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Railway Reform

Railway Reform

Note by the secretariat

I. Historical review of Railways evolution[1]

1. Railways and their roots present a varied picture around the world. In Europe and Asia they are generally owned and run by the state. In the United States, by contrast, the railroads are largely in private ownership. But this hasn't always been the case. Indeed, the construction of railways in Europe in the nineteenth and early twentieth century was mainly carried out by the private sector. It was only later the governments increased their control of the rail sector.

2. With road infrastructure still in an early stage of development, countries soon realized that rail networks were of critical importance to the economy. Governments also came to feel that it was their duty to ensure a functioning railway system operated in the public interest. European countries began to restrict commercialization and limit competition. This step led to loss of traffic and a noticeable deterioration in the financial position of railways. Private railways were no longer willing to invest in infrastructure and rolling stock. By 1950 nearly all the railways in Europe were state-owned and the vast majority of them still are.

3. The picture in the United States is very different. As early as the nineteenth century, American railroad companies were listed on the stock exchange. By 1970 all intercity railroad services – both passenger and freight – were privately owned but regulated by the government. However, passenger traffic was in decline and return on investment insufficient to maintain the track. The US Congress decided to establish a new, more balanced regulatory system that allowed railroads to act freely in terms of managing their own assets and setting prices for their services. The state-owned company Amtrak was founded to relieve freight railroads of most of their unprofitable passenger operations.

[1] Martin Streichfuss, Partner of Roland Berger, Article on "Railway Transformation" book of Roland. Berger Strategy Consultants.

4. The dissolution of the USSR and of Yugoslavia and Czechoslovakia led to the emergence of more than twenty new national railway companies. Some of these networks – the national railways of Russia Federation, Kazakhstan and Ukraine for instance – are among the largest in the world.

II. The drivers of Railways Transformation

5. *Liberalization.* One of the main drivers of railway transformation is liberalization. Governments have a number of different aims in pursuing this policy. They include encouraging innovation and quality by introducing competition, stimulating investment to create or safeguard employment, increasing efficiency and relieving the burden on the state in terms of financial support. Liberalization has a firm place on the discussion agenda in most countries with developed railway markets.

6. Three basic models of liberalization can be observed. In North and South America, most private railway companies vertically integrate their rail freight and passenger operations with infrastructure management. Strong demand on dedicated routes justify railroads offering parallel own networks, competing against each other. The infrastructure itself is either owned by the railway company, as in the United States, or run as a concession, as in Latin America.

7. A second model is found in Japan. Here privatization occurred in the early 1990s. However, no broad liberalization occurred on the markets. Today passenger rail business is provided by vertically integrated companies with a regional focus. The state-owned rail freight operator has access to the tracks owned by passenger railway companies. Private players face a major barrier to entry as they can only enter the market by offering their own infrastructure.

8. EU member states presents a third model. Vertically integrated incumbent railway companies run their passenger and freight operations separately from infrastructure management. At the same time, a regulator oversees access to the track. The result is that intramodal competition in the market is found in the rail freight business, with competition for the markets in the passenger sector limited to public tenders.

9. The European Union has approved a number of railway packages. The following figure details the contents of these packages and outlines their main objectives.

Figure 1
European Union railway policy

1st Railway Package	*2nd Railway Package*	*3rd Railway Package*	*Main Objectives*
All rail freight co's can access Trans-European rail freight network (TERFN)	Cabotage in freight transportation	Common approach to training drivers	Increase modal share of rail to reduce • CO_2 emissions • Road congestion
Infrastructure separate from transport business	Harmonization of security standards	Codification of passengers rights	Stimulate competetion and so raise efficiency and quality in the industry
Track access charges based on marginal costs	Market access improved through interoperability	Open access for all international services possibly including cabotage	Reduce government funding in the industry

1[st] Railway Package	*2[nd] Railway Package*	*3[rd] Railway Package*	*Main Objectives*
Independent regulator	Coordination and harmonization by European rail agency	Quality standards for rail freight sector	
EU-wide licenses			

Source: European Union

10. *Privatization.* Another driver for the liberalization of railways is the ultimate goal of privatization. The transformation from public to private ownership is a complex task for governments. The first step in the process involves the formal conversion from a public to a private legal form. This is followed by functional privatization, involving the transfer of sovereign duties to the new private company or companies.

