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Briefing Paper 1

SCOTTISH RAILWAY POLICY - PAST, PRESENT - AND FUTURE?

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The major thrust of this briefing paper is to evaluate current and past railway policy and to outline proposals which can overcome previous policy failures. Much of the discussion on railway policy has involved little more than posturing by the main political parties. Despite protestations to the contrary, their actual policies when in power have been remarkably similar. It is argued here that much of the contentious nature of the debate over railway policy can be resolved by a reappraisal of some fundamental economic attributes of railway services. On the basis of this reappraisal, suggestions are made for the possible restructuring of railway services and the implications of such proposals for Scottish railway services are explored.

Railway Policy - The Hidden Consensus

Railways are notoriously unprofitable. For British Rail this is a matter of historical record. The Scottish region of BR is no exception; in 1983, passenger income of £91.6m, freight revenues of £33m and operating expenditures of £191m, left a deficit of £66.4m. This financial failure of railways is cause for intense criticism from some quarters: it is taken as a symptom of inefficiency, stagnation, even of managerial ineptitude. On the other hand, defenders of railway systems have long pointed to social benefits which, they allege, are not encompassed in narrow financial deficits. These competing claims are fiercely contested. Indeed, the furor created over any radical policy initiative on railways makes this one of the most contentious aspects of public policy.

These differing views centre on the acceptability or otherwise of 'profit' as an objective for a financially unremunerative state industry, such as the railways. Contrasting views on the appropriateness of the profit objective are often presented as following a clear political divide, with the Right critical of monolithic, unprofitable state industry and the Left as proponents of the railway as a 'social corporation'. Indeed, such thinking permeates discussion of railway policy by policy-makers and other commentators. However, the policy initiatives of successive governments of varying political complexions have always responded to the (perceived) need for the railways to be profitable (at however modest a level). Consequently in terms of actual policy, these different views appear to have had little impact.

Attachment to the 'profit' objective can be traced back to the creation of the railways as a state industry, in which the familiar statutory financial obligation of 'breaking even, taking one year with the next', has been widely misinterpreted. This requirement referred to a measure of surplus or deficit quite different from profit or loss as measured by the best commercial practice of that time. Thus, in computing surplus or deficit, deductions from revenues received had to be made for transfers to reserves and for the redemption of debt. This implies the earning of some (unspecified) level of profit, as conventionally computed (see Lapsley, 1981a).

Furthermore, since the early days of nationalisation there have been successive pronouncements (regardless of the political complexion of the administration) which have

pointed to the pre-eminent, wider, 'social role' of the railways. These include the White Papers of 1956 and 1966, the Transport Act of 1968 and Ministerial statements to the House on the introduction of the Railways Act of 1974. However, these policy statements have been followed by changes in policy which not only responded to alarm over financial deficits, but which also sought to reassert financial objectives which did not take account of these 'wider, social benefits' (for a fuller discussion, see Lapsley, 1983). The recurring financial crises at British Rail and the responsiveness of successive governments to financial criteria as 'triggers' for key policy changes represents a 'hidden consensus' amongst policy-makers. Indeed, the most recent policy initiative, the Serpell Report, which explored the potential for a profitable railway (only to be roundly criticised for *daring* to do so), was an almost inevitable by-product of a financial policy implemented by a previous Labour administration. Thus, the Serpell inquiry was established as a consequence of the likelihood that BR's Public Services Obligation subsidy would exceed the limit on its size imposed by the Railways Act of 1974.

Commercial v. Social Objectives - A Resolution of the Debate?

