THE FOUR BIG MYTHS OF UK RAIL PRIVATISATION

Analysis from Action for Rail

Rail privatisation was promoted in the early 1990s in the UK with promises of a better, cheaper service for rail users and reduced taxpayer subsidy. Private rail companies, it was argued, would bring in capital and business expertise which would transform the sector's performance while competition would drive efficiency and innovation.

On each of these measures, UK rail privatisation has been a failure. Today's railways require billions more in government funding, private investment has failed to materialise and passengers face the highest fares and travel on some of the oldest rolling stock in Europe. Private train operating companies are net recipients of public subsidy while distributing nearly all their operating profits as dividends to the shareholders of their parent companies.

Advocates of rail privatisation adhere to the myth of franchising as a success story for the passenger and the taxpayer. This document busts those myths.

MYTH 1

UK RAIL PRIVATISATION HAS CREATED PASSENGER GROWTH

Proponents of privatisation claim that privatisation increased passenger numbers by 73 per cent in the period 1994 to 2013. The Rail Delivery Group (RDG), which represents train operating companies (TOCs) and Network Rail, claim that in the decade up to 2014 there has been a 50 per cent increase in passenger journeys.[1] Yet there is no evidence that privatisation has created growth in passenger numbers.

Passenger numbers were on the increase before rail privatisation. Evidence indicates that growth in rail passenger journeys is driven by three key factors that have nothing to do with train operating companies: long-term growth in GDP, changing commuting patterns as employment has concentrated in major urban areas, particularly in London and the South East, and the increase in motoring costs over the periods in question.[2]

Moreover, most passenger growth on the railways since 1994 took place in London and the South East.[3] Analysis also shows that passenger numbers increased on the publicly owned London Underground (which carries as many passengers as the entire national railway) by 60 per cent between 1994 and 2013.

These facts indicate that increased passenger numbers are in fact related to sustained GDP growth rather than the benefits of privatisation. A fact acknowledged by the Department for Transport which found:

> "A significant part of revenue growth that has occurred on past franchises has been due to macroeconomic growth rather than solely a result of good management on the part of the operator.[4]"

The key role that GDP plays in passenger growth is recognised by the train operating companies themselves. The Association of Train Operating Companies has been actively lobbying the UK government for revenue risk mechanisms that more closely reflect GDP growth, calling for "indexation of franchise payments according to the rate of change (up or down) of GDP growth", the rationale being that "passenger demand and GDP for most franchises are thought to be closely correlated."[5]

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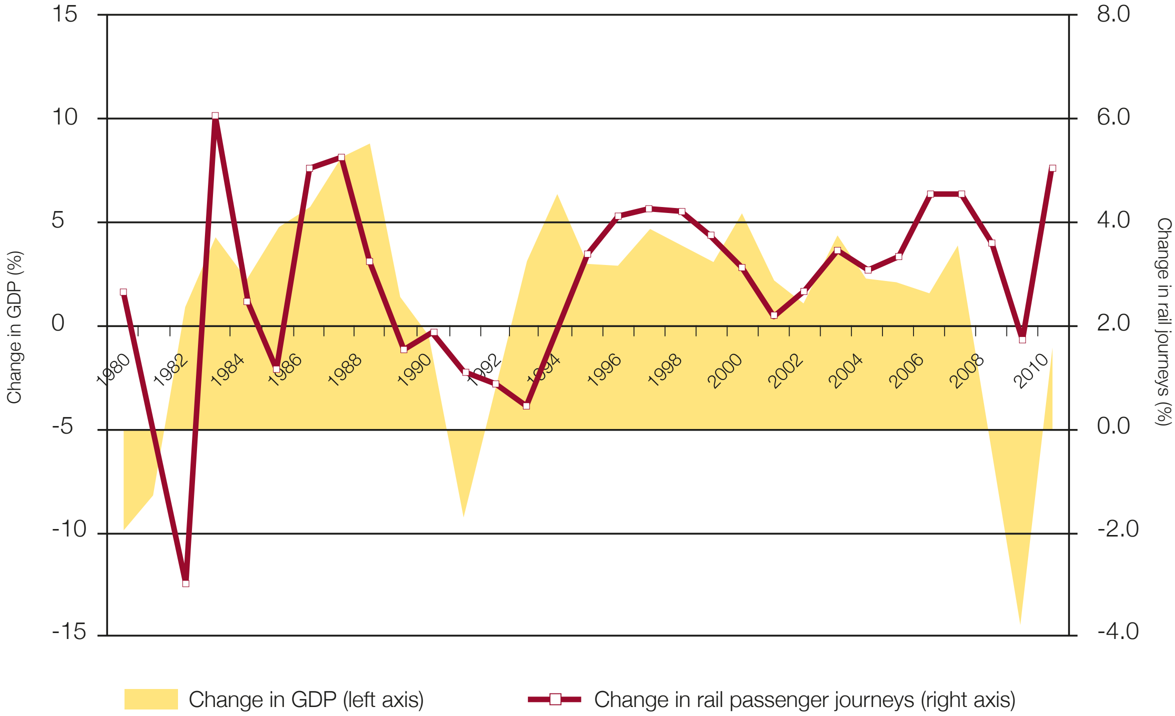
1 Rail Delivery Group (2014) *The Way Ahead* (London, RDG), p4, http://bit.ly/1e0Kq2w
2 CRESC (2013) *The Great Train Robbery,* http://bit.ly/JA8lq7
3 London Underground report and accounts 1994–2011; Transport for London (2014) Annual Report and Statement of Accounts 2013–14 (London, TFL), http://bit.ly/1zDcAGV
4 Department for Transport (2011) *Reforming Rail Franchising: Government response to consultation and policy statement,* January, p11, http://bit.ly/1KvaFaj
5 ATOC (2009) *Franchising Reform: A better railway for passengers and taxpayers* (London, ATOC), http://bit.ly/1vvLB1P

