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An illusion of success: The consequences of British rail privatisation

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ABSTRACT

This article accounts for the British experiment with rail privatisation and how it has worked out economically and politically. The focus is not simply on profitability and public subsidy, but on the appearances which accounting arrangements create. The article scrutinises the Network Rail subsidy regime, which enables train operators to achieve fictitious profitability without increased direct state support. This enables supporters of privatisation to claim train operators produce a net gain for the British taxpayer. The claim forms the heart of a trade narrative which is employed by the industry and their political backers to deflect criticism and stymy reform.

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1. Introduction

This article accounts for the British experiment with rail privatisation and how it has worked out economically and politically. The objective is to create a more complex analysis of the consequences of rail privatisation which focuses not simply on levels of profitability and public subsidy within the rail system, but on the appearances which these financial arrangements create, and their political consequences. The starting point for this analysis is a paradox between stories of brilliant success achieved by private train operating companies (TOCs), and a financial backdrop of accumulating public liabilities and complex state subsidy arrangements.

Twenty years after the Railways Act of 1993 which dismantled the integrated state monopoly, British Rail, the political sponsors of the privatised system are able to make confident claims about successes achieved. The Conservative Party Transport Minister Patrick McGloughlin, celebrated the twentieth anniversary of the founding of the Association of Train Operating Companies (ATOC) – the trade association established by private passenger train operators in 1993 – in July 2013 with a speech which heralded “20 years of rising investment [and] 20 years of extraordinary growth on our railway”:

> And think back to where we started. As a junior transport minister in the 1980s, I remember British Rail. Underinvestment in tracks and trains. Poor reliability. Managers whose good ideas were too often stifled by a lack of cash . . . And an ageing network in a declining industry. John Major – then the Prime Minister – knew things could be better. So tonight, I’d like to pay tribute to the people who got it right. And those who over the past 20 years have made it

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> happen. Let me start with some facts. For most of the time since the Second World War rail traffic has been falling. Since privatisation, journeys have doubled. The network is roughly the same size as 15 years ago. But there are 4000 more services a day . . . This is the success of privatisation. I could go on reading out figures (Department for Transport, 2013).

The rhetorical approach employed by ATOC is identical: highlighting past failures allegedly brought about by state mismanagement and under-financing, while using a barrage of statistics to demonstrate “the unprecedented growth and stunning improvements” since privatisation (ATOC, 2013). Particular emphasis is placed on passenger journey numbers, which have risen at a rate of just under 4% per-year from 1997 to 2012. This compares favourably to a 60 year average of 0.58% and is well ahead of passenger growth figures achieved in France, Germany and the Netherlands (Ibid, p. 16–20). These claims constitute a form of “imaginary” – a discursive construction of what a successful privatised rail system should look like – that forms the core of the rail sector’s trade narrative.

Attempts to actively manage perceptions about a company, a sector or a national economy have assumed an increasing prominence in recent decades and coincided with an increased academic focus on the role of economic discourse and narrative in shaping economic life (Miller & Rose, 1990; Callon, 1998; Froud, Johal, Leaver, & Williams, 2006). Within this field of study, trade narratives are not a technical language of expertise but simple and easily repeatable stories created by industry associations and lobbying groups, which differ across sectors but share common devices. Trade narratives serve to defend sectoral interests without appearing to favour the interests of particular companies. They do so through strong selective emphasis on positive attributes while occluding or explaining away negatives (Bowman et al., 2013a, p. 6). When successful, trade narratives ventriloquise journalists and front-bench politicians, creating an echo-chamber where decontextualised statistics and supportive assertions repeat themselves to frame public debate. Perhaps the most prominent case in British public life of trade narrative in practise has been the financial services industry. Lobbyists for and supporters of London finance in the pre-crisis period pushed a narrative which explained the beneficence of financial innovation and the need for light touch regulation which was endlessly repeated and politically endorsed. In the post-crisis period the City’s trade narrative switched to emphasise its tax and employment contribution in order to ward off reform (Froud, Nilsson, Moran, & Williams, 2012). In the case of rail, the trade narrative has attempted to counteract criticisms of privatisation through selective emphasis of specific performance metrics which endorse claims of success, specifically rising passenger numbers, falling direct public subsidy and slim net profit margins (Bowman et al., 2013a). However, if the framing of economic data is the process by which a trade narrative is corroborated, it is also the area in which it is vulnerable and can be undermined by events.

In case of rail, the trade narrative is particularly vulnerable because while data on passenger numbers supports one story of success delivered by private enterprise, the accounts of Network Rail – the company responsible for railway infrastructure after the collapse of Railtrack PLC in 2001 – tell a different story about state subvention for the railway system on an even greater scale than under British Rail. McGloughlin’s speech and ATOC’s flagship report released the same month (ATOC, 2013) do not mention the significant growth in the debt burden shouldered by Network Rail to fund infrastructure improvements – from just under £9636m in 2002/2003 (Network Rail’s first full year of operations), to £30,358m as of March 2012 (Network Rail, 2003, 2013). Over this period, the annual cost of interest payments on this debt financing increased almost seven fold to just under £1.4bn in 2012, surpassing spending on track maintenance which fell below £1bn that same year (Ibid, Network Rail, 2012).

While nominally a ‘private’ company Network Rail’s financial viability has depended on government guarantees to underwrite its bonds. This had the impact of reducing borrowing costs because Network Rail was essentially able to borrow at a risk free rate with Government guarantees. Moreover, alongside the group of companies that make up Britain’s privatised rail transportation system, Network Rail has also received significant additional state subsidies (Ibid, Jupe, 2009). In recognition of this, the Office for National Statistics (ONS) issued an announcement in December 2013 stating that Network Rail would be reclassified as a “Central Government body”. This has the effect of bringing over £30bn of additional debt onto the government balance sheet (Joloza, 2013). The ONS’s decision was required to bring the UK’s national accounting systems in line with the rest of Europe. However, the implications for the UK rail sector are profound, raising questions about whether the rail system can be considered privatised in any meaningful sense. Indeed, in April 2014, the Debt Management Office – the Treasury agency responsible for managing cash and debt on behalf of the UK government – went a step further. It announced that: “Government has now determined that, in future, value for money for the taxpayer will best be secured by Network Rail borrowing directly from the Government, rather than by Network Rail issuing debt in its own name” (Debt Management Office, 2014, p. 1). This effectively ended direct private sector involvement in financing Britain’s rail infrastructure.

