CATALYST

A CATALYST WORKING PAPER

Renaissance delayed?

New Labour and the railways

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Catalyst
150 The Broadway
London SW19 1RX
Telephone 020 7733 2111
email catalyst@catalystforum.org.uk
www.catalystforum.org.uk

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A Future for Rail

Transport and the railways in particular are both moving rapidly up the political agenda. There is now a near-universal consensus that the Tory privatisation of the railways was a disaster. But it is also becoming clear that the Labour government has yet to find a lasting solution to the problems this legacy has created. The logic of the situation, as revealed by pragmatic responses such as Network Rail's recent decision to bring maintenance back "in house", appears to point toward a progressive re-integration of the industry under public ownership. There is mounting evidence that the fragmentation of the industry and multiplication of commercial interfaces is a key factor in escalating costs. But there is no widely accepted or agreed route-map towards extending public ownership further, nor is it clear that the political will yet exists to take this process to its logical conclusion should the evidence point to it.

Against this background Catalyst is launching a research project on the future of the railways, the main components of which will be:

- analysis of the current structures and funding/financing of the railway industry since privatisation
- the record of privatisation in terms of delivery for passengers and value for money
- options for extension of public ownership and integration with consequent benefits to passengers and taxpayer
- the economic, social, environmental case for rail and options for expanding the railway

The publication of this Working Paper constitutes the first stage of the research project, which will continue through the second half of 2004 with further events and interim publications, culminating in a final report in early 2005. For more information or to become involved please contact Mark Donoghue in the Catalyst office on **020 7733 2111** or email **railfuture@catalystforum.org.uk**

This project is being undertaken with the generous support and close cooperation of the joint rail unions – ASLEF, RMT and TSSA. It should not be assumed however that this or other publications and outputs necessarily reflect their views.

Executive summary

1. Introduction: New Labour's "rail renaissance"

- In 1998 the Labour government promised a "rail renaissance" for the twenty-first century as part of a radical shift to a new integrated approach to transport based around social equity and cohesion, economic efficiency and development, and environmental sustainability.
- Four years into Labour's "10-year plan" for transport its objectives look seriously in doubt, despite considerable amounts of public money being spent, because the privatised and marketised railway system Labour inherited from the Conservatives is unequal to the task.
- The outcome of the government's recent rail review indicates that it is not yet ready to tackle this problem at root. There is a danger that future generations will look back on this episode as one of the greatest disappointments of Labour's period in office.

2. The historical legacy

- Since their earliest development Britain's railways have been held back by two problems –a lack of strategic coordination and chronic underinvestment. This is a particular problem for a "network utility" with a vital role to play in underpinning our society and economy.
- British Rail was crippled from the outset by Treasury-imposed austerity and political hostility from enthusiasts of the "great car economy". Nevertheless under public ownership Britain's railways became the most efficient in Europe, in return for the lowest government subsidy.
- In the twenty-first century the new Labour government seems to have recognised the need to invest in the nation's railway network. But the industry has been thrown back into a state of chaotic fragmentation by the Tory privatisation experiment.

3. The disaster of privatisation

- The Conservative experiment in privatising and marketising the railways was intended to spur efficiency and innovation through intra-industry competition and reduce the burden of subsidy and risk to the Exchequer.
- The record of privatisation has been one of deteriorating performance, compromised safety, escalating costs to the taxpayer, increased red tape and bureaucracy, and major social and economic disruption caused by key accidents and performance failures.
- Privatisation failed because a fragmented and marketised railway was inefficient and ineffective, and because the private sector has never provided the levels of funding and finance that the railway needed.

4. New Labour's modifications

- The Labour government made some modifications to the structure inherited from the Conservatives which attempted to subject the privatised industry to tighter regulation and stronger strategic leadership.

5. The Ten Year Plan: a progress report

- The new money allocated to rail in the Ten Year Plan has now largely been allocated and indeed increased in some areas. The private firms that now make up the railway industry are currently receiving public subsidy three times larger than that received by British Rail.
- At the same time the fragmentation of the industry has meant that infrastructure costs continue to escalate, estimated to now be running at three to five times their level prior to privatisation, with much of the increase having taken place since 2000.
- The result is that performance, far from improving, is at levels way below those achieved in the late 1990s, and is not expected to recover for several years. The government's original targets for passenger and freight growth look unlikely to be met and may be abandoned.

6. Towards a public service railway

- The government's rail review recognises that, despite previous measures, the industry is still not delivering. But the regulatory reforms proposed in its new White Paper continue to avoid the central problems of organisational fragmentation and cash leakage.
- **Network Rail** remains a regulated monopoly paying a return on private debt that has been guaranteed by the government. Direct public ownership under a unified railways agency would offer clear accountability to the public interest and better value for money for the taxpayer.
- All the evidence and experience of recent years tells us that bringing **track renewals** "in-house" could have a huge impact on the efficiency and cost-effectiveness of the railways and be a major step in beginning to reverse the fragmentation wreaked by privatisation.
- There is no justification for continuing with the franchising of **train operations** to private providers if, as the experience of South Eastern Trains indicates, the service can be provided just as well by the public sector without the extra costs and disruption.
- The **rolling stock** companies are in need of regulation. It is only when their role and performance has been carefully scrutinized that we can really decide if their transfer to private hands has produced the benefits they claim to bring.
- Exploiting the potential for a **rail freight** renaissance should be a central plank in an integrated transport policy that is economically viable and environmentally sustainable. It needs to be placed firmly back on the government's agenda.
- Independent **safety regulation** should be maintained – if fragmentation means that safety standards are expensive to meet, the response should be to reduce fragmentation, not subordinate safety concerns to economic regulation, as now proposed.
- **Devolution** of planning and control will be important to designing transport systems to meet social and economic need, but should not serve as a device for forcing service cuts.

7. Conclusion: the opportunity for rail

- There are still exciting opportunities for a renewal and expansion of Britain's railways as a key form of transport for an equitable, efficient and sustainable twenty-first century.
- The government is providing the public investment in pursuit of this goal. The appropriate model for ensuring it gets its return is a railway that is publicly owned and accountable.

1
Introduction: “renaissance” delayed?

In 1998, shortly after being elected, the new Labour government held out the promise of a “rail renaissance” in Britain.

This marked a radical and exciting shift in UK government policy that had been a long time coming and was by this point urgently needed. For most of the twentieth century Britain’s railway network had suffered from neglect and underinvestment, while the predominant laissez-faire approach to transport policy known as “predict and provide” fed and encouraged an increasing dependency on the private car (1). This approach has now been decisively discredited.

As early as the 1960s and 1970s transport experts as well as economists, sociologists and environmentalists were pointing out that an ever-increasing volume of, and reliance on, travel by private car was socially and environmentally destructive, and ultimately economically unsustainable. By the 1990s these negative effects were becoming almost universally accepted and even the Conservative government began to recognise that it was simply not going to be possible to meet the increases in demand for road travel that were projected for the coming decades (2).