Figure 1: Percentage change in GDP vs. change in rail passenger journeys



Source: *The Great Train Robbery,* CRESC, University of Manchester, June 2013

It should be noted that the 59 per cent increase in passenger growth on the UK railways has also obviously been stimulated by the 300 per cent increase in public subsidy since privatisation.[6]

It is also the case that while there has been passenger growth there has been no corresponding increase in rail's modal share compared to other forms of transport. That is to say the proportion of people using trains has not changed.

6 Written evidence submitted by The National Union of Rail, Maritime and Transport Workers to the Scottish Affairs Committee (October 2013), http://bit.ly/1L1uul0

MYTH 2

UK RAIL PRIVATISATION HAS RESULTED IN NEW INVESTMENT AND INNOVATION

The *Rebuilding Rail* report highlights the myth of private investment by demonstrating that genuine at-risk private investment in the railway in 2010–11 lay somewhere in the range of £100m–£380m, with the figure most probably lying at the lower end. In the same year, other sources of income for the railway – public money and the fare box – contributed £10.6bn.[7]

Rebuilding Rail concludes private investment represents just one per cent of all the money that is going into the railway and quotes the former Secretary of State for Transport Andrew Adonis to make the point,

> "In so far as there has been private sector investment by TOCs, that investment has been funded, let's be clear, by the state and by passengers, either through revenue support or through fares.[8]"

Taking one example, private investment in rolling stock was lower over the five years prior to 2013 than state investment in rolling stock over the five years prior to privatisation. State rolling stock investment totalled £3.2bn in the period 1989–1993, while private rolling stock investment was only £1.95bn during 2008–2012.[9] Rolling stock operating companies (ROSCOs), which are private companies that lease trains to TOCs, are completely unregulated in terms of obligations to reinvest profits. With sustained underinvestment, the average age of UK rolling stock has actually increased from 16 years at the time of privatisation to 18 years in 2013.[10] The National Audit Office (NAO) reported in 2004 that underinvestment in rolling stock was leading to overcrowding on many routes.[11] More recently, for Crossrail, Thameslink and the new Intercity Express Programme the government has led a process of direct procurement from manufacturers.

Over 90 per cent of new investment in the railways in recent years has been financed by Network Rail (the taxpayer-funded body responsible for rail infrastructure), and comes mainly from taxpayer funding or government-underwritten borrowing.[12] For example, following privatisation upgrades to the West Coast Main Line, which runs from London to Edinburgh and Glasgow, cost around £9bn, and were primarily paid for by Network Rail.[13] In September 2014, Network Rail was reclassified as a public sector body, following a review by the Office for National Statistics (ONS), which noted that it is almost a wholly publicly funded organisation. Between 2014 and 2019, £38bn will be invested in rail infrastructure in Britain, and this is being delivered by Network Rail.[14]