This article questions what is going on here economically and politically. From an economic and financial perspective, much appears to have gone wrong with rail privatisation. However, the political narratives from the sector and senior politicians are about privatisation working well and delivering on its promises. This article employs accounting numbers to critique the political rhetoric surrounding the privatisation of Britain’s railways. To begin with, the article argues, it is necessary to understand that rail privatisation, is a mess born out of efforts to relieve long-term problems with cost recovery and under-funding. As the subsequent analysis explains, this economic confusion also has political consequences.

The first section of the article takes a historical perspective on railway finances under nationalised and private ownership, highlighting, in Gourvish’s terms (2002, p. 2), the “deep-seated confusion about what the railways were actually supposed to achieve in a mixed economy”. Privatisation in the early 1990s was intended to secure financial sustainability through private

investment and increased operating efficiency, but the reforms ignored historical problems with a capital intensive industry where passenger fare revenue was rarely sufficient to recover the costs of investment (Shaoul, 2007). The second section of the article shows that this contradiction was played out through the financing of rail infrastructure. After the 2001 financial collapse of Railtrack, the PLC responsible for rail infrastructure from privatisation in 1994, Network Rail, its successor, was established to increase state-supported infrastructure while maintaining private ownership (Whitehouse, 2003; Jupe, 2009a). An outcome of the hurried policy making process leading to the establishment of Network Rail was a re-worked subsidy system that has enabled train operating companies (TOCs), which run passenger franchise services allocated through competitive bidding processes, to achieve fictitious profitability without increased direct state subsidy. The increased public subsidy channelled through Network Rail enabled track access charges (TACs) (the single major operating revenue source for Railtrack and Network Rail, paid by the TOCs) to be lowered alongside a massive programme of upgrades and maintenance.

Several other studies have noted the extent to which profit-making in the UK's privatised rail system has been dependent on various forms of public subsidy (e.g. Jupe, 2009; Shaoul, 2006; Stittle, 2002; Taylor & Slomann, 2012). This paper attempts to build on these studies in the third section first by presenting additional data which demonstrates the heavy indirect subsidy to the TOCs via Network Rail, and secondly by developing a new line of analysis on the significance of these funding flows for the politics of privatised rail—specifically, that they facilitate a trade narrative about operating successes and allow supporters of rail privatisation to claim that TOCs produce a net gain for the taxpayer. As the final section of the paper argues, the trade narrative is lent credibility and support by senior politicians because the backers of rail privatisation are co-dependent upon the train operators in upholding the appearance of success delivered by private enterprise.

2. The contradictions of rail privatisation: Promises and historical realities

Since the birth of the British railway network in the UK in the mid-19th century, matters of access, ownership, and standards have been a source of recurring controversy, but the underlying driver of periodic reform over the past 50 has been the issue of costs: how to meet the expense of a capital intensive industry which produces diffuse social and economic benefits, but cannot recover costs from passengers without pricing much of the population off the railways. The logic of nationalisation in 1945 was that British Rail, as with other strategic nationalised industries, would provide a cheap service for the rest of the productive economy, with operating losses tolerated because profit was not a privileged indicator of performance.

This logic never sat easily with the Treasury. After having peaked in 1952, post-war rail operating surpluses vanished (Loft, 2001, pp. 72–73). In 1956, the new Transport Minister, Harold Watkinson, in sympathy with the Treasury view, pledged to 'turn the railways away from being just another nationalised industry into an organisation that functions on normal and sensible business lines' (Ibid, p. 76). The 1961 White Paper, *The Economic and Financial Obligations of the Nationalised Industries*, introduced financial targets for state owned enterprises (Chick, 2002, p. 135–137), and within this frame railways were not a utility providing cheap services but an uneconomic industry charging artificial prices (Loft, 2001, p. 86). The Beeching cuts of 1963–5 closed 2363 stations and 266 services – roughly one third of the rail network – and were a drastic attempt to shape the rail network around cost recovery and reduced losses. As Beeching's report, *The Reshaping of British Railways*, stated:

> The railways emerged from the war at a fairly high level of activity, but in a poor physical state. They were able to pay their way, because road transport facilities were still limited, and they continued to do so until 1952. From then onwards, however, the surplus on operating account declined progressively. After 1953 it became too small to meet capital charges, after 1955 it disappeared, and by I960 the annual loss on operating account had risen to £67m (British Railways Board, 1963, p. 3).

British Rail's losses proved a stubborn problem because successive governments' promotion of motorways cut passenger numbers and increased British rail deficits in the early 1970s. The 1974 Railways Act imposed targets aimed at stabilising state subsidy while restricting external financing (Gourvish, 1990, pp. 120–121). A further White Paper on the Nationalised Industries in 1978 paved the way for stricter financial targets and more complex performance indicators, producing what Peter Parker, then British Rail chairman, described as a state of 'perpetual audit' (Gourvish, 2002, p. 44). These successive reform efforts obscured what Gourvish (2002) describes as:

> . . . [D]eep-seated confusion about what the railways were actually supposed to achieve in a mixed economy . . . from the beginning the politicians attempted to produce an entity which could combine public service aspirations and commercial viability, but after 25 years' experience this search was something of a Holy Grail. (Gourvish, 2002, p. 2)

The Thatcher government intensified commercial pressures. Targets for subsidy reductions amounted in real terms to a 25% cut between 1983 and 1986 (Ibid, p. 122). However, in a period of strong economic growth in the mid-1980s, all three passenger businesses increased their incomes, with an aggregate growth in real passenger income of 36% between 1983 and 1989 (Gourvish, 1990, p. 130). By the early 1990s the network was investment-starved but effective at controlling costs. In 1989, British Rail was recorded as being 40% more efficient than eight comparable rail systems in Europe used as benchmarks, whereas in 1979, it was no more than 14% more efficient (Ibid: 149).