A different approach was needed, one that recognised the wider social, economic and environmental importance and implications of transport policy and the corresponding role for public deliberation and state action to guide the development of a national transport system to meet social and economic need (3). This new approach was proclaimed in Labour’s “integrated transport” white paper of 1998. John Prescott announced:

> Privatisation and deregulation have dominated transport policy for 20 years. The result has been a decline in bus and rail services and over reliance on the car. The effect of noise and pollution is damaging people’s health and the quality of life in towns and cities. The countryside is being eroded and we are damaging the wider environment, even changing our planet’s climate. A consensus for radical change in transport policy has emerged. (4)

At the heart of Labour’s new transport strategy was a radical shift of emphasis back towards public modes of transport as more socially cohesive, economically efficient, and environmentally responsible than the private car. And at the heart of this new direction was a historic step-change in investment in and expansion of Britain’s railways, the great achievement of the nineteenth century that was now seen by serious transport analysts as the crucial platform upon which could be built a system of transport services fit for the twenty first (5). As then Transport Minister John Reid said in 1999, “if we don’t have a decent train system, we can't handle the other problems in creating an integrated transport policy. Train is the central element in solving all our transport problems"(6).

Labour's programme for transport was outlined in more detail in 2000 in *Transport 2010: The Ten Year Plan*. For the railways, this envisaged:

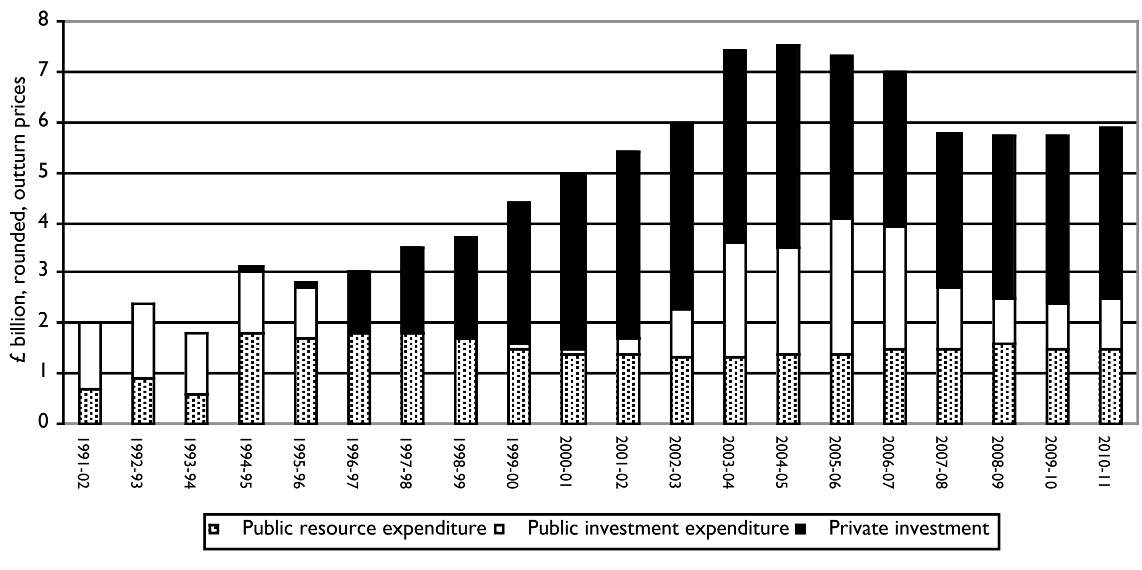
- a major **£63 billion** investment and expenditure programme, **£29 billion** of which was to come from the public sector (7)
- a dramatic increase in rail passenger usage – **50 per cent** overall, and 80 per cent for inter-urban routes – and an **80 per cent** increase in rail freight (8)

The radical nature of this policy shift, the ambitiousness of its objectives, and the potential importance of such a unprecedented commitment of public investment (see Fig. 1 below), should not be underestimated. Professor David Begg of the Commission for Integrated Transport has described it as "a radical vision of the kind of transport system needed in Britain" (9). Another key academic expert commented at the time:

> This is new territory. It means that public transport would need to grow, in the next few decades, faster than it has declined in the whole of the professional lifetimes of the managers and planners in charge. (10)

This was a promise to turn around the legacy of decades in which UK transport policy had been moving in the wrong direction which, if realised, would constitute one of the Labour government's most profound and progressive reforms to Britain's society and economy – as important and radical, in its way, as the increased investment in public services like health and education, or the attack on child poverty, or the modernisation of our constitution.

Fig. 1: Past and projected public and private investment in rail (2000)



Source: DETR, (2000) Transport 2010: The Ten Year Plan

Labour's ambitions for rail in 2000

"Investment on this scale means we can deliver the following broad package of improvements by 2010…

- 50 per cent increase in use, measured by passenger kilometres
- 80 per cent increase in rail freight
- improvements in service quality: more punctual and reliable trains, less overcrowding
- installation of new train safety systems
- modern trains and more attractive, secure stations
- modernisation and increased capacity on the West Coast and East Coast Main Lines
- the high speed Channel Tunnel Rail Link, also serving Kent and the Thames Gateway
- improved commuter services in London and other cities
- upgrading of freight routes to major ports
- better integration with cars, buses, taxis, bicycles and better links to airports."

DETR, (2000) Transport 2010: The Ten Year Plan

Four years on, almost mid-way through the "Ten Year Plan", much of that early promise and ambition seems to have been lost.

The promised money has been spent and invested – from the public side, at any rate – but, it seems, to very little effect. The story of disappointment and disillusionment has provided endless gifts to headline writers: Labour's plan for modernisation and expansion is "off the rails", "stuck in the sidings", has "hit the buffers", "run out of steam". We are now nowhere near "on track" to meeting the ambitious but necessary targets set out in 2000. Some suggest that we may be approaching the point at which we may have to revise or abandon them. We are in danger of squandering an historic opportunity to fundamentally shift the direction and emphasis of the development of the UK transport system, the consequences of which – social, economic, and environmental – could be severe.