7 Transport for Quality of Life (2012) *Rebuilding Rail,* p33, http://bit.ly/1D4F92g
8 Ibid, p34
9 CRESC (2013) *The Great Train Robbery,* p43, http://bit.ly/JA8lq7
10 Ibid, p.42
11 NAO (2004) *Improving Passenger Rail Services Through New Trains* (London, NAO), http://bit.ly/1QJ7LUy
12 Ibid
13 CRESC (2013) Op cit, p42
14 Network Rail (2014) *Delivering a Better Railway for a Better Britain: Our plans for 2014–2019,* http://bit.ly/1GeXOd2

It is also hard to find cases of private sector innovation that could not have been carried out by the public sector. Indeed the government's own McNulty report into the cost of UK railways agreed that fragmentation of the railway prevents industry innovation as companies seek to operate in their own short-term interests.[15] The opposition of private train operating companies to the extension of smart ticketing (Oyster card) by publicly owned Transport for London is a prime example of this.[16]

MYTH 3

UK RAIL PRIVATISATION HAS RESULTED IN CHEAPER AND BETTER SERVICES FOR PASSENGERS

Privatisation has created a less reliable, more expensive service. Comparing the last 20 years of publicly owned British Rail with the 19 years of private train operating companies prior to 2013, British Rail services were nearly three per cent more punctual than privately run passenger rail services.[17]

Since rail privatisation in 1995 up to 2015, all tickets (regulated and unregulated) have increased by an average of 117 per cent, or by 24 per cent in real terms.[18] Britain has Europe's highest commuter fares for both day returns and season tickets (see Table 1).[19]

Table 1: Average fare costs in the UK compared with other European countries (£/km)

	Day return (DR)	Restricted day return	Season ticket	Long distance (LD)	LD advance (1st city)	LD advance (2nd city)
UK	0.26	0.17	0.14	0.49	0.15	0.19
Germany	0.17	0.17	0.08	0.28	0.13	0.10
Switzerland	0.15	0.14	0.04	0.39	0.18	0.14
Netherlands	0.13	0.12	0.08	0.34	0.20	0.18
Sweden	0.13	0.13	0.06	0.21	0.10	0.08
Italy	0.12	0.11	0.04	0.22	0.10	0.07
Spain	0.09	0.09	0.07	0.24	0.16	0.09
France	0.08	0.08	0.08	0.15	0.06	0.05

15 Sir Roy McNulty (2011) *Realising the Potential of GB Rail; Report of the rail value for money study* (London, DFT and ORR), report commissioned by DFT and ORR, http://bit.ly/1KxzXor
16 Lydall, R. (2007) "Mayor Angry at Rail Firms Oyster Snub", *Evening Standard,* 9 January
17 GB Transport statistics 1974–1987 and 1992–1998; *British Rail Board (1989) British Rail Board Annual Report 1988–89* (London, BRB); Booz Allan Hamilton: Report for the Rail Regulator (2001) *Railtrack's Performance in Control Period 1995–2001;* National Year Trends 2001–02 to 2011–12.
18 Office for Rail Regulation (2015) Index showing average change in price of rail fares by regulated and unregulated tickets (Table 1.81), https://dataportal.orr.gov.uk/displayreport/report/html/920430f4-6a8d-4bb8-9762-2bf89259e346
19 Adapted from *Passenger Focus* data (http://www.transportfocus.org.uk/) but recalculated in terms of pounds sterling per passenger kilometre.

Between 2010 and 2014, the average season ticket in the UK rose by 27 per cent; increasing more than two and a half times faster than average wages.[20] Comparisons of UK season tickets with other European countries in 2014[21] and 2015[22] showed that UK commuters are paying significantly higher fares than their European counterparts using predominantly publicly owned railways (see Table 2).

Table 2: Season ticket comparison: UK privatised rail compared to predominantly publicly owned railways in Europe (2015)[23]

Country	From	To	Distance (miles)	Monthly season ticket (equivalent costs)	Annual median earnings	Monthly median earnings	Percentage of monthly median earnings
UK	Brighton	London	50	£390.60	£27,200	£2,267	17%
Germany	Aachen	Cologne	50	£218.55	£28,462	£2,372	9%
France	Compiègne	Paris	50	£274.78	£28,170	£2,348	12%
Italy	Civitavecchia	Rome	47	£118.78	£22,900	£1,908	6%
Spain	Segovia	Madrid	50	£98.19	£21,198	£1,767	6%

Privatisation has also made the railway more difficult to use. Thirty-five per cent of train users and 64 per cent of non-users do not understand the rail ticketing system.[24]

Yet the most expensive fares in Europe have not translated into better services. Analysis by Just Economics shows that UK railways are slower and more overcrowded than predominantly publicly owned rail services in Germany, France, Italy and Spain.[25] This is borne out by the fact that according to Eurostat these countries have eight times more coverage of high speed rail, while UK railways are bottom of the European league for electrification coverage (see Tables 3 and 4).