In the hurry to implement privatisation in the 1990s, the government did not acknowledge the railways' long-term problems about recovering costs from fares. The 1993 Railways Act introduced a disintegrated, tripartite structure: a stock

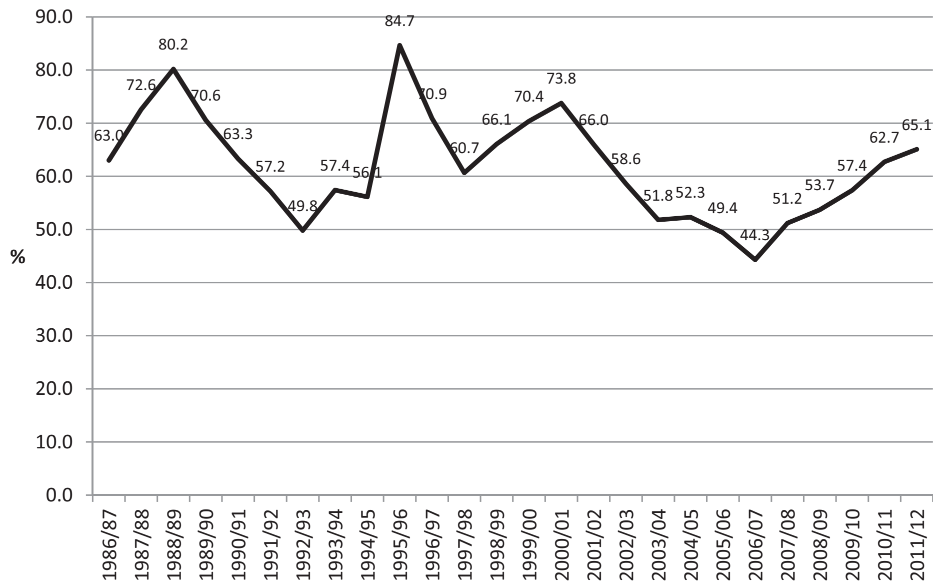

Fig. 1. *Passenger revenue as a percentage of total rail system revenue.* Sources: Office for Rail regulator (ORR) and SN/SG/617, House of Commons Note: Total passenger rail fares as a share of total revenues received.

market listed PLC (Railtrack) responsible for infrastructure, train operating companies (TOCs) bidding for franchises to run passenger services, with rolling stock (engines and carriages) leased from rolling stock operating companies (ROSCOs). The July 1992 White Paper, *New Opportunities for the Railways*, justified the system with a series of assumptions and promises which still form the basis for the imaginary of successful rail privatisation (Secretary of State for Transport, 1992). Alongside expectations of 'less scope and justification for government involvement'; 'Clear and enforceable quality standards'; 'greater opportunities to cut out waste and otherwise reduce costs, without sacrificing quality', the principle claim was that privatised railways would attract large-scale private investment, allowing modernisation of a kind which British Rail could never manage (Ibid). As Shaoul (2007) noted, this imaginary ignored the:

> . . . [P]articular circumstances of a capital intensive industry such as the railways. The source of the problem was not simply competition, regulation or its lack, but more importantly the insufficient surplus created by the industry relative to the amount of capital invested in the industry, to meet all the claims consequent upon privatization. (Shaoul, 2007, p. 211)

The Prime Minister at the time, John Major, did not discuss rail privatisation in his autobiography but when asked in 2008 to justify the policy his only positive argument was that rail privatisation would draw in investment because 'in the future – as in the past – no Government would ever provide the railways with adequate funding' (: Loc: 6594). Such expectations have proven misguided. Public funding did not disappear, but rather increased to be consistently higher in real terms in the 2000s than in the decade before privatisation, from £3718m in 1992/1993 to nearly £7415m in 2006/2007 (Appendix A). Fig. 1 also provides a long term view on the percentage of total rail system revenue accounted for by passenger revenue—that is, the revenue earned from the rail companies from their operating activities. In the 25 years covered by the available data, it is significant to note that passenger revenue never accounted for more than 85% of total rail revenue (Appendix A) and averaged just 60 percent of total income during this period (see Table 1).

The British rail network has never at any point in recent history managed to cover its costs from passenger fares. Government in recent years has reportedly set a target of recovering 75% of costs from passengers, a figure achieved only once since privatisation (BBC, 2013). Ticket prices under both public and private ownership have been subject to regulation in an effort to balance public accessibility with financial objectives, and bringing fare revenues in line with costs would risk

Table 1
Real passenger revenues and government grants.

Years	Total passenger revenue £bn	Total state support to the rail industry inc PTE grants (excluding freight) £bn	Total passenger revenue and total state grants £bn	Passenger revenue as a share of passenger revenue and total state grants %
1986 to 2012	125	85	209	60

Sources: ORR and SN/SG/617, House of Commons. *Notes:* Subsidy: 2001/02–2003/2004 includes £3.520bn government grants directly to Railtrack/Network Rail and London & Continental Railways. Including non-franchised passenger revenue (£36.7 in 2009/2010 and £45.5 in 2010/2011) Passenger revenue includes all ticket revenue.

jeopardising the former objective. Under public ownership, this gap between passenger revenue and total revenue indicated management failure. Under private ownership the matter has been more complex. While the privatised rail system has generated a number of profitable positions for companies within it, this has ultimately relied upon the cost of infrastructure being passed to the state.

2.1. Reconfiguring rail subsidies: Railtrack, Network Rail and 'Fixing the Finances'

The problems with cost recovery and infrastructure financing under privatisation have been met with a series of bodges and fixes relating to the flow of state subsidy around the rail system. The original 1992 White Paper on rail privatisation recommended rail infrastructure should remain publicly owned because there was no historical record of profitability. However, the expectation was that private sector management expertise coupled with capital market disciplines could financially transform some aspects of the rail system, and the decision was made to privatise Railtrack, which was formed in April 1994 and floated two years later in May 1996. Railtrack's source of income was the Track Access Charges (TACs) levied on the TOCs. These were set by the Office of the Rail Regulator (reformed and renamed as the Office of Rail Regulation from July 2004) for five year Control Periods. The charges were determined by the Regulator to cover operating costs, subject to efficiency savings, current cost depreciation, and provide a stable return on capital over a Regulated Asset Base sufficient to persuade shareholders of the merits of new investment (Stittle, 2002, pp. 150–151; Jupe, 2009, p. 183). Prior to 2000, it was expected that TACs would enable Railtrack to run without a public subsidy. However, TOCs were not able to meet the cost of the charges through passenger revenues, and so they were underwritten by state support which peaked at £2.5bn in 1997 (the first full year under a fully privatised system), but remained over £1bn by 2001 (see Appendix B). This direct subsidy for the TOCs was also therefore an indirect subsidy for Railtrack, which was able to distribute regular dividends to shareholders through the 1990s (Jupe, 2007, p. 149). Indeed, during Railtrack's existence between 1994/1995 and 2001/2002, subsidies to the TOCs averaged 92% of the value of Railtrack's TAC revenue (Appendix B). After 2000, the regulator added direct subsidies to Railtrack's revenue mix (Crompton & Jupe, 2007, p. 911).

