.gov.scot/publication/borders-railway-baseline-study-final-report/j418557-03/>
- <sup>27</sup> <https://www.tfgm.com/future-travel/bus-reform>
- <sup>28</sup> <https://www.manchestereveningnews.co.uk/news/greater-manchester-news/prime-minister-theresa-fends-bid-14781418>

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<sup>29</sup> <https://www.yorkshirepost.co.uk/news/opinion/judith-blake-inquiry-will-get-to-timetable-truth-over-northern-rail-1-9199855>

<sup>30</sup> <https://www.ippr.org/news-and-media/comment/it-s-time-for-crossrail-north>



## About this publication

This policy provocation is for anyone who uses or informs the delivery of our railway services. It emerges in response to the significant failings of marketisation.

It begins by providing an outline of the current UK franchise system and considering arguments both for and against public ownership. It then sketches out a series of alternative ownership models, before concluding with CLES's own view on how our railways should be run.

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