What has gone wrong? The problem is simple and obvious to all, even if the solutions may not be. When Labour came to power in 1997, it inherited a railway system that had just been subjected to the last and most notorious experiment in Thatcherite dogma (11), pulverised into hundreds, even thousands, of ineffective and profiteering pieces by an ill-thought out and ideologically driven attempt to privatise and marketise what used to be British Rail. In opposition Labour had attacked the Tories' scheme as "fatally flawed", and professed a commitment to a " publicly owned and publicly accountable railway". But on entering office Labour made only marginal modifications to this scheme, fearing that a bolder reversal would prove too expensive, disruptive to the industry and politically controversial. As two academic commentators have put it recently:

> Ministers who saw the train as "central to solving all our transport problems" were content to rely on an industry structure they had heavily criticised to deliver the level of service improvements necessary to place the railways at the heart of their sustainable transport policy. (12)

But the result of this decision has been that public money has been demonstrably wasted to very little result as it is poured into an unresponsive, inefficient and leaky system; the disruption caused by the ongoing failings and fiascos of privatisation – most notably the "collective nervous breakdown" following the Hatfield tragedy of 2000 – has been greater than any upset a more determined reversal of the Tory privatisation would have entailed; and, in failing to see the potential popularity and symbolic value of a policy that opinion polls show is supported by the vast majority of the British public, Labour has arguably missed one of the first great political open goals of the new century.

There is a danger that future generations will look back on this episode as one of the greatest disappointments and missed opportunities of Labour's current period in office. But it is not yet too late.

2
Britain's railways: the historical legacy

The problems of the UK rail industry are deep-rooted and long-standing, and predate by some decades the disastrous Tory privatisation which compounded and exacerbated them.

Indeed, the difficult history of Britain's railways can arguably be seen as a particular instance and manifestation of a general set of problems that afflicted and held back social and economic development in this country for much of the twentieth century: low and uneven levels of domestic industrial investment, and the weaknesses of the British state in taking up any strategic and developmental role (13).

In the case of railways, this can be specified as two long-running and interrelated problems that have at various stages and to various degrees held back the industry since its earliest development:

- the industry has suffered from fragmentation and a lack of strategic coordination
- the industry has suffered from low and uneven levels of capital investment

The economics of a public service railway

This is a particular problem for the railways because of two fundamental features that need to be borne in mind throughout any discussion of their history and indeed of the policy options that now lie before us.

The first is that, as every economics student knows, **the railways are a "natural monopoly"** – economies of scale and issues of organisational coordination mean that the most efficient way of running a railway is through a unified system of planning and control – a "single directing mind", as recent discussions have been putting it. Without such integrated coordination and strategic direction, wasteful duplication of knowledge, skills, activities and services, and excessive bureaucracy and transaction costs arising from a plethora of organisational interfaces, are bound to occur.

The second key feature, less widely appreciated, is that the railways form a capital-intensive industry with very high fixed costs – major resources are needed to invest in and maintain the network, the benefits of which are reaped only over a very long period of time, and this investment cannot be easily varied in response to short-term changes in demand for rail travel – not without a counter-productively negative impact on that demand.

The important consequence of this basic structural reality is that railways have rarely if ever been "profitable" in a commercial sense and have always been and **will always be in need of substantial public subsidy and support** if the maintenance and development of the network and service is deemed to be in the public interest. As Francis Terry puts it, "the broad economic benefits from having a good communications network can seldom be fully reflected in charges at the point of use" (14).

Deep-rooted cultural and political resistance to a clear recognition of these points, and reluctance to accept the policy implications, have meant that Britain's railways have followed an uneven and troubled path of development over the past two centuries. Schematically, this story might be simply summarised in terms of the interplay and mutual reinforcement of these two failings:

- for **the first 100 years** or more of its development, Britain's railways suffered from both fragmentation and underinvestment

- from **1948 to 1994**, the period of public ownership, better industry cohesion and strategic direction evolved but investment remained low and uneven

- from **1994 to 2000** the Conservative privatisation experiment returned the industry to a state of extreme fragmentation

- from **2000 to the present** investment has increased under Labour's Ten Year Plan but the railways remain fragmented and poorly coordinated

The early development of the railways: the failure of market forces

As Christian Wolmar says, the railway network which spread across Britain in the nineteenth century was "built by private enterprise and on the cheap, which is the root cause of many of today's problems" (15).

The absence of any strategic planning or oversight led to wasteful duplication of lines (Britain ended up with a denser network than any other country) and slow progress in establishing industry standards and systems of coordination. The UK experience contrasted sharply with parallel processes in other countries, were governments early on took an active and central role in supporting and directing the development of a railway network as a matter of wider social and economic interest. The Belgian railway system was entirely state-directed from the start, for example, while others such as the Swiss were nationalised at an early stage.

The consequence was severe financial instability in the industry. New railway lines would fold within twenty years of opening, followed by liquidations. The average return on railway shares between 1850 and 1873 was only 3.65 per cent. Even the most successful companies rarely generated a return of more than 5 per cent. The rail companies found it difficult to meet the long-term investment needs of the network at the same time as the immediate demands of their shareholders, particularly during economic downturns which impacted upon fare revenues (16).

In a belated and insufficient effort to consolidate and rationalise the industry, the government legislated in 1921 to amalgamate the more than one hundred railway companies into four big regional monopolies. But these fared little better. In the context of an economic downturn and increasing competition from road transport operating expenses were difficult to recover. The rate of return on capital fell to 2.9 per cent. For the inter-war period as a whole investment amounted to less than the depreciation charge, resulting in an increasingly dilapidated network (17).

The era of British Rail: managing decline

As Jean Shaoul has written, Britain's railways "were nationalised after the Second World War in part at least because of their severe financial problems that were never overcome, even under public ownership" (18).

Though Labour had been committed to the principle of public ownership of the railways since the early twentieth century, by 1945 the policy was as much driven by the needs and explicit demands of British industry as by ideology. British businesses "keen to move their goods cheaply, saw the railways as a public service which should not be run as a profit-making business" (19). Labour transport minister Alfred Barnes argued for consolidation "of the various elements of transport … into a single whole which would operate at the least real cost to trade, industry and the travelling public" (20).

However, this broader economic and social imperative came into conflict with the Treasury's reluctance to commit public funds to the network, and a widespread (and of course, we now know, faulty) presumption that the growth in car travel and developing motorway network would render rail travel increasingly redundant (21). British Rail was crippled by payments to the former railway shareholders and on the major debts it had taken on, while any investment in the network had to be financed through interest-bearing public debt rather than government grants (22). The result was that the network continued to deteriorate faster than it was being renewed, and investment could never reach the level needed to reverse the spiral of decline.