The flaws in the Railtrack business model were exposed by a succession of fatal rail accidents at Southall in 1997, Ladbroke Grove in 1999, Hatfield in 2000, and Potter's Bar in 2002. Subsequent official inquiries exposed serious underinvestment in track and signalling, and an aggressive outsourcing strategy which raised the real-terms costs of new investment projects to 2–3 times the levels paid by British Rail (National Audit Office, 2000; Crompton & Jupe, 2007, p. 910; Jupe, 2007, p. 150). The complexity created by these outsourcing arrangements, the absence of a British Rail-style asset register, and the loss of experienced senior staff in the cost-cutting drive, meant Railtrack was unable to provide concrete assurances over the safety of the rail network. Reduced speed limits were imposed around the country, incurring fines for Railtrack as compensation to TOCs, pushing passengers to other forms of transport and causing an industry-wide financial crisis (Crompton & Jupe, 2007, p. 914; Jupe, 2007, p. 150). Combined with recognition of the scale of spending required to replace and renew infrastructure, these financial strains led government to intervene. The sharp rise in state subsidy from 2001 in Fig. 1 reflects the extent to which the state took on responsibility for funding the urgent infrastructure track and replacements. In 2001, its final full year of operation, Railtrack secured a £1.5bn government grant and proposed paying shareholders £138m in dividends while making a pre-tax loss of £534m (Railtrack Group PLC, 2001).

The New Labour government decided in late 2001, after further requests from Railtrack for financial support, that fundamental reform was required. However, it shied away from its pre-1997 election promise to renationalise the railways. Having put Railtrack into administration in October 2001, it instead took a Third Way-inspired decision to create, in October 2002, a new "not-for-dividend" infrastructure company, Network Rail (Whitehouse, 2003). In legal terms, the company was private and 'owned' by members (drawn from industry and other stakeholder organisations) who were intended to act like shareholders (Jupe, 2007, p. 253). However, government could appoint a director, and exert control through regulation, with the Office for Rail Regulation (ORR's) targets for Control Periods agreed by the Transport Minister, and financial support (Ibid, p. 254). Rather than sourcing capital from equity markets, Network Rail was to issue bonds with repayment guaranteed by the Treasury, making its financing costs similar to those of gilt yields. Despite this arrangement its debt appeared, until 2014, as a private sector liability rather than in the public sector debt figures in the national accounts. The ONS initially accepted the argument that it was a contingent liability for government that was unlikely to be called (Crompton & Jupe, 2007, p. 914). The matter caused considerable disagreement though, with the National Audit Office arguing the debt should be formally considered a public liability (McCartney & Stittle, 2006, p. 149).

The formation of Network Rail brought with it increased commitments for public funding of the railways. As the ORR explained (2003, p. 7):

> . . . the Regulator has concluded that it is appropriate to allow for Network Rail to spend significantly more than he allowed Railtrack in his October 2000 access charges review, because this will enable Network Rail safely and effectively to tackle the legacy it inherited from Railtrack: a legacy of poor planning and project delivery; inadequate arrangements for managing suppliers and subcontractors; inadequate levels of maintenance and renewal activity; poor customer focus; and an insufficient grasp of the causes of and cures for poor day-to-day performance.

In 2004 the ORR sanctioned a rise of 50% in funding for the 2004–2009 control period (Jupe, 2009, p. 194). Alongside the debt guarantee, which lowered borrowing costs and enabled a rapid expansion in balance sheet capitalisation, the growth in Network Rail spending was further inflated by the commencement of major annual grants to Network Rail (see Fig. 2).

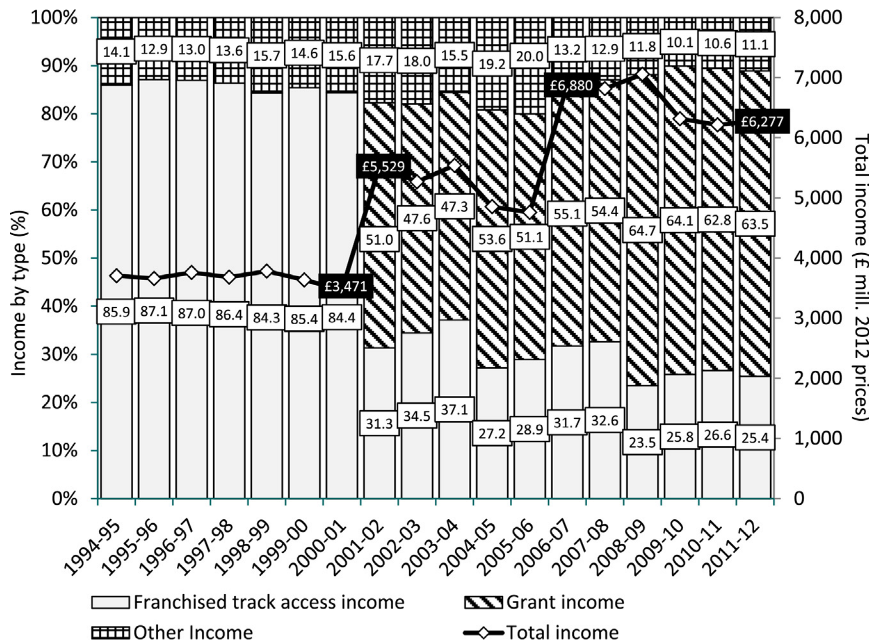

Fig. 2. *Railtrack and Network Rail share of income by type 1994–2012.* Source: Railtrack and Network Rail annual report and accounts, various years. Notes: Grants includes deferred grants and incentive adjustments.

These grants were made all the more important by the fact that, in real terms, income from regulated TACs fell in the years after the establishment of Network Rail, despite a growth in passenger kilometres travelled (see Appendix C). Academic discussion of Network Rail has focused on the quantitative impact of this policy decision on railway financing leading, as it did, to major increases in public rail expenditure. Equally significant, this paper argues, is the impact it had on perceptions of railway financing and the role of public subsidy thereof. In rerouting the bulk of direct subsidy away from the TOCs and into Network Rail, while reducing the burden of TACs, the appearance of railway financials was radically altered. While grants to the TOCs pre-2001 had formed a vital indirect subsidy for Railtrack profits, post-2002 this situation was reversed so that government grants to Network Rail became an indirect subsidy for the TOCs. Essentially, this fix allowed the private sector TOCs to appear more profitable and less burdensome to the taxpayer.

