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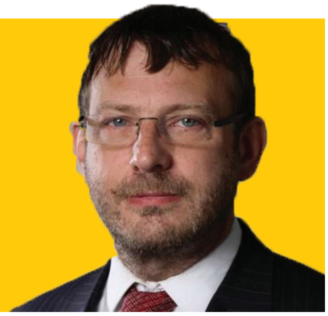


Three scenarios for Network Rail

In my final article on Network Rai, I move from a consideration of the optimal solutions for reform, to the politically viable ones

SCENARIO 1: The NHS option (as is)

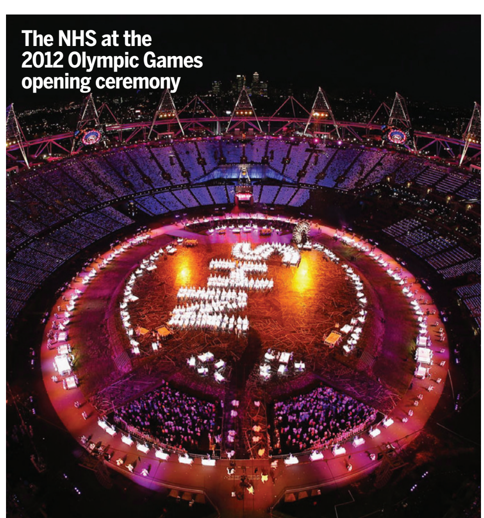
For some people, the most striking aspect of the spectacular opening ceremony of the 2012 London Olympics was the sight of the all-singing, all-dancing NHS doctors and nurses. My American family were completely confused, but to we Brits, the significance was clear. It confirmed the dictum that "the NHS is the closest thing the English have to a religion" and that any systematic discussion about efficiency or priorities was definitely vulgar, probably wicked and completely impossible (which is to say any, evidence-based discussion about how to provide better medical outcomes, at an affordable cost).

This is one possible future for Network Rail, and here's how it works.

The pretence that Network Rail is not an arm of government has already been dropped. Everyone agrees that we need more capacity, and so a Very Wise Person (who was previously CEO of British Industrial Underwear plc) is appointed to run NR. The Very Wise Person has a plan to improve outputs and investment without the risks of fundamental changes to structures or incentives, but the precise details of the plan are never completely clear. What the Very Wise Person does need is some pump-priming subsidy to get the plan going, which they duly receive.

After a few years of apparent progress, there is then some sort of crisis. In the NHS this may be a winter flu epidemic, or an increase in mortality rates. There is a cash crunch, because there always will be in any entity whose costs are constantly escalating. On the railways, the crisis might be a serious accident, or the revelation that budgeted costs for a major project have been exceeded by some enormous multiple (or the project delayed). Press and politicians become Very Angry. The Very Wise Person steps down. (If the Very Wise Person is Exceptionally Wise, they leave voluntarily just before the crisis, and get a well paid job somewhere else, having burnished their CV).

Once the crisis is in the political arena, there are then "only 300 days to save the NHS/NR". Red-faced Tory backbenchers become extremely cross. Jeremy Corbyn accuses the government of "privatisation by the back door".



The NHS at the 2012 Olympic Games opening ceremony

Tim Farron makes calls for the government to do something "very moderate" to solve the problem. Alex Salmond rages about "ScotRail being let down by Westminster". The Treasury provides bridge funding, and a new and Even Wiser Person is appointed. A Very Important Report is produced, and we learn that the Very Wise Person had in fact presided over a regime of decadence and waste. Staff morale had been at 'rock bottom' all the time. Costs were out of control. Quality had been flushed down the toilet. Luckily, the Even Wiser Person (who had previously been the respected chairman of green energy giant CliMiddEa Inc) has an Even Better Plan. And so the pattern is repeated.

Mrs Thatcher once said that the problem with socialism is that, eventually, you run out of other people's money, but like many economic forecasts, whilst the end destination may be accurate, the timing is almost always wrong. This kind of cycle can run for decades, because money can usually be found if the howls of objection to "cuts" is loud enough. London Transport (now Transport for London) operated on this pattern from about 1948 until the appointment of Peter Hendy as commissioner in 2006. Most of the state-owned European railway administrations have worked like this since 1945.