From 1979 Margaret Thatcher was unabashed in her disinterest in public transport and enthusiasm for the "great car economy", while her government instituted a requirement that the railways make a 6 per cent return on capital employed. Thus, in Shaoul's words,

> by the 1980s, the form of the nationalised regime, far from resolving or compensating for the structural problems of the industry, was arguably more

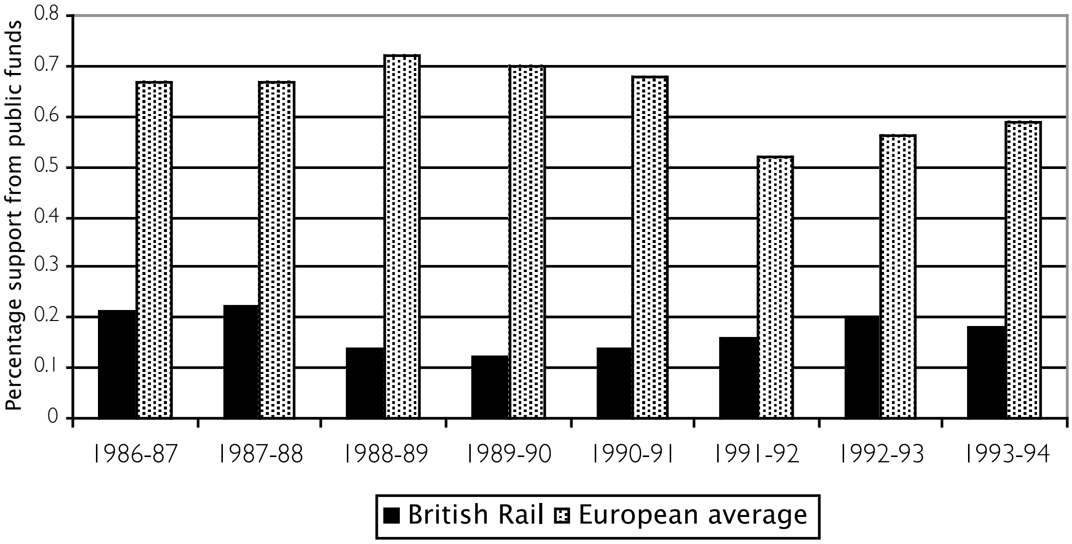
onerous than that of the private sector itself. It combined the commercial for-profit requirement with political control hostile to rail. (23)

The Conservative government also sold off British Rail's surplus-generating subsidiaries in areas like hotels and shipping, depriving it of the sources of cross-subsidisation upon which its meagre investments in socially necessary services and networks depended.

The performance of Britain's railways under public ownership

No assessment of the performance of Britain's railways under public ownership can then be complete without accounting for the fact that they received less public financial support than almost any other railway system in the world. In the period running up to privatisation government grants had fallen from 26 per cent of revenues in 1976 to 15 per cent in 1994, making BR the least subsidised railway system in Europe (24).

Fig. 2: Government support for British Rail before privatisation



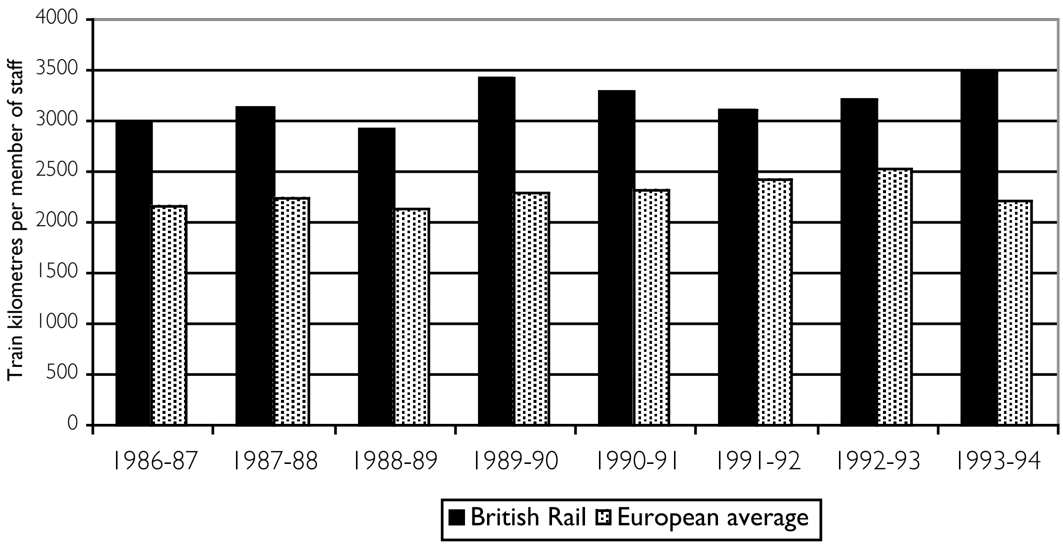
Source: Shaoul, J (2004) from British rail annual report and accounts (various years) (25)

As a consequence, even under nationalisation investment in Britain's railways remained at rock-bottom levels compared with other countries: just 26.4 pence per train kilometre per year, compared to 70.3 pence in France, £1.28 in Germany and £2.15 in Austria (26), which is why other countries now have well-developed high-speed rail networks while Britain has barely begun in this area.

British Rail did not, then, provide a truly modern, high performance, high quality system of railway transport. Like other UK public services assessed in comparison with other countries, we can see that it provided a low-cost service that was basic but, within the financial parameters set down by the Treasury, highly efficient – the most efficient in Europe, in fact.

In its later years it became recognised that British Rail was "boosting productivity enormously" (27). As Jean Shaoul says, examination of BR's record "suggests that private sector management has no monopoly on efficiency techniques". Between 1976 and 1994, BR shed one third of its workforce. Wages rose more slowly than the rate of inflation and less than those in comparable trades (28). Working practices were modernised and labour-saving technologies introduced. Britain pioneered single-manning and driver-only operation. BR's infrastructure engineers could match the cost and quality of the best in Europe.

Fig. 3: Labour productivity under British Rail before privatisation



Source: Shaoul, J (2004) from British rail annual report and accounts (various years) (29)

In its final restructuring British Rail was split into four divisions: Railfreight, InterCity, Network South East and Regional/Provincial, each of which ran as "stand-alone businesses … whose managers were expected to run them like commercial concerns by taking responsibility for marketing, investment and cost allocation" (30). The first two of these were profitable by the late 1980s. Observers of the industry during this period recognised that in general British Rail was offering a highly competitive service:

> In recent years, under existing management, considerable strides have been made towards providing a modern efficient customer-oriented service comparing well with that in other countries… (31)

BR's safety record was excellent, and its service reliability far better than customarily presumed, especially when the restrictions on infrastructure investment and severe squeeze on labour costs are taken into account. Wolmar concludes:

> Through a combination of tight management under a good run of chairmen and some, though insufficient, investment, BR had largely got it right. The management had finally got rid of the regional baronies, they had developed a competitive – or market-orientated – fares policy, strikes were reducing, the passenger's charter had been developed as a means of measuring performance – which was improving … efficiency was the best in Europe and productivity still rising. British Rail bore comparison with any major railway operation in the world. It was "little short of miraculous in the circumstances", as [a] former BR board member put it… (32)

This peak in the UK railways performance in the early 1990s came at the end of a long process of consolidation, integration and rational and strategic planning that despite an investment policy that remained problematic had at least begun to overcome the disorganisation and chaos of the railways' early history. The lesson of the railways' long development is that such a complex yet essential system needs focused strategic direction based in a clear vision of the various social and economic roles that it needs to fulfil.