In its present form, BR cannot be profitable - it must be subsidised. Indeed, a need for subsidy was envisaged even in the most extreme of the options considered in the Serpell Report, in which the rail network was to be reduced to 1,630 route miles (as opposed to its present 10,700 route miles) to provide a 'commercial' railway. However the differing viewpoints over whether BR should be a 'commercial' or a 'social' railway are essentially misguided. Thus, it is possible that the debate over the appropriateness of 'commercial' or 'social' objectives can be resolved by a reappraisal of the fundamental nature of railway services. Specifically, BR has always been treated by policy-makers as a vertically-integrated system - this fails to take account of the fact that there are two, quite different, parts of the railway: (i) the carriage of freight and passengers (the 'operating services') and (ii) the permanent way of track, signalling and support facilities (the 'railway infrastructure'). The

segregation of these two distinct aspects of the railways would result in a 'commercial railway' (ie the operating services) and a 'social railway' (ie the infrastructure).

The rationale for such a segregation is based on (a) the desirability of liberalising transport services and (b) the uneven incidence of social benefits. As regards the first of these, there are marked differences between the principal assets of the operating services and the infrastructure for all modes of transport (road, rail, air and sea) which are critical influences in the development of market structures. Thus, on the one hand, the principal assets of the **operating services** largely exhibit the following characteristics: low capital cost (whether acquisition cost or opportunity cost) relative to infrastructure assets; short useful lives; little indivisibility. As a consequence of these attributes of their principal assets, the operating services of road, air and sea generally face competitive markets for their services because of weak barriers to entry, which permit rival firms ready access to such markets. The major exception to this is rail, presently organised as a statutory monopoly, although government regulation has often reduced competitive pressures in the other modes, too.

On the other hand, the principal assets of **transport infrastructure** of road and rail (and, to a lesser extent, for sea and air) have attributes which contrast with those of the operating services. Thus, their capital costs are exceptionally high; their assets are highly specific, with little or no alternative uses; often these assets have high economies of scale and are highly indivisible. All of these attributes create high barriers to entry, which inhibit competitive pressures and promote monopoly, often accompanied by state ownership. (For further details, see Lapsley, 1984). Therefore, by segregating the railway service from the railway infrastructure, a liberalisation of operating services by all modes would be promoted and infrastructure assets of all modes might be treated on a consistent basis.

Furthermore, this proposed segregation is supported by a closer examination of the issue of whether or not there are social benefits associated with railway services.

In the first instance, there is evidence that the **social costs** (of serious injury and loss of life; of noise; and of efficient use of energy) of railways are slight (see Lapsley, 1981b). Also, the **social benefits** of the railways appear to be largely associated with the railway infrastructure, rather than with the operating services. Thus, in the cost-benefit analyses of numerous branch lines, at the time of the 1968 Transport Act, the weight of evidence suggested that there were **no** social benefits of such railway operations.

On the other hand, it is evident that there is a failure of the price mechanism in the provision of transport infrastructure. Thus, there is no system of road pricing, in which motorists pay for the use of roads. The current system of taxing road users represents a poor proxy for money prices. With the present system of taxes, the motorist perceives a zero price to be paid for the use of roads and severe congestion of roads can arise as a result. The existence of a rail network provides an alternative system of transport which eases this congestion - a social benefit which does not appear in BR's financial results. Also, as regards investment policy, the strategic nature of investment in transport infrastructure (ie the maintenance of society's choice of transport modes for present and future generations) is not reflected in financial results.

Restructuring Railway Services: Some Proposals

To the casual observer, the proposed segregation of railway operating services and railway infrastructure might appear somewhat odd. However, there is already considerable use of BR's track by privately-owned freight wagons (some 16,000 such vehicles in 1983, almost two-thirds of which were tank wagons). In the recent past, Pullman trains were privately-owned railway operators. Also, in the distant past, railway companies owned the infrastructure and other organisations were carriers. Sometimes these carriers were the sole operators, sometimes they competed with each other and railway companies. Such competition tended to be eliminated by the restrictive practices of railway companies, a trend

which was further reinforced by government regulation and state ownership. The following proposals outlined here would reverse this trend.

