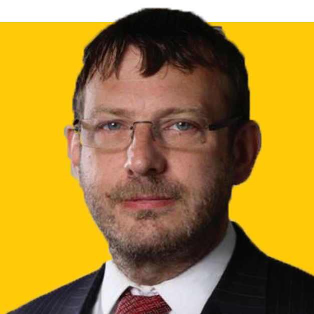
DAVID LEEDER



Three things reform must address*

* But probably won't. We should not ignore structural cost creep, the role for market forces and the right size to attract investment

In Part 1 (PT122), I looked at the role of economic incentives. This week I will list some of the other big topics that any fundamental reform of Network Rail should address (but which are quite likely to be fudged).

1. What's the plan to tackle structural cost creep ?

All railways, and especially the structure that has evolved in the UK since 1996, tend to suffer from structural cost problems. A Treasury official once put it to me like this; "why does it cost £5,000 to erect a bus shelter at the side of a road, but £50,000 to place an identical one on a railway platform?" This problem exists throughout the supply chain, and is very visible in industry labour costs. In the late 1970s, railway workers (and bus workers) were paid something like average wages. Since that time, bus wages have fallen (and now recovered) relative to average incomes, but rail earnings have more than doubled.

Any serious medium term plan to tackle rail costs must start by systematically reducing barriers to entry, and the rigidities in the rail supply chain that create these effects. This will require a frank discussion about topics such as industrial relations, regulation, training and safety, which have previously been avoided. Long term 'perpetuity' businesses would have much stronger incentives to tackle these issues than the stop/go TOCs, which can simply pass the cost inflation back to the taxpayer at each franchise renewal point.

2. What role should there be for market forces in determining renewals and improvements?

The big debate in the bus industry, since the 1984 White Paper (and since the 1920s, for the historically minded) comes down to a single question; "should bus networks and fares be determined by bus operators, responding to passenger demand, or by local government planners ?" All the policy heat and noise flows from this. There is an exact analogy in rail. Should train operators take over more responsibility for planning and funding upgrades, in response to changing passenger demands, or should this be a role for government?

Who should decide which lines to electrify, which stations to rebuild and so on (and if so, in response to what incentives?). Or should the private sector simply be a source of finance and project management expertise to deliver the politically-determined 'Grands Projets'. To see what this means in practice, one only has to compare the elegant, but physically modest, 1930s stations of the Piccadilly Line (designed when London Underground was at least trying to operate without perpetual subsidies) with the grand architectural gestures of the Jubilee Line Extension, which opened in 1999.

The answer may lie in chancellor George Osborne's plans for regional devolution. The 'regional railway' can broadly be defined as one in which costs are always likely to be

far higher than revenue. These segments should probably be placed under political control (as per Transport for London or Transport for the North), and their operations and infrastructure contracted out.

This is a very live issue, as the continual encroachment of bodies such as TfL, the devolved assemblies and the forthcoming "Osborne" super mayors will have a direct impact on what schemes are pursued. All of these bodies are, or anticipate becoming, sponsors of new projects. Many of them will no doubt wish to go down the TfL route of detailed project specifications, as we already have seen in the light rail sector since the early 1990s. The problem is that such bodies are not be much more likely to develop cost effective capital projects than Network Rail, since they are also funded by The Bank of Other People's Money (HMT) and in the case of the new transport authorities are likely to be even more politicised, and eager to spend 'free' capital.

But this leaves the question of the

"Should train operators take over more responsibility for planning and funding upgrades"

Engineering works on the Edinburgh-Glasgow Improvement programme

'commercial' railway. My instinct is that, within the right incentive and regulatory structure, fully commercial entities could plan, fund and operate large parts of the network. This is the model already used in energy and water, and was the model for UK railways from the 1820s until the 1940s. This would require an end to franchising of the 'commercial' networks, a closer integration of infrastructure with operations, and creation of 'perpetuity' businesses that could raise significant capital for infrastructure investment. (And as the pre-1920s railways showed, this would not preclude open access running on other people's tracks).

3. What's the right size of network to be investable ?

If Railtrack (and Network Rail) was 'too big', what is the right size to pass the Goldilocks Test? There is no simple answer. Infrastructure funds tend to like investments in a range from the mid hundreds of millions to the low billions of 'net asset value'. Examples would include High Speed 1, or non-franchised operations such as Heathrow Express. London Tilbury & Southend (c2c) would certainly fit this model. In the USA the vertically integrated freight railroads are far larger, and have successfully attracted both stock market and private equity investors in recent decades.

One size will not fit all, and there is a need to avoid a repetition of the Bowker-period Strategic Rail Authority's philosophical musings on the 'perfect' size of a TOC. The fallacy is to believe that there is some simple set of rules that determines the perfect size. The pre-grouping railways probably provide some decent clues to what is both operationally sensible, and right-sized to attract capital on a competitive basis.

Taxpayers and passengers are people, too

Why am I pessimistic about these issues being tackled? It's because the existing industry participants - Network Rail, the trade unions, and the TOC owners - all have so much to lose.

Driving through change will require a willingness to challenge these vested interests, an ability to attract new investors and industry players, and the PR skills to articulate why painful change might be desirable. The most vital task is to explain why a more efficient railway is in the interests of passengers and taxpayers. Sir Peter Hendy, Network Rail's new chairman, could be the man to do this. ■

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.