This financial arrangement in turn enabled the TOCs to construct narratives extolling the benefits of rail privatisation and reinforcing claims laid out in the 1992 White Paper. The argument of this paper is therefore that the TOCs have capitalised on a series of haphazard accounting fixes that have inadvertently served a political rhetoric. The tilt towards a heavier reliance on the Network Grant and publicly-guaranteed debt, and a lesser reliance on TACs, was the outcome of a process which began with the Rail Regulator's 2000 Periodic Review, and ended with the subsequent implementation of a new charging regime from 2004. The proposals created by Network Rail and the ORR in 2003 at the end of the Periodic Review's consultation process recommended scaling down government subsidies and substantially raising TACs. As set out in Table 2, track access charge revenue under the proposals would rise to £4.1 billion as other grants were discontinued, becoming the sole source of revenue for Network Rail as was originally intended for Railtrack (ORR, 2003a). The target of £3164m from TACs in 2004/2005 was more than double the £1256 achieved in 2001/2002 and £1356 in 2002/2003.

These targets were the outcome of 15 months of analysis and consultation, but 10 days before the ORR was due to publish them, the Department for Transport informed them that 'for accounting reasons it would be desirable for the Strategic Rail Authority (SRA) [the non-departmental planning and regulatory agency established by the Transport Act 2000 and abolished in 2005] in future to increase the amount of money that it pays in grant to Network Rail allowing access charges to be set at a lower level' (ORR, 2003a, p. 11). The accounting rationale was complex. TOCs could claim support from the SRA to pay

Table 2
Proposed Network Rail revenue profile (£m).

	Expected track access charges (TAC) revenue £m	Grants from the Strategic Rail Authority (SRA) £m	Total Network Rail revenue £m
2004/2005	3164	1279	4443
2005/2006	3759	652	4411
2006/2007	3690	552	4242
2007/2008	4199	0	4199
2008/2009	4137	0	4137

Source: ORR.

for increases in TACs introduced at new five year control periods that were not in their franchise agreements. However, the SRA preferred to pay grants to Network Rail rather than the TOCs, as the ORR explained:

> [T]he DfT and the SRA explained that allowing the SRA to pay more directly to Network Rail in grant would reduce the pressure on the SRA's overall franchise support budget at a time when the cost to the SRA of subsidies paid to franchise holders had already risen sharply and was likely to cause the SRA to incur expenditure beyond that which has been allocated to it (Ibid, p. 11).

The other reason given for channelling public funding through Network Rail was that it would be counted as capital rather than current expenditure, a key consideration given then-Chancellor Gordon Brown's professed focus on fiscal prudence as a central plank of economic policy (Brown, 2001). As the ORR explained:

> The accounting rules that governments throughout the European Union must adhere to, do not allow grants to the private sector to be accounted for as capital formation, unless paid directly to the private sector entity undertaking the capital formation. Therefore, such grants cannot be routed through the TOCs (ORR, 2008, p. 328).

The then-transport secretary Alistair Darling argued to the House of Commons that the government's fiscal rules prohibited it from borrowing to fund current expenditure, which it would be doing if it gave subsidies to the TOCs to cover higher TACs. The solution was to ensure subsidy to Network Rail did not exceed its capital investment (renewals and enhancements), while its income from sales (TACs) needed to cover 50% of its production costs (operations and maintenance, plus depreciation) (ORR, 2003b). Capital grants to Network Rail would thereby not be recorded as current expenditure by the ONS (House of Commons, 2003, 122–124). Fig. 2 displays the financial outcomes of the transition from Railtrack to Network Rail. Whereas the former had been 85% financed by TACs, Network Rail has received only around one quarter to one third of its income from this source. The balance comes principally from government grants, which in 2011/12 amounted to nearly £4bn.

3. Fixing profits and managing appearances

McCartney and Stittle (2006, p. 150) conclude over the creation of Network Rail, "The suspicion must be that the unusual, if not unique structure of Network Rail is a result, not only of some idée fixe about the political implications of extending state ownership but also concern for the economic reporting implications." Politically sponsored reforms coupled with opportunistic accounting enabled a dramatic growth in debt financing for rail infrastructure without a commensurate increase in reported government indebtedness. This all came to an end with the ONS's 2013 decision to bring Network Rail debt onto the public sector balance sheet (Joloza, 2013; Debt Management Office, 2014). However, as this section argues, Network Rail has continuing political relevance in altering the financial appearance of privatised rail in a manner which supports the trade narratives of TOCs. This is done by artificially inflating TOC profits in a manner which enables them to make larger franchise payments back to the taxpayer. This, in turn, provides the TOCs with an important rhetorical opportunity not only in terms of defending their profitable niche within a loss-making industry but also in maintaining the imaginary of privatisation among political backers of the policy.

As mentioned, a key promise of rail privatisation was the elimination of public subsidy followed by a net gain for the taxpayer in the form of franchise payments levied on the TOCs a state that was expected to be achieved by 2005/2006 (Shaoul, 2006, p. 152; Jupe, 2009, p. 188). Under the Network Rail regime, TACs were lowered as passenger journeys increased and ticket prices rose above the rate of inflation. This improved the fortunes of the TOCs to the extent that the Department for Transport became a net beneficiary of rail franchising in 2011/2012. As Fig. 3 shows, net subsidy to TOCs transformed from over £1bn at the formation of Network Rail in 2001/2002 to a small net gain for government from 2011 onwards as franchise payments made by TOCs exceeded direct subsidies. This has however coincided with large increase in direct state subsidy for the infrastructure company. Thus, while subsidy to the TOCs as a percentage of passenger revenue has fallen the direct subsidy to Network Rail has remained equal to around 50% of passenger revenue (see also Appendix B).

