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Discuss whether the privatisation of British Rail has been successful. Evaluate whether the new structure is likely to be a more effective and efficient way if managing a national rail network. [40]

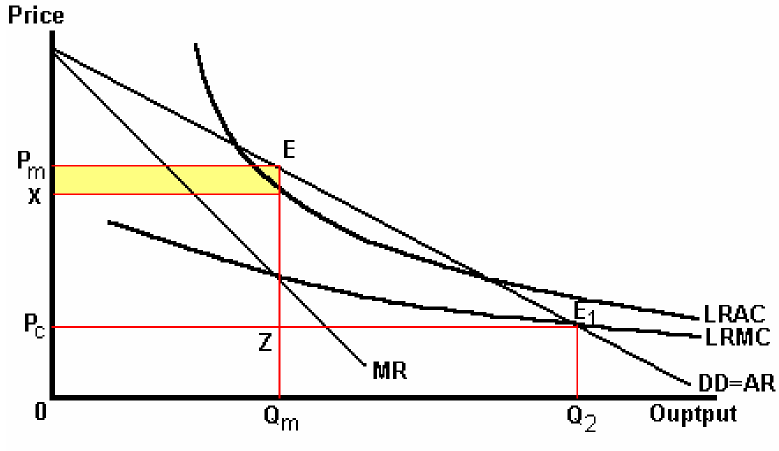
Privatisation was developed by Mrs. Th atcher's government as a way to re-introduce the profit motive to many of the industries that had been nationalised in the past. The poor performance of the nationalised industries meant that they were a heavy drain on the public finances. The government w ere looking for a way to restore the profit motive and make them more efficient. Privatisation - returning the companies to the private sector - was the method that was developed.

As with many of the later privatisations, British Rail was privatised in a way, which separated the natural monopoly from the potentially competitive parts of the industry. The track and signalling are unavoidable monopoly that has been privatised as a separate company known as Rail Track. This company was heavily regulated to p revent it exploiting its market position. The operation of rail services on the monopoly track can be arranged in a more competitive way. In some cases, other modes with provide sufficient competition. Where rail services do not face strong competition fro m other modes, price regulation is necessary, particularly in the case of commuter routes; low prices may be desirable to reduce congestion.

The privatisation of British Rail was a complex issue. Unlike other transport privatisation, it was complicated by ; the loss making nature of British Rail as a whole; the heavy dependence in external subsidy for the operation of many provincial and commuter services; the need to see safety as an overriding operational consideration; and finally, rail transport having its own dedicated track and infrastructure. It was believed that the privatisation would have particular benefits, including increased efficiency by reducing costs and cutting out waste. Also it was believed that there would be more concern fro customer ne ed and management freedom to give a market led service. There was to be increased employee motivation and the hope that less subsidy would be required from central and local governments.

Privatisation was hoped to transform an industry that looked inward s to the Department of Transport for support into one that looked outwards to its market for custom. It was going to bring into a rather introspective and protected industry successful operators of other transport modes. It was going to reduce the subsidy for running trains, by removing some of the cosy practices that had grown up unchallenged for decades and freeing up the money for other public services.

The natural monopoly argument is particularly valid for a single supplier. Railways have high capital costs; duplication serves little purpose and capital could become severely under-utilised. As the figure below shows, economies of scale accrue in the market, and the LRAC curve has not yet reached its minimum point. Moreover, the LRMC curve lies below it, indicating that economies of scale continue to be gained. The dilemma facing natural monopolies is that cannot survive as profit maximisers while producing at the social optimum (PcQ2) on the diagram. Consequently, subsidy is required in operate at this point.



E1 = socially efficient output level
Private monopolist would produce where MC = MR (i.e. price is Pm output Qm)
Monopoly profits = the yellow shaded rectangle
Deadweight loss under private monopolist = EZE1
KEY PROBLEM: losses are made in the long run, so _subsidy_ is required.

In the case of British Rail, in 1995/96 – the last year of public sector operation – subsidy in the form of the Public Service Obligation was £1669 million, which was 39% of total passenger receipts. Although the sum has fluctuated in recent years, most services will continue to require subsidy under their new private sector owners.

There have been many problems with the privatisation of British Rail. Potential franchises have been deterred from entering the rail sector f or fear that they would have insufficient control over their operation, suggesting the failure to establish a contestable market.

The way in which the government has privatised the railway system has put much emphasis as possible on competition. Critics of the process have highlighted problems of coordination between trains run by different companies. The main problems of dividing up the railways into so many franchises are that firstly, it becomes more difficult to create a coordinated timetable with conne ctions between trains run by different franchises. Rail track was given this coordinating role. Buying a ticket on a route that uses several different franchise companies requires coordination between them is a single ticket is to be issued. In the same wa y, methods must be found to continue with timetable and ticket coordination between different modes of transport, such as rail, which may have been easier in the public sector.

In October 2001, five years after the privatisation, the government announced the decision to put Railtrack under administration. On the day of the collapse, Railtrack had net debts of 3.3 billion. Since the business was technically insolvent (its debts were larger than its assets) the government invoked an option to put Railtrack i nto administration, effectively making the value of Railtrack shares worthless. The privatisation had ended a failure.