20 "UK commuters spend more than twice as much of their salary on rail fares than most European passengers", *TUC Press Release,* 2 January 2015, http://bit.ly/1wPDerh
21 "UK commuters spend over three times more of their salary on rail fares than most European passengers", *TUC Press Release*, 2 January 2014, http://bit.ly/1QIPkz8
22 "UK commuters spend more than twice as much of their salary on rail fares than most European passengers" (op cit)
23 Ibid
24 See Department for Transport (2012) *Public Attitudes Towards Train Services:* Results from the April 2012 opinions survey (London, DfT), p49, http://bit.ly/1L1UXVU
25 Just Economics (2013) *A Fare Return: Ensuring the UK's railways deliver true value for money* (London, Just Economics)

Table 3: Electrified railway lines in Europe

Country	Total length of electrified line (kilometres approx)	Percentage of total railway line
Belgium	2,955	84.1%
Netherlands	2,154	74.6%
Sweden	7,866	71.4%
Italy	11,714	71.1%
Poland	11,924	59.0%
Germany	19,857	52.0%
Finland	3,067	51.8%
Portugal	1,436	50.6%
France	15,312	49.0%
Slovakia	1,577	43.5%
Slovenia	503	40.9%
Romania	3,974	36.8%
Croatia	985	36.2%
United Kingdom	5,250	33.2%

Table 4: High Speed Rail in Europe (kilometres approx)

Country	In operation	Under construction
Belgium	209	0
France	1,872	234
Germany	1,285	378
Italy	923	0
The Netherlands	120	0
Spain	1,604	2,219
United Kingdom	113	0

A train satisfaction survey carried out by consumer group Which? published in 2015 found that 15 out of 20 train companies received an overall score of less than 60 per cent when marked on areas including punctuality, availability of seating, condition of trains, reliability and value for money.[26] Furthermore, the *National Rail Passenger Survey (2014)* found that only 46 per cent of passengers were satisfied with the value for money of their ticket.[27]

26 Which? (2015) "Best and worst UK train companies", Which? website, http://bit.ly/1lZvoZD
27 Transport Focus (2014) *National Rail Passenger Survey 2014,* http://bit.ly/1K698vl

MYTH 4

UK RAIL PRIVATISATION IS A BETTER DEAL FOR THE TAXPAYER

Privatisation has cost the taxpayer more. The cost of running the railway has more than doubled in real terms since privatisation from £2.4bn per year (1990–91 to 1994–95) to approximately £5.4bn per year (2005–06 to 2009–10).[28] In 2013–14, the government contributed £3.8bn to the UK rail industry.[29]

It is estimated that the additional costs of rail privatisation in the UK amount to over £1bn a year. This is the accumulated costs of debt write-offs; dividend payments to private investors; fragmentation and transaction costs, including profit margins of complex tiers of contractors and sub-contractors; excessive bonus payments and executive remuneration; and costs associated with franchise bidding rounds, marketing and re-branding on franchise takeovers.[30]

Private train operators in the UK are net recipients of government subsidy. Official figures show that all but one of the private train operators in the UK receive more in subsidies than they return in the form of franchise payments to the government. Private train companies in the UK rely on a combination of direct subsidy from the government and through artificially low track access charges funded by the government, an indirect subsidy from the taxpayer. The top five recipients of public subsidy alone received almost £3bn in taxpayer support between 2007 and 2011. This allowed them to make operating profits of £504m – over 90 per cent (£466m) of which was paid to shareholders.[31]

Therefore, being dependent on public subsidy does not prevent private train operators from paying dividends to their owning companies. A total of £183m was paid in dividends in 2013–14. The three largest dividend payers, Transpennine Express, Northern Rail and Southern alone paid £80m in dividends to shareholders after receiving nearly £1bn in public subsidy (see Table 5).