Analysts of this history have suggested that, in Mark Casson's words, "the evolution of consolidation reveals the work of 'invisible hand', moving the system slowly towards the most efficient organisational form". But this achievement was to be dismantled in a matter of months.

> Overall, it can be seen that for a period of about 150 years, from 1825 to 1992, there was a progressive consolidation of ownership, culminating in unitary control from 1948. This evolutionary process was reversed in a single radical step on privatisation in 1993. (33)

3
The disaster of privatisation

The patent absurdity and disastrous consequences of the Tory experiment in privatising and marketising the railways are well known. But it is important to understand properly exactly what went so wrong, and why.

There is little doubt that the privatisation of British Rail was one of the most ill-thought through policies actually put into practice by a British government in recent years. The idea was seized upon for ideological and short-term political reasons, its working detail devised hurriedly by ministers and civil servants as they rushed to legislation, its likely consequences barely subject to any serious assessment at any stage (34).

Insofar as there was any rationale or justification behind the policy, two basic premises can be identified:

- it was claimed that **competition and contracting** between different components of the industry would lead to greater efficiency and innovation
- it was believed that privatisation would allow the government to pass the burden of **funding, financing and risk** from the Treasury to the private sector

These theories resulted in a policy that would fragmentation of the industry into a multitude of private profit-seeking firms:

- a single **"track authority"** (originally Railtrack) charging train operators for access
- hundreds of **engineering and infrastructure companies** ("INFRACOs") contracted (and subcontracted) to Railtrack for maintenance, renewal, signalling, etc
- 25 **Train Operating Companies** ("TOCs") charging fares to passengers and paying "track access charges" to the track authority
- 3 regionally based **freight companies** (subsequently sold to a single bidder and consolidated as the English Welsh and Scottish railway)
- 3 **Rolling Stock Companies** ("ROSCOs") maintaining and investing in rolling stock and letting them on hire to Train Operating Companies

This fragmented industry would then be regulated by a number of new agencies:

- an **Office of the Rail Regulator** (ORR) supposed to prevent the track authority from abusing its monopoly position by fixing the track access charges

- an **Office of Passenger Rail Franchising** ("OPRAF") licensing TOCs, penalising and rewarding their performance, and subsiding them in the initial stages

- **Her Majesty's Railway Inspectorate** (now based within the Health and Safety Executive) to monitor safety standards and investigate accidents

The extraordinary story of how this all worked (or rather, didn't work) in practice has been told in colourful detail elsewhere, and need not be recounted here (35). What is most important for our purposes is to gain a broad understanding of why it was such an inappropriate and damaging policy to take to Britain's railways.

This can be simply summarised in terms of the fundamental flaws in the two key premises of the Tory policy – the benefits of competition, and the potential of private finance. As history should already have suggested, the relevance of these Tory shibboleths to the railways was highly doubtful.

The failure of competition

As we have seen, the railways comprise a complex system of interconnected infrastructures and activities that depend upon careful, finely judged and flexible coordination at all times to ensure their smooth running. For this reason the industry is simply not amenable to being broken down into component parts as if they could have operated independently upon one another.

The first consequence of this was that "competition" would in any case always be something of an illusion, with the result that the main effect of privatisation was to create a series of **private monopolies and near-monopolies**. The "track authority" was a private monopoly, Railtrack, whose charges were subject to regulation to try to keep it from abusing its monopoly position, and which could only be replaced at great cost to the taxpayer and travelling public (as we all discovered in 2001).

Competition between the Train Operating Companies for passengers along the same routes took place only at the margin, and at huge costs. The vast majority of their business took the form of the effective monopoly over a given area of the network granted under their franchise, subject again to performance and fares regulation by OPRAF, and again they were difficult to replace meaning that the withdrawal of a franchise could only be a last resort. In any case a secondary market in train company take-overs soon resulted in the majority of services being controlled by four large groups: National Express, First Group, Connex and Virgin/Stagecoach (36).

Similarly the proposed three freight companies were amalgamated into one at the point of sale; and the profit margins extracted by the three Rolling Stock Companies (which ended up in the hand of three banks – HSBC, Royal Bank of Scotland and Abbey National) have prompted increasing questions about their market power over the train operators who lease their trains.

Not only did the disciplines of "competition" prove to be largely chimerical, the break-up of existing networks of communication and cooperation in the industry would carry a huge cost which we are still counting today. The **replacement of collaborative with adversarial relationships** throughout the industry resulted in massive transaction costs – rocketing legal and consultancy fees, elaborate mechanisms of contract and performance monitoring, and cumbersome regulatory bureaucracies.

Moreover, none of these measures proved equal to the task of maintaining requisite standards of work and service delivery – the delivery of an efficient and effective railway service involves a constant process of fine judgement in response to changing factors and circumstances that can never be reduced to the crude and simple terms of a legal contract or output target. In the absence of a shared commitment to the overall service that a proper public service ethos can bring, there will always be ample opportunities to cut corners, sidestep difficult problems and pass responsibility or blame to other agencies.

In addition to this, one of the most devastating consequences of the privatisation process was the **fragmentation and loss of industry knowledge**. Running a railway – making decisions about investment, timetabling, safety, workforce deployment – requires an intimate acquaintance with changing infrastructure conditions, technological possibilities and service requirements throughout the network, that in the case of British Rail was held collectively by its workforce and managers and brought to bear upon decision-making through systems of cooperation and communication at all levels of the industry. This organisational knowledge base, never wholly centralised and much of it effectively tacit, was dissipated with the break up of the industry.

Many highly skilled engineers who knew things about the railway network that no one else did lost their jobs; some hired that knowledge back to the industry as private consultants (37). Habits of information sharing and freely given advice were interrupted by the requirements of commercial confidentiality. Hard-won accumulations of local and specialised knowledge were lost in the shift to an increasingly casualised and individualised workforce. (38)

The failure of private investment

The other key rationale of privatisation was the belief that an influx of private funding and investment would allow the Treasury to scale back public subsidy and allow private financiers to shoulder the risk. An understanding of the financial history of the railways could have shown that this was unlikely to work.

Railtrack had no interest in developing the railway network and, with track access charges fixed by the regulator, quickly saw that returns to its shareholders would be maximised by cutting back on maintenance and renewal costs. As a consultants' report to the Rail Regulator diagnosed in 1999:

> Railtrack has no effective incentive to enhance and develop the network in an entrepreneurial manner [and] the performance regimes are structured to encourage focus on short run benefits rather than on long run considerations of asset condition and network capability. (39)

Demands placed upon Railtrack by the original Conservative plan were low but even then total investment was only £3.84 billion over the four years to March 2000, "still less than either expected or required" (40). Instead of investing in the infrastructure Railtrack maximised dividend payments by adopting a policy of "sweating the assets" by slowing down the rate of track replacement and modernisation. Meanwhile dividends totalling £709 million were paid out between 1995-96 and 2000-01, representing 41 per cent of total operating profits and a significant "opportunity cost in lost investment" (41).

