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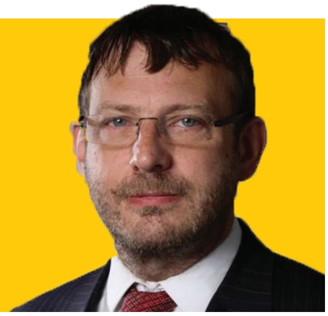

Has Hendy bought NR more time?

Without mandatory structural change, it will once again be up to Network Rail's management to decide whether to reform

Nicola Shaw has one of the sharpest minds in the UK transport sector, and her scoping report into Network Rail reflected her usual clarity of thought. It is therefore surprising that the final executive summary seems such thin gruel.

The seven recommendations are shown in the box on the page opposite.

Five of these re-state the pieties to which large organisations are now prone. Who is ever opposed to more and better staff training? There are the usual encomiums to 'diversity', 'strategy' and 'efficiency', plus that oldest of transport clichés, "putting passengers first". And Shaw dutifully repeats the elite mantras around devolution (a "Very Good Thing"), and The North - "an even better thing". This is all a long way from the kind of hard-nosed economic analysis that I would normally associate with Nicola.

The executive summary might be simplified as "on reflection, we should give Network Rail one more chance". It reads like a bad case of the McNultys. How has this happened again?

Firstly, Network Rail now has a very formidable chairman in Sir Peter Hendy, with a reservoir of goodwill in Whitehall built-up during his stewardship of Transport for London. The government trusts Hendy. He will have made compelling arguments about the career risks of hasty structural and economic change when so much political capital is being invested in infrastructure projects. He will also have been influenced by TfL's long-running, and ultimately successful, battle against the Tube PPP. Moreover, by pro-actively offering up asset sales (of surplus land, some stations, communications networks etc), Hendy has spiked the Treasury's guns with regard to any break up of the core railway business: NR is finally making some financial sacrifices to keep the railway 'whole'.

Secondly, the century-old argument about the supposed wickedness of private investors in our railways remains politically toxic. This is a big issue for a cautious government with a small parliamentary majority. Much better to sell off some stations and support functions, and avoid nasty headlines in *The Guardian*.

Polling consistently shows broad public opposition to rail privatisation, and pending the EU In/Out Referendum the government is keen not to frighten its wobbly middle class (and rail-using) constituency. It was notable that the report was buried amongst the broader Budget messaging (now gone horribly wrong following the resignation of Ian Duncan Smith).

Thirdly, NR's perpetually weak cost control, and its long-standing uncertainty over the condition of its own assets, make any immediate break-up difficult. This is a fundamental issue. The NR patient is currently too weak to survive major surgery. Shaw provides her diagnosis of the 'disease' in the report itself, carefully expressed in unthreatening, technocratic jargon.

Finally, ex last month's second 'Omnishambles' budget, HMT is now taking a more sanguine view of transport finance than when Shaw was commissioned. George Osborne's route to Number 10 was supposed to run via Crossrail 2 and High Speed 3. Major structural and economic change is hard, and George wants spades in the ground quickly.

In other words, the soothing exec summary looks rather more like George Osborne's homework, than Nicola's. However the report itself contains a more rigorous set of recommendations that, if implemented, would change NR in fundamental ways.

Recommendation 2, route devolution, (if pursued relentlessly) might yet allow comparative benchmarking and - ultimately - privatisation of some of NR's assets (but please don't use that word).

The text is supportive of the idea that NR's regions (now called 'routes'), should broadly match the emerging geography of the devolved administrations. Shaw also correctly (if politely) draws out the contradiction between the simultaneous political desires for both devolution and conformity. One person's devolution remains another person's "postcode lottery".

Shaw correctly links devolution to stronger regulation. This is a key point. Only by allowing NR's regional businesses to operate independently, and to generate transparent cost and performance data, can any regime of economic regulation hope to succeed. And progress in this area would also represent a major step towards the introduction of private sector risk capital, or equity, at a later date. The routes (if not too large) have the potential to be 'right-sized' for a fairly broad pool of infrastructure capital. This would require, at minimum, clarity about operational performance, regulation and asset condition (a vast issue that neither Railtrack nor NR has ever sorted out), and demonstrable progress with independent accounting.

Only time will tell if NR is serious about allowing the 'routes' to evolve in an independent way. There are precedents. The National Bus Company (and London Transport) were broken into smaller, autonomous, pieces in the '80s and '90s, and this resulted in a step-change in efficiency. But NBC had fewer centralising tendencies than NR, and was not dependent on central government funding for survival.