During the first decade of Network Rail's existence, passenger kilometres travelled increased by some 43%, while passenger fare revenue for the TOCs increased by 48%; meanwhile, Network Rail's revenue from TACs, adjusted for inflation, declined 12% from £1.8bn to £1.6bn. The effects of this system of indirect subsidy on the financial performance of individual TOCs is illustrated by figures released by the Department for Transport (2012) shown in Table 3. Excluding the effects of the Network Grant to Network Rail, only eight of 18 franchises received a net direct subsidy during the year whereby subsidies exceeded franchise premium payments. However, when including the Network Grant for the 16 franchises for which the DfT lists the value in pence per mile[1], 15 are net recipients of government subsidy.

The levels of state support for the TOCs are however greater than they appear in Table 3 because alongside the Network Grant, Network Rail has augmented its operating income by issuing bonds in the capital market with government guarantees. The result, in terms of capital structure, was a major shift towards debt financing. Railtrack was never less than 50% equity financed because it could not issue large amounts of investment grade paper. Network Rail however has been nearly 80%

[1] Arrival Trains Wales and First Scotrail fall under the jurisdiction of the Scottish and Welsh devolved governments.

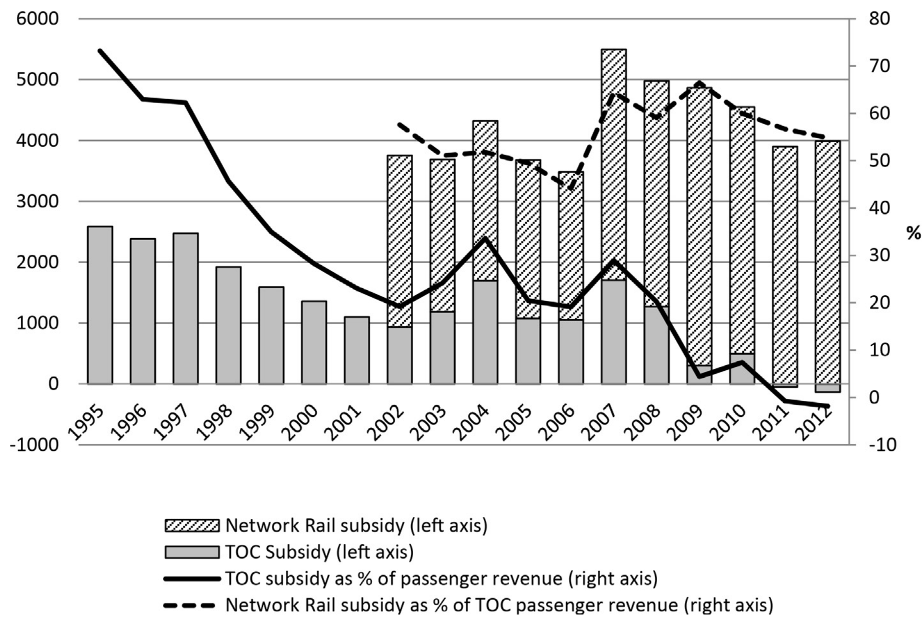

Fig. 3. *Network Rail and TOC subsidy, 1995–2012*. Source: ORR, Network Rail Annual Reports and Accounts. Notes: Network Rail subsidy includes grants deferred grants and incentive adjustments. Subsidy to TOCs includes grants, franchise payments and performance receipts.

Table 3
Government direct and indirect subsidy for current UK rail franchises 2011/2012.

	Net franchise payments Pence per mile	Net revenue support Pence per mile	Total direct government subsidy to TOCs Pence per mile	Indirect government subsidy via Network Rail grants Pence per mile	Total direct and indirect government subsidy[a] Pence per mile
Arriva Trains Wales	n/a	n/a	19	n/a	n/a
C2C	−2	0	−2	7	5
Chiltern Railways	1	0	1	12.4	13.5
CrossCountry	−0.6	0.9	0.3	14.7	15
East Coast	−6.2	0	−6.2	6.6	0.5
East Midlands Trains	−4.8	1.9	−3	13.7	10.8
First Capital Connect	−9.1	1.5	−7.6	5.4	−2.2
First Great Western	−8.8	5.8	−3	8.8	5.8
First Scotrail	n/a	n/a	18	n/a	n/a
First TransPennine Express	8	0	8	12.1	20.1
Greater Anglia	−4.2	0	−4.2	8.1	3.9
London Midland	5	0	5	10.7	15.8
National Express East Anglia	−5.3	1.8	−3.5	8.6	5.1
Northern Rail	8.2	−0.9	7.3	27.6	34.9
Southeastern	1.5	1.9	3.4	9.7	13
Southern	−0.6	0	−0.6	7	6.4
South West Trains	−8.8	2.4	−6.4	7.4	0.9
Virgin Trains	−5.7	1.2	−4.5	8.1	3.6

Source: DfT/ORR.
[a] *Notes:* Direct subsidy' relates to payments made directly to the TOCS, calculated from the company annual report and accounts and ORR data. 'Indirect subsidy' includes the effects of the government's Network Grant to Network Rail, which enables the company to charge lower track access charges to the TOCs.

debt financed in recent years, increasing its debt to over £30bn in the space of a decade, consisting mainly of recently issued long-term debt[2]. This heavy reliance on debt financing will continue as Network Rail implements a planned £38 billion of capital investment over the next five years (Department for Transport, 2014). While easing the financial stress on the TOCs, the result of this debt burden is that the rail system as a whole acquired a new stakeholder with financial claims that must be prioritised above cash used for internal re-investment. In 2003–2004, Network Rail's spending on track maintenance was, at £1.5bn (adjusted for inflation) roughly four times larger than interest paid. The company's debt has subsequently increased to the extent that Network Rail in 2011/12 spent significantly more on servicing its debt than on maintaining the track, with £968m on the latter and £1324m on the former (Appendix D). While perhaps not intended as such, the outcome of Network

[2] Network Rail's bank debt and loans in 2003 was £1.4bn and in 2012 the total was £29.4bn (Source: Annual report and accounts).

Rail's financial arrangements has been the construction of profitability among TOCs which would otherwise have depended on substantial direct subsidy.

3.1. Financial transformation and trade narratives

Rising passenger numbers, increased TOC profits and inflated franchise payments to government enabled the TOCs to argue that privatisation has been successful and delivered on its promises. The underlying referent for these claims of success is the model of rail privatisation set out in the 1992 White Paper which formed the basis for subsequent legislation. This short document laid out a series of promises about what rail privatisation would achieve. Alongside vague assurances about competition, management freedom and increasing the focus on customers' needs a significant measurable promise was the (eventual) total transfer of costs and financial risks to the private sector (Secretary of State for Transport, 1992).