A similar neglect of long-term investment needs in preference for short-term profitability was replicated throughout the industry, as the multitude of private contractors and subcontractors each sought to extract a surplus for their contribution. In Wolmar's words, "The railways are inherently unprofitable, and fragmentation into smaller, *soi-disant* profitable companies can only worsen this fundamental problem, since each entrant needs to make a profit" (42). As Gerald Crompton and Robert Jupe put it,

> The structure of the privatised system had major implications for railway finances and railway investment. These may be summarised as "interface costs" and "cash leakages". Interface costs arise because many companies are involved in a supply chain, and so there is upward pressure on prices as each company aims to make a profit on its contribution. (43).

This process has been identified as a key factor in the escalation of infrastructure maintenance costs as every subcontractor looks for their mark-up. As one observer describes it, "There are so many piddling sub-contractors, and contractors are taking a 10 per cent management fee." (44).

Further drains on the public purse emerged when several train operating companies got into difficulties after winning franchises on the basis of over-optimistic bids. Subsidies to train companies were supposed to decline under the Conservative plans, but a number of firms were bailed out by the government to help them stay profitable, as a smaller price to pay than the disruption that would have resulted from the company being unable to run services. Longer franchises have been proposed to encourage operators to make their own investments, but it is clear that TOCs have little interest in long-term investment, being near "virtual companies" contracting with the government and renting trains and stations from others (45).

Wolmar summarises the situation thus:

> The belated discovery by those who privatised the railway that the network is inherently unprofitable meant that any hopes for a privately led investment revolution in the railways would be stillborn. In fact, as Railtrack's chief executive Steven Marshall has admitted, there are no commercial projects on the railway. All investment on the railway had to be mostly – and now, after the collapse of Railtrack, often entirely – funded by the taxpayer. (46)

Overall we can see that the attempt to lever in extra private investment into the railways has resulted in neither service improvement, nor reduced risk, nor reduced taxpayer subsidy (in fact all these have moved in the opposite direction). As with other mechanisms to involve private finance in public services (47), the only clear beneficiaries have been the Treasury mandarins eager to keep commitments off the PSBR, and the private shareholders and financiers who have steadily drawn value out of the industry in the form of windfall profits and guaranteed returns.

4
New Labour's modifications

New Labour's policy towards the railways since 1997 has hardly ever remained still but has continually evolved over time – a measure, perhaps, of the inadequacy of its original starting point.

As we have seen, Labour shied away from major structural change to the railways when it came into office. As Gerald Crompton and Robert Jupe have noted, "the key change introduced by *Transport 2010* was financial rather than structural – the need to increase public funding in order to expand the network and increase passenger and rail freight use over ten years" (48).

Thus the railways were left in their privatised and fragmented state, with the government hoping that increased investment and better coordination could be brought to the industry by applying pressure from the outside, through tighter regulation and strategic "leadership". This translated into a number of modifications to the regulatory structure that it inherited from the Conservatives which were aimed at ensuring that the increased levels of public investment produced the right results.

- the Office for Rail Passenger Franchising was renamed the **Strategic Rail Authority** with an enhanced role directing investment
- **Passenger Transport Executives** (PTEs) were given an enhanced role in implementing integrated transport strategies for major conurbations

In addition to these reforms contained in the 2000 Transport Act, further shifts in the government's relationship to the railways followed in response to events, notably the Hatfield crisis and the continuing failure of the industry to improve services and modernise the network:

- in October 2001 Railtrack was taken into administration, and replaced a year later by **Network Rail**, a government backed not-for-profit trust funded by debt
- in December 2001 new SRA chairman Richard Bowker instituted a more proactive and interventionist **passenger franchising policy**
- in June 2003 the SRA announced that it would be taking over the **South Eastern franchise** from poorly performing operator Connex
- in October 2003 Network Rail brought all **maintenance work in-house** as a step towards controlling infrastructure costs

- in February 2004 the first new **integrated control centre** was opened at Waterloo Station to bring about closer working between Network Rail and train operators

It is clear that all these changes have been based in a recognition of the inability of the privatised industry to deliver the outcomes set out in the Ten Year Plan. Jon Shaw and John Farrington have suggested that "taken together, these policy initiatives indicate that the government seems willing for the state to assume a more active role in the operation, development and financing of the railway than that foreseen in the 10 Year Plan" (49). The Transport Select Committee have concluded that "the present, fragmented state of the railway is forcing consolidation incrementally on the industry" (50). They might even be seen as illustrating the slow return of the "invisible hand" guiding the industry back towards an optimal level of integration in response to the pressure of events.

The question, then, is whether this process has yet gone far enough. Examination of the record of the railways during Labour's tenure suggests there is a very long way to go indeed.

5
The 10 Year Plan
a progress report

The government is due to review progress on the 10 Year Transport Plan as part of this year's wider Spending Review. The picture is not a happy one.

Not only have the generous spending commitments set out in 2000 been fulfilled, spending on the railways is already above that already envisaged, and is now projected to increase even further over the remaining years of the 10YP period. But at the same time plans to develop and expand the railway network have been progressively scaled back as a result of continuing cost inflation. The result is that despite the increasing and ongoing commitment of public funds the overall performance of the railway system has barely improved and it now looks unlikely that the ambitious goals set out in 2000 will be met.

Increasing expenditure

One element of the 2000 programme that has certainly been fulfilled is that money is being spent – already more, in fact, than originally envisaged.

In January 2002 the SRA's Strategic Plan announced that the £29 billion public spending originally envisaged in the Ten Year Plan had been increased to **£33.5 billion** as a result of increases in Railtrack's "projected cash requirements" and "pressures that have arisen in getting the 10 Year Plan investment programme for the railway going" (51). Significant elements of this expenditure were brought forward, including an extra £1.5 billion advance to help Railtrack cope with the aftermath of Hatfield (52). By 2003-04 Train Operating Companies were in receipt of an extra £650 million in SRA subsidy on top of that already planned in 2000 (53).