There was no aspect of Rail privatisation that was not profoundly flawed, largely because its designers were blind to inherent tension between maximising shareholder value and serving public interest. British Rail's privatisation was ultimately a failure, demonstrated by the collapse of Railtrack. There was hope of improved customer service and opening the market up to competition. The co llapse of Railtrack was not only a disappointment to the government, but also brought immense embarrassment. As for the shareholders of Railtrack, the announcement of it being put into administration was a tragedy after the faith and financial backing they had all placed in the company, bearing a huge financial loss to many.

Now it is openly acknowledged that the fragmentation of the industry into a myriad of contractors all attempting to maximise shareholder value would inevitably create an incentive structure in which the name of the game was to pass the buck, cut costs indiscriminately and take risks with safety and service.

The initial structure of the privatized British Rail was for Railtrack to take over British Rail's infrastructure; i.e. the track, signaling, the stations and extensive land and property assets. It is responsible for the operating timetable, and determines charges for train operating companies and raises capital for future investment. Twenty -five Train operating companies (TOCs) were awarded operating franchises for passenger services. Most receive external subsidy. Bus and coach groups, other trans - port operators, newly formed companies and management groups now operate services. Freight business was initially spilt but is now firml y under the control of English Welsh & Scottish Railway (EWS), owned by US-based Wisconsin Central. Freightliner is the only part not under EWS's control, having been bought by a management team in May 1996. Rolling stock companies (ROSCOS) consisted of th ree companies (Porterbrook, Eversholt and Angel) owning all of the passenger locomotives and rolling stock. They lease this out to TOCs.

The debate about how the railways should have been run has been brought into sharp focus by recent accidents and the resulting concerns over safety. The crash at Hatfield was thought to have been caused by faulty rails and as a result speed limits have been imposed in a number of places throughout the network. There was chaos on the railways while it was all sorted out. There have then been further accidents with the one at Potters Bar thought to have been caused by loose nuts on a set of points.

Privatisation occurred in 1996 and in the year before privatisation there were 989 rail accidents. In the year after (1996/7) there were 1,285. This certainly does not seem a good record. The figure has come down to 1,164 in 1998/9 but this is still above the number before privatisation. If we look at the number of derailments there is a similar picture. In the year before privat isation there were 104 derailments and in the year after (1996/7) there were 119. This fell in 1997/8 but has risen again in 1998/9, the latest year for which figures are available. Looking at all this is would be tempting to say that safety has deteriorated since privatisation and that may be true, but how significant are the changes. There were major train crashes in the era of nationalisation and we cannot hark back to some sort of golden age before privatisation. However, perhaps we can expect more from privatised companies.

As for the future structure of British Rail, the transport minister, Stephen Byers plan to regionalize part of the rail network is entirely feasible and could well redeem his reputation. Few ministers have inherited policy disasters on such a scale: Railtrack, the London Underground, infrastructure under funding and the air traffic control system, among others. Of course, the transport minister has been on the receiving end of attacks that should have been directed at those who left h im with the problems.

Mr. Byers wishes to transfer control over parts of the railways to democratic regional bodies. This would be good for several reasons. Firstly, the regionalisation of decisions about service levels, subsidy and quality would greatly improve local accountability. Local taxpayers would face trade - offs between costs and benefits of services.

Second, by transferring many decisions about service levels and subsidies to the city or regional level, it would be easier for Byers to sort out the wreckage of Railtrack and the Strategic Rail Authority. It would be possible for public transport authorities, such as Merseytravel or the mayor of London's Transport for London (TfL) to contract with train operating companies in a way that linked train and track operations, removing a key problem of rail privatization.

The third potential advantage - particularly for the transport minister - would be the transfer of many awkward decisions about the future of the railways from his department to regional and local bodies.

The national rail is a large enterprise serving completely different functions. It is unlikely that a single solution would be right for all parts of it. The collapse of Railtrack has revealed an appalling lack of capacity to deal with major projects, such as the West Coast main line upgrade. Commentators have rightly observed that Britain has lost its capacity to organise and manage major public sector developments.

Another advantage of shifting most of the responsibility for planning and financing railways to regional or local government would be the opportunity to transfer projects to passenger transport authorities, Transport for London and regional bodies. The promotion of major projects (CrossRail in London and tramways in cities) would be taken over by new, accountable, institutions.

This is an opportunity to improve the control and management of the railways.. Any moves towards giving the regions an opportunity to direct their own destiny would be strengthened by greater transport powers. The transport secretary's proposals for speeding up planning are also expected to enhance regional power. The reform of the railways could democratize railways while, at the same time, improving them.

The method by which the rail industry was fragmented made it difficult for Railtrack to be a success. It was inefficient, monolithic and hidebound by tradition. The skeleton of the advanced passenger train at Crewe is a monument to the problems that the public sector had in introducing new technology. British Rail's culture stifled the good management potential that was locked inside.

Standards of service have yet to return to pre-Hatfield levels. However, an improvement in the efficiency of the railways is sure to occur due to a company being limited by guarantee but with public-interest objectives and no shareholders, allowing the rail industry to go forward removing dome of the inbuilt contradictions that have trapped it until now. Yet the main driving forces - increasing use of the railways, economic growth, rising road traffic congestion and regulated fares - remain in place. With step-by-step reform, the long-term prospects for Britain's railways are bright.