Recommendation 5 calls for 'competition in the planning of enhancements' - a very significant change, and the report sketches

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out a number of potential mechanisms for allowing parties other than NR to identify, define, and fund enhancements. This looks like a work in progress, and greater clarity will be needed in this important area.

Recommendation 6, explore new ways of paying for the growth in passengers and freight on the railway - this is the core of the report, and the language is notably more modulated than in the scoping document. The decision to reject wholesale privatisation is both politically and financially realistic. Railtrack was a public relations disaster, being both ‘too big to fail’ and ‘too big to be investible’. The Tube PPPs were too complex and rigid to deliver innovation or efficiency. Infrastructure funds are happier with smaller chunks and long-term, more flexible concessions, like Shaw’s own High Speed 1. By rejecting ‘privatisation’, Shaw has cleverly opened the door to a step-by-step approach to monetising NR’s assets that would flow logically from real progress with NR devolution.

There are important, if technical, proposals to create ‘financial buffers’ (what 19th century railways called ‘capital reserves’) to ensure route-level businesses within NR are financially resilient. Once again, this would be an important evolutionary step towards these businesses breaking free, either by concessioning (as proposed by Shaw), or outright sale, at some later date.

By placing these structural and economic proposals in the reassuring warm bath of ‘focusing on customers’ and ‘improving skills and diversity’, Shaw has avoided alarming headlines about “Bringing Back Railtrack”. Privatisation by stealth (as with HS1) is more politically realistic.

What is being proposed is a sensible, gradualist approach to reform, which, if followed through, could set NR on a new path. But everything will depend on NR’s own willingness to change. There is nothing here that addresses the fundamental problem of how to force change on a monopoly that has come out of the closet as a nationalised industry, but which has no private shareholders to incentivise efficiency or innovation.

What happens next?

One scenario would see the changes implemented with speed and rigour. This would open the way to further asset sales, and real financial pressure to improve delivery and reduce costs. Routes would be concessioned in a step-by-step process, once they had achieved independence and vigour.

The more pessimistic view is that the proposals are further diluted. The NR machine will be quite happy to kick all this into the long grass. NR has already proven itself adept at resisting both its regulator and its owner, and has a broad repertoire of techniques to evade change. Half-hearted devolution, slow progress with asset and performance management, and the political desire to deliver big projects, regardless of cost, will provide plenty of scope for under performance.

Furthermore, the conservatives within Network Rail have time on their side. Just days after Shaw’s report was published, the budget - intended to smooth the way for a ‘remain’ vote in June - is already a smoldering wreck, and the ‘infrastructure’ chancellor’s political career hangs by a thread. The policy context of Shaw’s report may already be obsolete. ■

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.

SHAW’S SEVEN RECOMMENDATIONS

1. Place the needs of passengers and freight shippers at the heart of rail infrastructure management. Train operators should drive this customer focus into Network Rail through scorecards and agreed action plans, recognising they are sharing use of the network with others and operating within a national (and international) system.

2. Focus on the customer through deeper route devolution, supported by independent regulation. Building on the current Network Rail move to greater devolution to its routes, there should be a step-change in the degree of autonomy of these routes to deliver more flexibly and responsively for their customers, passengers and freight shippers.

3. Create a route for the North. This new route will work closely with the customers there and in particular the new regional government body, Transport for the North. Network Rail should also work closely with other integrated transport authorities, city regions, and London, as funding and delivery models evolve. HS2 will remain a separate organisation.

4. Clarify the government’s role in the railway and Network Rail. In particular, the roles of the Department for Transport - as funder, client and owner of Network Rail - should be considered and clarified. As the body responsible for transport in England and Wales, the DfT should also develop a visible longer-term strategy for rail travel, co-ordinating as appropriate with the governments of Scotland and Wales.

5. Plan the railway based on customer, passenger and freight needs. Enhancement planning should be generated from passenger and freight shipper requirements. Routes should be given the freedom to build up their plans based on these needs and recognising the role of the railway in the wider transport, economic and social objectives of the area.

6. Explore new ways of paying for the growth in passengers and freight on the railway. Further options for involving private sector finance - for example, from letting a concession, or involving suppliers in technological investment - should be explored to release government capital, encourage innovation, and speed up delivery of improvements for passengers. Routes should also be required and empowered to find local sources of funding and financing, including from those (such as local businesses or housing developers, for example) who stand to benefit from new or additional rail capacity.

7. Develop industry-wide plans to develop skills and improve diversity. People are one of the railway’s greatest assets. But the industry as a whole needs to support and grow the pool of skilled and talented people working in the railway better and encourage more diversity.