28 Transport for Quality of Life (2012) *Rebuilding Rail,* p7
29 Office for Rail Regulation (February 2015) *GB Rail Industry Financial Information 2013–14,* http://bit.ly/1HdxhwE
30 Ibid, p17
31 CRESC, *The Great Train Robbery,* pp22–23

Table 5: Subsidies, grants and dividends by train operator in the UK (2013–14)[32]

Train operator	Franchise receipts from government (£m)	Network Rail grant (£m)	Franchise payments to govt (£m)	Net subsidy (£m)	Dividends paid by operators (£m)
First Scotrail	506	38	0	544	21
Merseyrail	82	43	0	125	16
LOROL	68	59	0	127	5
London Midland	57	167	0	225	0
Virgin Trains	0	322	97	225	10
Arriva Wales	152	180	0	331	16
Trans Pennine Express	66	144	0	209	30
First Capital Connect	0	220	195	25	5
South West	0	246	297	-51	16
Southern	0	244	153	90	23
South Eastern	69	255	0	324	5
Northern Rail	346	323	0	669	27
First Great Western	0	336	118	218	0
Abellio Greater Anglia	0	261	164	97	0
East Midlands	13	246	0	258	0
East Coast	0	194	217	-23	0
New Cross Country	31	271	0	302	0
Chiltern	0	60	9	50	0
c2c	0	45	4	41	8
Total	1,389	3,653	1,255	3,788	183

The case of the East Coast Main Line demonstrates that in fact it is a publicly owned train provider that offers the best deal for the UK taxpayer.

East Coast was taken back under public ownership in 2009 after two previous private train operators were forced to walk away from the franchise due to financial difficulties. Publicly owned Directly Operated Railways (DOR) on the East Coast was successful. DOR provided consistently higher returns to the taxpayer in premium payments, far ahead of the comparable long-distance private operator Virgin Trains on the West Coast Main Line (see Table 6).

32 Office for Rail Regulation (February 2015) Op cit

Table 6: Premium payments by train operator 2009–10 to 2013–14

Train operator	Virgin West Coast (£m)	DOR East Coast (£m)
2009–10	-50	46
2010–11	167	177
2011–12	165	188
2012–13	104	203
2013–14	97	217
Total	483	831

Source: 2009–10: Transport Select Committee, *Rail Franchising 2013–14,* Written evidence submitted by the RMT, http://bit.ly/1bPanAn; 2010–11: Ibid; 2011–12: Ibid; 2012–13: Office for Rail Regulation (April 2014) *GB Rail Industry Financial Information 2012–13,* http://bit.ly/1cwxbp3; 2013/14: Office for Rail Regulation (February 2015) Op cit.

In 2013–14 DOR East Coast returned money to the government; as a consequence its share of government funding was -0.6 per cent. In the same period Virgin-operated West Coast received a 5.9 per cent share of government funding and East Midlands Trains received 6.8 per cent.[33] Put another way, DOR on the East Coast returned £1.15 to the government per passenger journey, while Virgin and East Midlands Trains received £7.03 and £10.72 in funding per passenger journey respectively.[34]

Under public ownership, DOR East Coast received high passenger satisfaction ratings, won 35 industry awards, and its performance equalled or out-performed any comparable private operator. Despite this, the line was re-privatised in March 2015.

Private train operators' operating profits are modest at around three per cent of turnover[35] but this disguises much higher returns when compared to the capital investment that train companies make. Train companies provide negligible investment, with no capital invested in trains or track. As such, rates of return on capital employed (ROCE), a more accurate measure of the profitability of rail franchises, shows much higher profits. Figures show that for 2010–11, the 22 private train companies in the UK made a return on capital of 121.6 per cent (see Table 7).[36]

Table 7: Capital employed, profit and return on sales, UK train operating companies 2010–11

Long-term debt and shareholder equity (£m)	Pre-tax profit (£m)	Pre-tax return on sales (%)	Pre-tax return on capital employed (%)
219	266	2.8	121.6

It should also be noted that, according to press reports,[37] as part of reforms to the rail franchising process the government was considering a check of the credit rating of private companies bidding for rail franchises. FirstGroup, Go Ahead, and Stagecoach all have low credit ratings[38] and such a policy move would be disastrous for the companies and pave the way for a return of the national railways to the public sector.

33 Ibid
34 Ibid
35 ATOC (2013) *Growth and Prosperity: How franchising helped to transform the railway into a British success story,* http://bit.ly/1vw7KwM
36 CRESC (2013) *The Conceit of Enterprise,* September 2013, p15
37 Odell, M. (2013) "FirstGroup Downgrade Threat to Rail Bidding", *Financial Times,* 12 May, http://on.ft.com/1H3olC1
38 Insight Investing (2015), "Credit Ratings", 11 May 2015, http://bit.ly/1IAQie3

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