The system of rail privatisation set out in Britain has therefore achieved almost the exact opposite financially of the objectives set out in the 1992 White Paper. The state has been burdened with the financial risks and costs of the rail infrastructure. Meanwhile, the system of accounting creates artificial profitability in an activity that would otherwise be entirely uneconomic for the TOCs. The accounting fixes facilitate the paradox whereby the TOCs' trade association, ATOC, and political backers of privatisation are still able to claim that the reforms have delivered "stunning improvements" and constitute another "a British success story" (ATOC, 2013). These claims form part of the rail sector's trade narrative, which upholds the imaginary of privatisation and shapes public discourse on rail around the interests of the TOCs.

This trade narrative has become increasingly strident over recent years as the franchising model has come under criticism. This criticism was sparked by high profile failures of two successive franchises on the East Coast Mainline (ECML) after over-optimistic bids were accepted by the DfT, and the aborted re-franchising of the West Coast Mainline in 2012 following the discovery of errors in the DfT's assessments of the winning bid (McCartney & Stittle, 2011; Brown, 2013). As well as providing ammunition for the arguments of anti-privatisation opponents in the British trade union movement, these problems have, more significantly, led to the opposition Labour Party stating that it would favour allowing a state-owned organisation to continue operating the ECML, or even consider wholesale renationalisation of the system (Pickard & Odell, 2013; Wintour, 2013). Opinion polls have also highlighted continued public support for re-nationalisation of rail (e.g. YouGov, 2013).

The trade narrative is propped up by supportive statistics highlighting growth in passenger journeys – a metric which is heavily influenced by factors beyond the control of the TOCs – and satisfaction survey scores, which frame choices in narrow and depoliticised terms (Bowman et al., 2013b, pp. 110–128). It is also crucially supported by the claim that rail operators produce a net gain for the taxpayer and that this benefit has been achieved through competition among private enterprises. ATOC in recent public-relations material claims Franchise Payments to government have risen from £400m in 1997/8 to £1.7bn in 2012/13, as a result of the increased profitability of the rail operators (ATOC, 2013). The organisation states:

> The franchising model has enabled train companies to generate significant financial returns for the Government, played a crucial role in delivering unprecedented growth in journey numbers, and provided passengers with improved services and better value (Ibid: 29)

Richard Branson's defence of Virgin's West Coast Main Line (WCML) franchise in August 2012 is an apt example of the narrative in action, touching upon the elimination of state subsidy, and the role of private sector management expertise in transforming a failed industry under state ownership:

> (Virgin) won the franchise in 1997 with an agenda to change radically the way people viewed and used the train. At the time the track was run-down, staff demoralised, the service riddled with delays and reliant on heavy subsidies. We set hugely challenging targets to dramatically speed up journey times with modern tilting trains, increase the frequency of the service, improve the on-board experience; as well as double passenger numbers and return the line to profit. We were told it was 'Mission Impossible' and our plans were laughed at by critics. However, 15 years later, despite continued problems with the track, we have achieved our targets (Virgin Trains, 2012).

In a subsequent article for *The Guardian* newspaper defending Virgin's record on the WCML claimed the company had achieved "a big turnaround from the liability we inherited and in that time we and our partners have taken total dividends of £499m, while the government and the taxpayer have seen a rise in revenues and a massive increase in assets values" (Branson, 2013).

3.2. Political co-dependence and the political resilience of privatisation

The political significance of the subsidy arrangement described in the preceding sections is reflected in the adoption of the trade narrative by key government officials and government ministers, who are enrolled in – and co-dependent upon – the appearance of success in rail privatisation. Similar arguments, for example, have been made by transport secretary, Patrick McLoughlin, speaking at a celebration hosted by ATOC for 20 years since the onset of rail privatisation outlined his commitment to the model of rail franchising by drawing a dichotomy between past failures under public ownership and recent success derived from the entrepreneurial skill of the TOCs:

> Franchising might still be criticised by those who want to turn backwards. Those who think centralised control is the future. Those who can't see the significant benefits that private sector operators have

> brought to the railway. Those who haven't learnt any lessons from the past (Department for Transport, 2013)

The Brown Review of rail franchising (Brown, 2013), commissioned in the wake of the 2012 West Coast Mainline franchising failure, demonstrates simultaneously the resilience of the rail industry trade narrative and the interconnected interests of political, state and private sector elites around rail. Instead of a lengthier review of the franchising system carried out by disinterested parties, the Transport Secretary explicitly tasked Richard Brown, chair of Eurostar and a former chair of ATOC, to develop recommendations on 'how to get the other franchise competitions back on track as soon as possible' (DfT, 2012a). Brown delivered a report front-ended with the statement, 'I share the Government's view . . . that the rail industry works, and that there is no credible case for major structural change . . . It is very important that the franchising programme is restarted as soon as possible' (Brown, 2013). This allowed the Transport Secretary Patrick McLoughlin to say, 'The review has confirmed that Government's approach to rail franchising system is still the best way to secure the rail services for tax payers and fare payers alike' (DfT, 2013a).

The government's commitment to maintaining rail franchising in the face of challenges was further underscored with the re-franchising process for the East Coast Mainline (ECML) in 2014. We have already noted that two successive private sector operators of the franchise had failed in rapid succession: Great North Eastern Railways in 2007, and National Express East Coast in 2009 after making what proved to be excessively optimistic estimates of the revenues they would receive and the franchise payments they could thereby afford (McCartney & Stittle, 2011). As a result the UK Government took over the ECML franchise through Directly Operated Rail (DOR). During difficult economic circumstances, and with one of the oldest rolling stock fleets of any operator in the country, DOR performed creditably, using less subsidy than any of the privately-controlled franchises, returning £208m to the taxpayer in premium payments and dividends, and achieving the highest ever Passenger Focus satisfaction score for the ECML in the 2012/13 financial year (Directly Operated Rail, 2013). These successes led to calls from the Labour opposition and the trade unions to maintain DOR's control of the franchise to serve as a benchmark for private sector-controlled franchises, or allow it to compete with private sector operators in a re-franchising process (Topham, 2013). The government's response was to push the re-franchising process for the ECML forward to enable it to take place before the 2015 general election and forbidding DOR from competing in the bidding process (Topham, 2014). Announcing the decision to the House of Commons in March 2013, Transport Secretary Patrick Mcgloughlin stated that success on Britain's railways in terms of growth in passenger numbers:

> . . . hasn't been achieved despite privatisation. It has been achieved because of privatisation . . . for the money that passengers and taxpayers put in we should expect. . .ambition. . .innovation. . .and even better performance for passengers. And this [franchising] is the way to get it (DfT, 2013b).

