

Executive summary

This report advocates step by step reform of the ownership, structure and regulation of Britain's railways, in particular:

- establishing a new not-for-profit company to own, operate, maintain and renew the rail network;
- restructuring infrastructure maintenance and renewal work into fewer, longer-term contracts based on geographical zones with train operators represented on zone management boards;
- merging the Strategic Rail Authority (SRA) with the Office of the Rail Regulator (ORR), to create a strategic rail regulator, possibly also encompassing safety regulation;
- creating an independent railway ombudsman to arbitrate disputes between the train operating companies and the strategic rail regulator;
- replacing short-term passenger franchises with fewer, longer-term franchises, to secure more investment and higher standards of service, linked to greater regional accountability;
- setting up public private partnerships to finance and deliver major projects;
- reviewing the ten-year spending plan for railways to ensure sufficient investment to achieve targets of a 50 per cent increase in passenger use and 80 per cent increase in freight carried by 2010.

Evolution not revolution

In spite of the short-term difficulties, railway reform should recognise the strengths of the current structure as well as addressing its weaknesses. The record of the railways since privatisation has been mixed. Until the Hatfield crash in October 2000, there was strong growth in both passengers and freight. Railways were carrying more passengers than at any time since World War Two. Punctuality and reliability, on passenger's charter standards, were overall slightly better than in the final years of state ownership. Standards of safety were gradually improving, notwithstanding the major fatal accidents at Southall, Ladbroke Grove and Hatfield. Privatisation arguably introduced some useful innovations, notably competition in the delivery of passenger and freight services, performance incentives linked to the passenger's charter, transparent regulation, security of funding and access to private finance for investment.

Hatfield

Plans for a major expansion of Britain's railways were derailed by the tragic rail accident at Hatfield, only months after the publication of the government's ten-year transport plan in July 2000. Hatfield exposed fundamental weaknesses in Railtrack's stewardship of the network, including poor

management of maintenance and renewal contracts and poor asset management. Railtrack's ignorance of the condition of the track led it to make a crisis out of a drama by imposing hundreds of speed restrictions across the network. Its financial problems were exacerbated by poor management of major projects, including upgrading the west coast mainline, the cost of which has escalated from an initial estimate of £2.3 billion to more than £7 billion. Railtrack appeared unable to reconcile its public interest objectives with the interests of its shareholders to maximise profits. When it demanded even more public money on top of the £6.7 billion in direct grants alone already promised over the next five years, the government rightly decided to call a halt.

A not-for-profit network operator

The Institute for Public Policy Research has advocated and welcomes the government's preferred option for the new operator of Britain's rail network to be a not-for-profit company. Properly designed and integrated with other parts of the industry, the creation of a not-for-profit network operator would be an important step in getting the railways back on track. There are strong reasons in principle for common ownership of the rail network, a complex natural monopoly with vital public interest objectives, including safety. A not-for-profit company would have advantages over a traditional state owned industry in terms of accountability to stakeholders and access to private finance. It would have lower costs of finance than Railtrack and any profits would be reinvested in the network, not distributed to shareholders. The Secretary of State should reject alternative bids and underpin the not-for-profit status of the new network operator by statute, when the opportunity arises.

Promoting partnership

The Secretary of State has proposed that of the twelve to fifteen strong board of directors of the new network operating company, one non-executive director should be appointed by the Strategic Rail Authority (SRA) and one should be appointed after consultation with the passenger and freight train operators. Based on the experience of NavCanada, a non-share-capital corporation operating air navigation services in Canada, the government should consider including other stakeholder representatives on the board, notably for passengers and the workforce. The Public Private Partnership for UK National Air Traffic Services also includes the workforce.

In place of shareholders, the not-for-profit company would have members who would have an important role in holding the board to account. They should be appointed through open application by an independent panel according to published criteria to represent a range of stakeholder groups, including train operators, passengers, trade unions, local authorities, financial institutions and others. As well as electing the directors, members should vote annually on directors' remuneration. Management incentives should be linked to public interest objectives, such as safety, service delivery and financial performance, instead of profit maximisation.

Improving network maintenance and renewal

Fragmentation as a result of privatisation has contributed to poor management of infrastructure maintenance and renewal contracts, through loss of engineering skills, artificial separation between maintenance and renewal contracts, and a proliferation of badly managed sub-contractors. Good management requires clear lines of accountability and the co-ordination of track and train operations but does not need train operators to be in charge of track maintenance, known as vertical integration. Sweden's railways, for example, have operated successfully with separation between track and train operators since legislation in the late 1980s. Vertical integration would create competition problems between train operators using the same track. Instead, there should be fewer, longer-term maintenance and renewal contracts based on geographical zones, with train operators represented on zone management boards to oversee them. To ensure greater accountability, there is also a case for passenger and trade union representation on zone management boards.

Reforming regulation

Regulation of the railways is currently divided between the SRA as franchise regulator, the Office of the Rail Regulator (ORR) as economic regulator of Railtrack and the Health and Safety Executive (HSE) as safety regulator. The SRA and ORR have competing roles in determining service levels and investment programmes, which would be resolved by combining their functions in a new strategic rail regulator. There should be passenger and trade union representation on the board of the new authority. In place of independent economic regulation by the rail regulator, a new independent railway ombudsman could take on the more limited role of arbitrating disputes about track access charges and agreements, and periodic reviews of long-term passenger franchises. Based on the successful model of the Civil Aviation Authority, which is both safety and economic regulator for its industry, there is also a case for transferring responsibility for rail safety regulation from the HSE to the new strategic rail regulator. This would create a single integrated strategic planning and regulatory authority for the railways.

Delivering the ten-year plan

In the aftermath of Hatfield, the government has already committed significant extra resources to the railways. A higher and sustained level of public investment will be required to meet ten-year plan objectives of a 50 per cent passenger growth and 80 per cent growth in rail freight. The key to securing private finance for investment is transparent regulation and security of funding through franchise and track access agreements. For major projects public private partnerships are appropriate, where the costs and risks are clearly delineated. Partners in these projects would include the strategic regulator, the network operator, train operators, engineering companies and financial institutions. They would be financed through individual companies established for the purpose, known as special purpose vehicles. When the new network operator is in place, the process of replacing the current short-term passenger franchises with fewer, longer-term franchises should be resumed to secure more investment and higher standards of service and including profit-sharing arrangements. Fewer, longer franchises more closely aligned to national and regional boundaries would also create opportunities for greater democratic

accountability of local and regional rail services. With the economic conditions for growth in place and a government committed to developing Britain's railways in partnership with the private sector, the long-term prospects are bright. Railways have a vital role in an environmentally sustainable transport policy. Establishing not-for-profit network operator, rationalising regulation and reviewing the ten-year transport plan are vital steps towards getting the railways back on track.