11. Privatization in Europe presents a complex picture (figure 2). Only Great Britain has completely privatized its railways. The former national incumbent British Rail was broken up into more than 100 separate train operating companies among them six freight companies. Following their sale to the US company American Wisconsin Central Railroad, five of these six freight companies were amalgamated to form English, Welsh and Scottish Railways (EWS). EWS was sold to Deutsche Bahn in 2007. The company remains to this day the UK's leading rail freight provider. In 2002 the infrastructure management company Rail track was brought back under public control and renamed Network Rail.

Figure 2
Railway privatization in Europe

Country	*Passenger Rail*	*Rail Freight*	*Infrastructure*	*Comment*
Denmark	X	✓	X	Rail freight sold to Deutsche Bahn
Estonia	(X)	(X)	(X)	66 % of integrated railway operators sold; re-nationalization followed reduction of track access charges which made operator's business unviable
Germany	(✓)	(✓)	X	IPO planned but was postponed
Great Britain	✓	✓	(X)	British rail split into 100 companies; infrastructure re-nationalized after several major accidents caused by infrastructure failure
Hungary	X	✓	X	Rail freight sold to Rail Cargo Austria
Netherlands	X	✓	X	Rail Freight sold to Deutsche Bahn

✓Prioritized, (✓) Partially / soon to be privatized, X Not privatized, (X) Privatized then re-nationalised

Source: Railway Transformation

12. The pattern is different in other European Union member states. In the Netherlands, Denmark and Hungary, rail freight operations were sold to incumbent railway companies from other countries.

III. Recast of the first railway package

13. The first railway package consisted of three directives (2001/12/EC, 2001/13/EC and 2001/14/EC) which were substantially amended in 2004 (second package) and 2007 (third package). Its purpose was to revitalise railway transport (still largely in the hands of state monopolies confined to their national markets) by gradually opening it to competition at Europe-wide level. The market for rail freight transport has been completely opened since 2007 and for international passenger services since January 2010.

14. The level of success of this policy is demonstrated by the stabilisation of rail's modal share during the last decade after a long period of decline (its share among inland modes has remained around 17.1 % in tonne kilometres for rail freight and between 8.6 and 8.4 % in passenger kilometres for rail passenger transport since 2002). But, despite this achievement, which was difficult to arrive at, the establishment of a single rail market is a fragile construction and is hampered by several problems.

15. The recast the first railway package is: firstly an exercise in legislative simplification and consolidation (*"codification"*) with the merger of the three directives in force and their successive amendments (all in all nine directives, one decision and two acts of accession). The recast also aims to modernise the legislation and tackle key problems areas which have been identified on the market over the last 10 years.

16. The EU railway market suffers in particular from three major problems:

(a) *A low level of competition* due to market access conditions which are not sufficiently precise and therefore still biased in favour of the incumbents.

The persistence of conflicts of interest in particular for access to rail related services (access to terminals, maintenance and servicing of trains etc) between different market players and discriminatory practices.

Concrete examples of discriminatory practices on access to tracks and rail-related services include: km-based infrastructure charging or kWh-based charging for electricity that give disproportionate discounts to the largest operator (incumbent); insufficient information on requirements for newcomers' access given in "network statements" (the document setting out the characteristics of the infrastructure and the conditions for its use); denied access to central stations for international passenger trains competing with those of the incumbent , no information nor ticketing facilities in stations for these same trains; denied or very limited access to freight terminals when no alternatives are available.

(b) *Inadequate regulatory oversight* by national authorities, often with insufficient independence, competences and powers. With a small number of exceptions, regulators' offices in most other Member States are understaffed, have limited investigating powers and cannot enforce their decisions with financial penalties. When appeals against decisions by the regulator have suspensive effect, these decisions can be challenged through the entire judicial system and it can take years before a decision putting an end to an anti-competitive practice is enforced. Under present legislation cases concerning access to services (the most sensitive and frequent ones in the domain of competition on the rail market) may not be brought to the regulator. In several Member States the office of the rail regulator belongs to the ministry of transport, which also owns or controls the incumbent railway undertaking – a clear case of conflict of interest.

(c) *Low levels of public and private investment* as the quality of infrastructure is declining in many Member States because of insufficient funding, investment in railway services becomes less attractive both for incumbent and new operators. Underinvestment at national level is partly due to the absence of a clear "financial architecture" (investment plans, long term strategies, transparent and state-aid compatible relations between the state – nearly always the infrastructure owner and often the owner of the incumbent railway company – and infrastructure managers and railway undertakings).

