Why the system of rail privatisation in the UK has been a disaster

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Michael Moran*, one of the authors of a report on the system of rail privatisation in the UK, discusses its findings. Some important issues he raises are the manipulation of the licensing system so that public subsidies are essentially paid out to shareholders as dividends and Network Rail's large and unsustainable debt, which has negative consequences for physical infrastructure and likely means that rail will one day have to be bailed out by the public. The core issue is the longstanding problem that rail cannot operate without some £10 billion of (direct and indirect) public subsidy because passenger income is insufficient to cover costs. Capturing the externalities of public transport lines on land and property values via taxation is a potential policy solution to the broken business model but is politically difficult and actively opposed by well organised lobbying efforts.*

A troublemaking report from the Centre for Research in Socio-Cultural Change (CRESC) has been upsetting the powerful again. *The Great Train Robbery: rail privatisation and after* has a great deal to say about the business models that now underpin the disastrous system of rail privatisation in the UK, but it also reveals a pattern that will particularly interest the readers of a *politics* blog. It shows that the initial vision offered by privatisers of a transparent and democratically accountable set of privatised markets has turned out, in reality, to be something very different: the politics of rail privatisation involves backstairs lobbying, manipulation of the terms of public debate by well resourced private interests and a blurring of the divide between the public and the private.

Some of the problems of the privatised rail system are well known. Perhaps best known is the systematic gaming of the train operating franchise system. Franchisees – as in the catastrophic case of the East Coast Line – can walk away from the franchise without serious penalties when the ludicrously unreal projections that won the contract in the first place turned out to be fantasies. Less known, and systematically documented in the CRESC report, is the extent to which the train operators have been able to manipulate the licensing system so that they effectively pay dividends to shareholders from direct public subsidy; between 1997 and 2012 on the West Coast Mainline, Virgin Trains paid out a total of £500 million in dividends and received a direct subsidy of £2.5 billion.

(Credit: Bob Jenkins)

Worse still, the report highlights the large, hidden and indirect subsidies to train operating companies which have completely wrecked the balance sheet of the quasi-public Network Rail company that provides infrastructure. Train operating company profits are politically constructed through a hidden subsidy of low track access charges levied by Network Rail. These have fallen from £3.2 billion at the start of privatisation to £1.6 billion today, despite the increased demands on the infrastructure made by increased train and passenger numbers: in the age of privatisation the state is keeping the trains running.

The end result is a shocking and largely undiscussed increase in public liabilities. Network Rail (NR) is not only failing to recoup the real cost of operating the infrastructure but also spending an extra £5 billion a year on capital investment in improving the network. This is largely financed by issuing private bonds which are publicly guaranteed. Network Rail's position is increasingly unsustainable because it is burdened with huge debts. The cost of servicing that debt is now greater than spending on track maintenance: in 2003 NR spent more than £1.5 billion on maintenance and £256 million on debt interest; in 2012 NR spent £968 million on maintenance and over £1.5 billion on debt interest. The financial consequences for the taxpayer are considerable because repayment of principal is publicly guaranteed and Network Rail has an accumulated debt which now stands at £30 billion. The consequences of this kind of financial regime for the physical infrastructure, on which the promise of an efficient rail system crucially rests, are economically catastrophic. The consequences of the accumulated debt burden for the public purse are equally politically dire because rail is going to need a bailout.

At the *economic* root of this lies a long standing problem about the business model of recovering costs by charging passengers: rail cannot operate without some £10 billion of (direct and indirect) public subsidy because passenger income, even with some of the highest fares in Europe, cannot cover costs. Indeed the importance of passenger revenue has declined under privatisation: in the last ten years of British Rail passenger income averaged just over 64 per cent of total revenue whilst under privatisation's first ten years it averaged just over 55 per cent. That explains also why the privatised system is more heavily subsidised than was British Rail.

The predatory profits of the Train Operating Companies are a problem, but they are not the most serious part of the problem. Demonising dividends and value extraction by operators like Richard Branson certainly fixes on a problem with the politics of the privatised system. But it is akin to the demonization of individual bankers after the financial crash: it fails to fix on the fundamental faults of the system. The biggest fault is the determination, under the privatised system, to operate a for profit rail network with not enough money in the fare box; and behind that, the business model of charging users which does not capture social functions and external benefits like land and property values. A simple example which anyone can verify from their own experience is the way investment in new public transport lines can transform house prices of property with access to those lines. For instance, the investment in Crossrail, which cost £16 billion, is projected to boost property values within one kilometre of the project by £5.5 billion.

Any attempt to reshape rail policy so as to capture these externalities – for instance via property taxation – will be politically explosive. More insidiously, the whole well organised constellation of interests created by rail privatisation now operates a smoothly oiled lobby so that the Train Operating Companies now define the agenda of reform; that suits them but is not in the public interest. The Association of Train Operating Companies creates a distinctive public narrative: each successive inquiry into the malfunctioning of the system (such as that into the West Coast franchising renewal fiasco) is told as a story of minor glitches in a fundamentally well-functioning machine where the first priority is to get the franchising system back on track. The problem of Network Rail's debt and the inadequacy of the business model do not figure in public discussion.

At the dawn of privatisation we were promised not only a new business model, but also a new political model: one where backstairs manipulation of policy (for instance by Ministers) would be replaced by the transparency of open contractual competition and public regulation. Instead we have a mixture of crony capitalism, a world populated by well paid lobbyists and well networked insiders, and smoke and mirrors accounting which makes it impossible for normal citizens to penetrate what is going on. In this sense, rail privatisation has indeed proved a model; a model of how things are now done in the post-privatisation state in Britain.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

About the Author

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