Odds: 70%

SCENARIO 2: Break-up, but still publicly-owned

The current drive towards devolution, that started in 1997, appears to be inexorable. The devolved entities created by Labour in Scotland, Wales and London, have a powerful drive to accumulate new powers and new assets. The recent decision to hand the entirety of suburban rail in the capital to TfL is simply the latest manifestation of a secular trend. TfL, the Scottish Government and Transport for the North will all seek similar control over their portion of the rail infrastructure.

So I predict very strong pressure for some kind of break-up along regional lines. This could take the form of agency agreements between Network Rail and the new entities (which will be Network Rail's least worst option) or a full break-up, with the operations and assets legally transferred to the regional powerhouses (which will require time, and legislation).

This would improve benchmarking and create more coherent management entities

"I predict very strong pressure for some kind of break-up along regional lines"

(why do railways in Scotland need to be owned and run by the same entity that owns branch lines in faraway Kent?). What it wouldn't do is anything much to solve the problem of how to bring private finance into the industry. (Although the regional owners may begin to develop their own solutions, once access to central government grant becomes scarce).

TfL debt is already "visible from the moon", so the concept of building up vast piles of "prudential" borrowing (explicitly or implicitly guaranteed by HM Treasury) cannot be repeated too many times before there is a collision between the desire to spend money, and the amount of money available.

Odds: 40% in Scotland, Wales, London and Northern Way

SCENARIO 3: Break-up, with some private capital

In this scenario, the "regions" would be transferred to the relevant devolved institutions, and the rest of England would be progressively broken up. Wales, Scotland, London and a TransPennine region would be detached from the Mothership.

My suggested approach would be the progressive removal of logical parts of the remaining network, which could be auctioned via long term concessions to infrastructure funds and similar long term investors.

The boundaries of each area would be set by logical service groups (probably and inevitably with some resemblance to the pre-grouping railways). So let's call them PGRs, and they might include Merseyrail, LTS (unless TfL get their hands on it first), South Eastern and perhaps Anglia, to name just a few.

Step 1 would be to legally separate such entities from Network Rail, and Step 2 would be to convincingly establish the condition of assets and risks before sale. Valuation would be highly dependent on investors' confidence in the asset condition - something that Network Rail (and Railtrack before it) have conspicuously failed to resolve. Step 3 - sale of the concessions - would only occur when the entities had established their independence and credibility.

The PGRs would have a Regulated Asset Base, a clear set of deliverables for each five or 10-year Control Period and clear incentives to reduce costs (whilst being commited to pre-determined minimum service levels).

A Network Rail employee at Leeds station. Will Transport for the North seek control of rail infrastructure?

"There are serious pools of investor capital available for 'infrastructure'"

The PGRs would require a clear set of operational and investment objectives from the Department for Transport and (in some cases) could also be train operators (as already happens in the light rail concessions in DLR, Manchester and elsewhere). A step by step approach might allow HMT to build investor confidence (and the prices that investors would be prepared to pay for such businesses).

Why would HMT ever do this? Because funding rail improvements on the scale currently being contemplated in Great Britain requires enormous amounts of money, and because the sale of High Speed 1 and Eurostar has demonstrated that there are serious pools of investor capital available for "infrastructure".

The commitments already made (to TfL) or implied (to the devolved Osborne "super mayors", and to High Speed 2) will require mind-boggling amounts of hard cash. So why look a gift horse in the mouth? Because the politics remain very difficult. There will be immense pushback from Network Rail, although dividing it into regional chunks (that remain, at least initially, in public ownership) would be a manageable first step to any of these changes. Significant reform would take most of this parliament and sales would only be possible after 2020.

Odds: 20% in niche parts of the English network

Ultimately any restructuring of Britain's railways will come down to the political balance between the desire to fund vote-winning projects, and the amount of cash the government actually has available. Only if the demand for money exceeds HMT's real available budget (always much larger than the published number), will economic reform ever take place, and then only on a step by step basis.

However, if the next UK Olympics opens with a parade of dancing railway workers, we will know that the rail sector has entered that same, blessed realm as health, where the answer to every policy question is always "more cash". ■

ABOUT THE AUTHOR

David Leeder has over 20 years of experience in transport, and was an executive director of National Express Group and a main board director of FirstGroup. He is co-founder and CEO of the German bus business MET and managing partner at Transport Investment Limited.