This means that today public expenditure on the railway system has reached **£3.8 billion a year** (Table 1) – more public support than at any time in the last 30 years, and several times the level ever received by British Rail (Fig 2). The current position was recently summarised by leading railway analyst Roger Ford in a report for Transport 2000:

> simply stated, after seven years of sustained economic growth, today's privatised railway needs nearly twice the subsidy of BR in the depth of the early 1980s recession, just over four times the subsidy of BR at its most successful or 2.8 times as much in the year immediately prior to privatisation. (54)

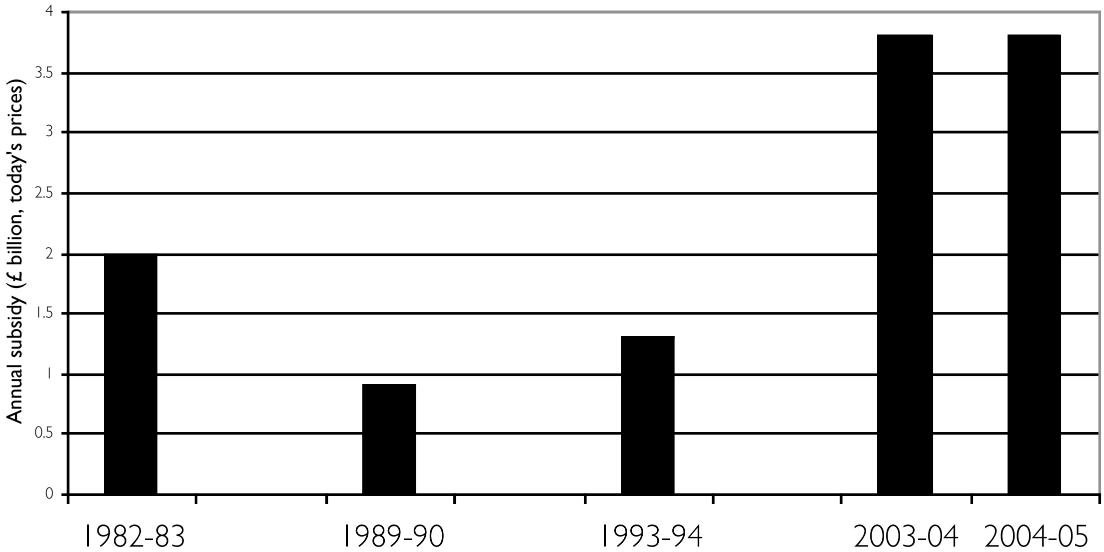
Table 1: Current projections of public sector spend on railways

(£ million, nominal prices)	2003-04 budgeted	2004-05 indicative
Funds available	**3,840**	**3,680**
DfT (mainly CTRL)	**490**	**460**
Committed grants to Network Rail*	**1,480**	**1,350**
Franchising	**1,450**	**1,570**
Freight revenue support and facilities grant commitments	**40**	**40**
Project development and implementation	**170**	**210**
SRA central and other costs	**210**	**230**
Total	**3,840**	**3,860**

* Excludes any additional charges that might arise from the Regulator's Interim Review

Source: SRA, (2003) Strategic Plan (55)

Fig. 4: Annual public subsidy to the railways – past and present



Source: Ford, R, (2003) The Rising Cost of Britain's Railways, Part 1, Transport 2000 (56)

But this is not all. The SRA's public subsidy figures for 2003-04 and 2004-05 exclude the results of the Regulator's interim review of track access charges, concluded in December 2003. In March 2003 Network Rail's first business plan envisaged total spending of £34.5 billion over the five year period 2004-05 to 2009-10 – which would have meant public subsidy increasing to around £7 billion a year. This total was progressively forced down by the Regulator until a final figure of £22.2 billion was arrived at, bringing the annual revenue requirement up to around 4 or 4.5 billion a year, still more than £7 billion above that originally allocated by the government.

Table 2: The Regulator's final conclusions on Network Rail's revenue requirement

(£ million, nominal prices)	2004-05	2005-06	2006-07	2007-08	2008-09
OPEX	1,178	1,101	1,031	991	953
Maintenance	1,222	1,124	1,034	951	875
Schedule 4 & 8 costs	78	85	91	92	93
Amortisation	1,367	1,383	1,383	1,388	1,391
Return	1,281	1,422	1,410	1,475	1,531
Gross revenue requirement	**5,125**	**5,114**	**4,949**	**4,898**	**4,843**
Other income (e.g. property; freight access charges etc)	(682)	(703)	(707)	(699)	(706)
Revenue requirement	**4,443**	**4,411**	**4,242**	**4,199**	**4,137**

* Excludes any additional charges that might arise from the Regulator's Interim Review

Source: ORR, (2003) Access Charges Review 2003: Final Conclusions (57)

After much wrangling, it now appears that this requirement will be met by allowing Network Rail to borrow (with government backing) an extra £3b for the first two years and then receive increased access charges from 2006-07. Because (controversially) borrowing by Network Rail does not increase the PSBR this will allow the government to avoid busting its own spending plans in the run-up to an election (58).

So, in broad terms (the precise figures are not always directly comparable), we can see that the railway's funding requirements for the period of the 10 Year Plan have increased steadily, from the already generous pledge of nearly **£3 billion** a year set out in 2000, to more than **£3.5 billion** now budgeted by the SRA, and now almost **£4.5 billion** a year for the remaining five years following the Rail Regulator's interim review.

At a time when government spending in other areas is being reined in, this is undoubtedly an impressive and welcome commitment of public expenditure to the railways. But what are we getting in return?

Downsizing development

As Rail magazine editor Nigel Harris has said, "the industry is *awash* with money … the problem is that it is being spent rather badly" (59). This poor return received by the public for its investment in the railway is a direct consequence of its privatised state, which as we have seen has resulted in poor planning and project management, and cash leakages as a plethora of private players ensure they get their return.

Labour's ambitious plans for developing and expanding the railway network soon began to come under pressure as the continuing cost escalation began to become clear. As early 2001 it was apparent that, in Will Hutton's words, "privatisation is leading to an explosion of costs so that the assumptions on which the 10-year transport plan were made are already history".

> The Government had budgeted to provide Railtrack £1 billion a year for steady-state upgrading of the existing network, and up to another billion to extend it – with the rest of the finance being leveraged in via the private sector. Now it faces the bill for every mile of modernised track trebling, and a reduced private sector contribution. (60).

As already noted, this escalation of infrastructure costs had begun in the years immediately following privatisation, but it is now clear that the process continued and indeed accelerated during the first years of the 10 Year Plan. The most notorious example has been the major West Coast Mainline modernisation, first budgeted at £2.4 billion but latterly soaring to the region of £13b (the latest government figure is £7.6 billion, following some adjustment of the original plans). The struggle between Network Rail, the Regulator and the Strategic Rail Authority over the fate of this project prompted the Transport Committee to remark that "It is hard to think of a more telling example of the divided leadership of the railway and the powerlessness of the SRA" (61). But it is clear that this reflects a general pattern experienced across the network. According to Roger Ford's latest analysis, OMR figures for 2002-03 show an 80 per cent increase on 1999-00 and 2.7 times the figure of ten years earlier. Ford concludes:

> These statistics suggest that the cost of infrastructure renewal schemes has increased in two stages since privatisation. For the first five years there was a gradual rise, which can be explained by a number of factors, including margins on margins through a chain of subcontractors, the loss of productive time in possessions due to safety regulation changes and increased bureaucracy. After the Hatfield derailment in 2000, costs escalated dramatically.