17. In this context a new forward step in rail reform is necessary to remove these obstacles and create a genuine Single Railway Area, which would provide a key contribution to the effective completion of the internal market and the development of an efficient and competitive transport system in line with the EU 2020 Strategy objective of smart, inclusive and sustainable growth.

What is the link with the on-going infringement procedures?

18. The persistence of these problems is partly due to the incorrect or incomplete transposition of the existing EU rail market access legislation by Member States. The on-going infringement procedures on the transposition of the Directives of the first railway package address these shortcomings. However, the Commission recognises that other parts of that legislation need to be modernised, clarified and adapted to become more effective. The Commission proposal has therefore been designed to address the 3 key problem areas mentioned above, as well as consolidating all the existing legal texts. It has no direct connection with the infringement procedures. The objective behind this two-track approach is however the same, i.e. that of establishing a Single Railway Area in Europe.

What are the key elements of the recast?

The recast of the first railway package:

19. is firstly an exercise in legislative simplification and consolidation (*"codification"*) with the merger of the three directives in force and their successive amendments (all in all nine directives, one decision and two acts of accession), the elimination of cross-references and the harmonisation of terminology;

20. secondly, it aims at clarifying existing provisions (solving in particular problems of diverging interpretations by Member States) and at adapting them to the evolution of the market during the last decade, with a view to addressing key problem areas - building on the experience of the last 10 years. These are the problems mentioned in the second section above and facilitating implementation.

21. In particular, concerning the issues referred to in the second bullet point, the changes address the problems identified above as follows:

(a) *Competition issues:* the recast will improve transparency of the rail market access conditions for example by

- requiring more detailed network statements -documents published annually so potential newcomers can see clearly the characteristics of available infrastructure and conditions for its use;
- establishing improved (and in certain cases guaranteed) access to rail-related services (subject for instance to management independence requirements) for freight and passenger trains;
- establishing explicit rules on conflicts of interest and discriminatory practices in rail related services.

(b) *Regulatory oversight:* The recast strengthens the power of national rail regulators including:

- extending the competence of national regulators (to rail-related services);
- requiring the independence of national rail regulators (from any other public authority);
- strengthening the powers of the national rail regulators (with sanctions, audit and ex-officio investigating powers) and establishing the obligation imposed on these bodies to cooperate with their counterparts on cross-border issues.

(c) *Investment:* the recast aims to strengthen the "financial architecture" to encourage investment including by

- requiring national long-term strategies and multi-annual contractual agreements between the state and infrastructure managers linking funding to performance, and business plans. These instruments of medium to long term planning should allow an orderly development of the infrastructure and give market players better predictability of business opportunities and thereby facilitate their own investments;
- requiring more precise and smarter infrastructure charging rules. Better implementation of the charging principles contained in the existing legislation should lead to lower track access charges for rail transport operators in many Member States. The new charging rules (with common rules for the introduction of noise-related modulation as the rail equivalent to external cost charging for road transport, mandatory modulation of charges based on the equipment of trains with European signalling systems) should also stimulate private investments in greener and interoperable technologies.

22. What about extending the scope of market opening to domestic passenger rail services?

This recast is conceived to ensure fair competition on the rail market segments that have already been opened to competition, i.e. rail freight services and international passenger transport, not to extend the scope of market opening. As far as domestic passenger rail services are concerned, the Commission intends to adopt a new initiative by the end of 2012, as foreseen by the EU legislation in force.

23. Facts and figures –the potential of rail in Europe

Between 2000 and 2007 the European railway industry has managed to increase the number of passengers and quantity of freight volumes transported, from 370.7 to 395.3 billion passenger-kilometres in 2007 (+6 %) and from 403.7 to 453.1 billion tonne-kilometres in 2007 (+12.2 %) respectively. Rail has thereby stabilised its modal share. In freight transport, rail continues to account for more than 17 % of all intra-EU inland transport activity. On the passenger side, the rail share of intra-EU inland transport remains between 8.4 and 8.6 %. However, these percentages do not properly reflect the role that rail plays in carrying freight and passengers over medium-long distances. On some rail corridors, its modal share can in fact reach up to 35 % (such as for freight transport on the Rotterdam-Genoa rail line) or even 80 % (such as for passenger transport on the Lyon-Paris rail line). This is indicative of the potential of rail transport if well organised and managed. While rail passenger transport managed to gain some ground, rail freight experienced a bigger drop in activity than other modes during the deepening economic crisis in 2009.