As far as the Scottish railways are concerned, the nature of their services is consistent with the infrastructure-operating services dichotomy outlined above. Thus, it is evident that Scottish railway **services** operate in a competitive environment, despite being part of a statutory railway monopoly. This can be seen from the competition which the railways face on the two main Anglo-Scottish Inter-City routes from Edinburgh and Glasgow, which face strong rivalry from air and road travel for business and casual travellers. Improved air links and the availability of motorways have also provided competition for sleeper and motorail services to the South. Also, the suburban lines in the Greater Glasgow and Edinburgh areas have parallel bus routes and comprehensive road networks which promote competition from bus services and private motorists for commuter and casual traffic.

Given that this is so, how might the proposed restructuring of the railways be implemented and what benefits are likely as a result? It has already been suggested that two companies - a railway infrastructure and a railway operating company - might be formed. From the same basic analysis, it is possible to envisage a number of variants. For example, on the infrastructure side, it would be possible to divide responsibility for the railway infrastructure on a regional basis, particularly where this would promote a systems approach to infrastructure development and extension. Thus, central government in Scotland might oversee major road and railway infrastructure development in an integrated fashion.

The potential for variation is even greater with the operating services. Thus, given the nature of these services - the absence of social costs and benefits and the competitive nature of their operations - there is a potential for the introduction of private capital as an alternative to a publicly-owned railway company. There need not be a single operating company, public or private and, indeed, it is likely that more than one railway operating company would emerge. Thus, for example, a nationwide

Inter-City company, linking all the major cities of the UK and including the Glasgow-Edinburgh-Dundee-Aberdeen routes, might be formed. In addition, smaller companies based on areas of dense population might serve local commuter needs. This would most evidently apply around Edinburgh and Glasgow, but might also include Aberdeen and Inverness. There would still be a need to serve rural travellers, in Highland, Grampian, Dumfries and Galloway and the Borders, where the same mass movement does not occur. Faced with a low density of traffic, it is unlikely that such services would prove to be profitable. However, it would be possible for such services to be provided by operators in receipt of some subsidy.

These proposals must be judged against the status quo and what is likely to occur if the present railway policy persists. Current policy does not augur well for Scottish railway services. Two alternatives for Scottish railways present themselves, on the basis of past and existing policies towards BR. On the one hand, there might be a drastic (or, possibly, a piecemeal) reduction in the size of the railways. This has happened over the past 20 years and the existing route network cannot be taken for granted. The most extreme of the options in the Serpell Report (in which Scottish railway services were limited to Carlisle-Carstairs-Edinburgh-Glasgow) appear unlikely to be implemented. However, on the basis of past behaviour, decisions on the future of the rail network will be on financial grounds. Dependent on the depth of the financial crisis confronting the government of the day, the Glasgow/Oban/Fort William/Mallaig; the Inverness/Kyle of Lochalsh, the Inverness/Thurso/Wick and the Aberdeen/Elgin/Inverness lines would be in greatest jeopardy from closure.

On the other hand, BR might just doggedly stick to ever-tightening financial constraints and survive. In this case, on the face of it, there might be no substantive differences from the railways of today. However, the major difference is likely to be in the quality of service with older, slower locomotives losing out in the competition for passengers with an ever-more comprehensive road system which is seen as a free good by its users. Indeed, this is most likely to occur in

those lightly-used rural services mentioned above, where there is much single track which makes railway services doubly vulnerable to the lack of punctuality (and concomitant loss of customer confidence) caused by delays and breakdowns of older locomotives.

As an alternative to this slow decline, the proposed segregation of operating services and infrastructure would bring the following benefits:

- (1) An improvement in the planning and co-ordination of major expenditures on road/rail infrastructure.
- (2) A closer relationship between the operating companies and consumers, with the likelihood of increased operating efficiency and improved quality of service. In addition, in those rural areas where competition is least in evidence, greater co-operation over the co-ordination of transport services between all modes would be promoted.
- (3) In an industry facing a severe shortage of capital, a particular benefit would be the possible injection of additional, private funds into the provision of modern rolling stock by private railway operating companies.

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