It is difficult to imagine that these claims about success from Brown, McGloughlin, Branson and ATOC could be made with as much force and confidence were the TOCs to still be in receipt of significant direct public subsidies required to pay Network Rail's full costs. In this scenario, the TOCs would be unable to be portrayed as efficient enterprises achieving independent success. The role of accounting in terms of disguising and displacing income, costs, capitalisations and risk is used to support the political narratives that in turn generate the appearance of a successfully privatised utility. Deconstructing the financial numbers and following the money reveals the discrepancy between promises and outcomes. This paper therefore underlines how accounting systems can be implicated in the process of appearance management by policy and industry elites.

4. Discussion and conclusions

This article has argued that the British rail industry can barely be called privatised in a meaningful sense any longer, because of the extensive subsidies provided for infrastructure provision and, from 2014, the formal re-designation of Network Rail debt as a public liability. However, the manner in which subsidies have been channelled through Network Rail has allowed backers of privatisation among the train operators and the political elites to maintain their narratives about the promise and outcomes of privatisation. This is because the accounting numbers and their presentation are malleable and implicated in the attempts to create a favourable image of the privatised rail industry. The purpose of this paper has been to deconstruct these numbers and identify how reforms displace and alter the presentation of financial information over time. This paper therefore suggests that accounting and critical accountants have a role to play in challenging the political narratives about transformation in privatised utilities such as rail.

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Appendix A.

Real passenger revenues and government grants

	Total passenger revenue £mill.	Total state support to the rail industry inc PTE grants (excluding freight) £mill.	Total passenger revenue and total state grants £mill.	Passenger revenue as a share of passenger revenue and total state grants %
1986/1987	3441	2020	5461	63.0
1987/1988	3688	1394	5081	72.6
1988/1989	3803	941	4743	80.2
1989/1990	3673	1531	5204	70.6
1990/1991	3741	2168	5909	63.3
1991/1992	3713	2778	6491	57.2
1992/1993	3718	3748	7466	49.8
1993/1994	3697	2743	6440	57.4
1994/1995	3536	2764	6300	56.1
1995/1996	3784	686	4470	84.7
1996/1997	3970	1629	5599	70.9
1997/1998	4209	2729	6938	60.7
1998/1999	4541	2331	6872	66.1
1999/2000	4807	2024	6830	70.4
2000/2001	4786	1702	6488	73.8
2001/2002	4891	2517	7408	66.0
2002/2003	4907	3467	8374	58.6
2003/2004	5061	4711	9772	51.8
2004/2005	5261	4796	10,057	52.3
2005/2006	5508	5642	11,150	49.4
2006/2007	5891	7415	13,306	44.3
2007/2008	6278	5982	12,261	51.2
2008/2009	6865	5921	12,787	53.7
2009/2010	6750	5016	11,766	57.4
2010/2011	6881	4088	10,968	62.7
2011/2012	7273	3901	11,174	65.1

Sources: ORR and SN/SG/617, House of Commons. *Notes:* Subsidy: 2001/2002–2003/2004 includes £3.520bn government grants directly to Railtrack/Network Rail and London & Continental Railways. Including non-franchised passenger revenue (£36.7 in 2009/2010 and £45.5 in 2010/2011) Passenger revenue includes all ticket revenue and miscellaneous charges associated with passenger travel on national railways, e.g. car parking charges. For tickets involving travel on London Transport, receipts have been apportioned. Passenger revenue does not include government support or grants.

Appendix B.

Government subsidy for Train Operating Companies and Network Rail (£m, 2012 prices)

	Net central government revenue support grants for Train Operating Companies £m	Network Rail grant income £m	Network Rail/Railtrack income from Track Access Charges paid by Train operating Companies £m	TOC passenger revenue £m	TOC subsidy as % of passenger revenue %	Network Rail subsidy as % of TOC passenger revenue %	Train Operating Company direct subsidy as % of Track access charges %
1995	2589	0	1955	3536	73	0	132
1996	2383	0	2003	3784	63	0	119
1997	2473	0	2119	3970	62	0	117
1998	1923	0	2131	4209	46	0	90
1999	1589	0	2169	4541	35	0	73
2000	1359	0	2175	4807	28	0	62
2001	1103	0	2089	4786	23	0	53
2002	940	2818	1256	4891	19	58	75
2003	1186	2506	1356	4907	24	51	87
2004	1701	2622	1581	5061	34	52	108
2005	1077	2604	1043	5261	20	49	103
2006	1054	2431	1122	5508	19	44	94
2007	1705	3793	1855	5891	29	64	92
2008	1269	3711	1968	6278	20	59	65
2009	302	4564	1458	6865	4	66	21
2010	500	4051	1501	6750	7	60	33
2011	−52	3901	1603	6881	−1	57	−3
2012	−133	3989	1593	7273	−2	55	−8

Source: ORR, Network Rail. *Notes:* Network Rail grant income includes grants deferred grants and incentive adjustments. Subsidy to TOCs includes grants, franchise payments and performance receipts.

Appendix C.

Franchise passenger km travelled, compared to Network Rail revenue and TOC passenger revenue (all £m adjusted to 2012 prices)

	Franchised passenger kilometres travelled km	Network Rail revenue from track access charges £m	TOC revenue from passenger fares £m
2003	39,678	1817	4907
2004	40,906	2056	5061
2005	41,705	1320	5261
2006	43,146	1376	5508
2007	46,154	2180	5891
2008	48,930	2224	6278
2009	50,613	1656	6865
2010	51,101	1630	6750
2011	54,074	1655	6881
2012	56,900	1593	7273
% Increase, 2003–2012	43	−12	48

Source: Regulatory accounts and ORR National Rail Trends.

Appendix D.

Network Rail spending on infrastructure compared to net interest paid (£m, 2012 prices)

	Spending on maintenance £m	Net interest paid £m
2003	1502	256
2004	1763	548
2005	1559	899
2006	1429	1133
2007	1342	1193
2008	1264	1250
2009	1274	1126
2010	1147	1134
2011	1095	1460
2012	968	1324

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