Overall this has meant that "unit costs have increased by a factor of three or more since privatisation. In some cases the multiple can be as much as five times … the most serious conclusion is that when government ministers claim record levels of 'investment' in the railway, the money is buying perhaps a third of its pre-privatisation value". (62).

This has gradually been conceded in government statements. In December 2002 the SRA began to try to scale down expectations, admitting that its £33.5b ten year budget "was now largely allocated" to simply maintaining the railway infrastructure in its current (far from satisfactory) state, and that there was effectively nothing to spend on enhancing and expanding the network. "Electrification and platform lengthening might suffer, along with upgrades to Thameslink and to urban rail systems in the West Midlands and Greater

Manchester." (63). Richard Bowker was quoted as warning that 'Costs are rising steeply both in projects and in operations, and this is squeezing out funding for investment". The allocated £33.5 billion "now buys less than it did … so there is less to invest" (64).

The Department for Transport's progress report on the 10 Year Plan published at the end of 2002 seemed hesitant, stating that "Expanding the capacity of the rail network remains a central objective of the 10 Year Plan, and is reflected in the medium-and long-term priorities set out in the Strategic Rail Authority's (SRA) first Strategic Plan" (65). But the new Strategic Plan published by the SRA in January 2003 confirmed that the West Coast Mainline Upgrade would be cut back and that measures to relieve congestion in the south east such as Thameslink and Crossrail would be delayed (66).

Last September, as it became clear that its original request for funding of £35 billion (£7 billion a year) over the remainder of the 10YP period would not be approved by the Regulator, Network Rail warned that revisions to its business plan would mean "shabbier stations, less reliable signals and more broken rails" (67).

As Alastair Darling's statement to parliament in January this year made clear, the extra money now allocated to the railways following the Regulator's review of access charges does not mean that we are going to get extra capacity or faster progress towards performance improvement. It only reflects the recognition that "the cost of upkeep of Britain's railways is £1.5 billion a year more than was thought necessary just three years ago" (68).

Downscaling ambitions

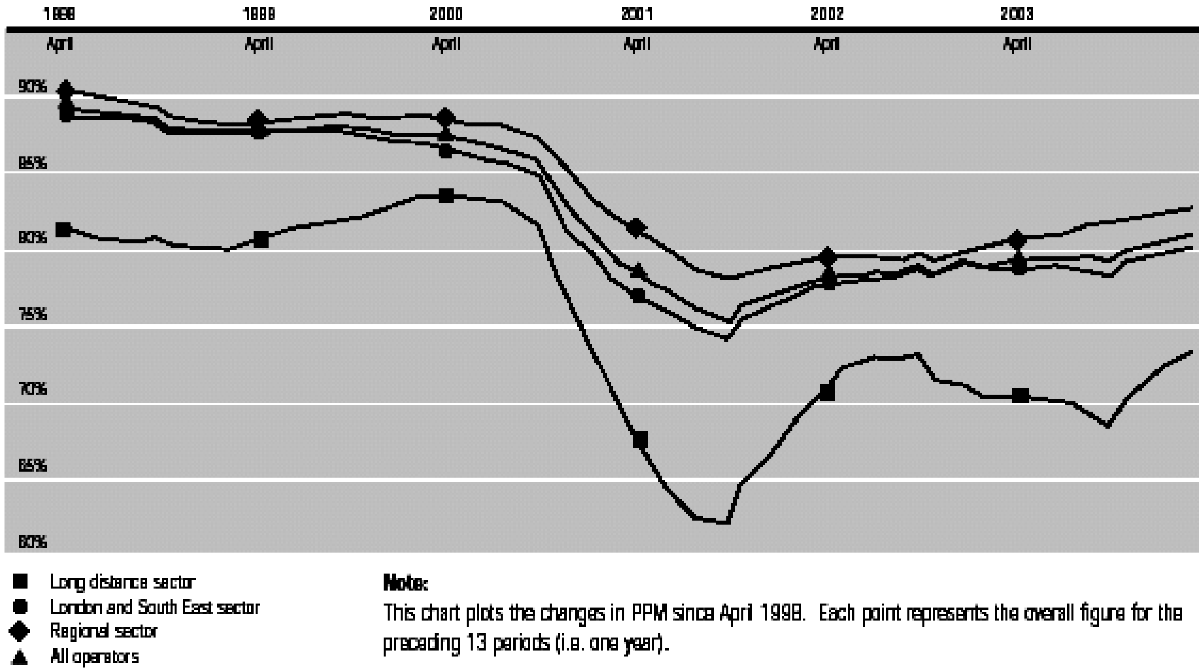
Predictably, this continual cutting back of enhancement plans has meant that very little improvement in the performance of the railway has been seen and the ambitious targets set out in the 2000 Ten Year Plan now look unlikely to be met.

Performance

A key aim of Labour's Ten Year Plan was to return the performance of the railways (standardly measured by a combined index of punctuality and reliability known as the "Public Performance Measure" or PPM) to levels experienced on British Rail before privatisation – meaning, broadly speaking, than nine out of ten trains arrive on time.

In the aftermath of the Hatfield disaster this measure, predictably, crashed to a mere 75 per cent, but most dismaying has been the slow progress in recovery since – still, according to the most recent figures, barely four out of five trains arrive on time, and there is now no serious intention of raising performance levels to those experienced in the late 1990s and not until 2014 that we will see an actual improvement on performance levels established in 1999.

Fig 5: Public Performance Measure: moving annual percentage of trains arriving on time



Source: SRA National Rail Trends 2003-04, p. 14, Table 2.1 (69)

The Transport Select Committee recently described this performance as "highly unsatisfactory", noting that

> As public sector support for the railway has tripled, underlying spend has doubled and revenue has remained static; while the SRA's graph reveals the industry's inability to sustain and improve its performance. The taxpayer has paid progressively more in this period for a declining service. (70)

In addition to the uninspiring progress on train delays, overcrowding remains at levels higher than in the late 1990s. Last year the House of Commons Transport Committee found that "the level of overcrowding is so great that many travellers face daily trauma on their journeys. Passengers are unable to board vehicles, or if they can, are forced into intolerable conditions". On rail, this was the result of "lack of track capacity, a flawed franchising structure, a substandard and unreliable network, a lack of vehicles, or the choice of inappropriate train formations" and "the problem is not being treated with anything like sufficient urgency" (71).

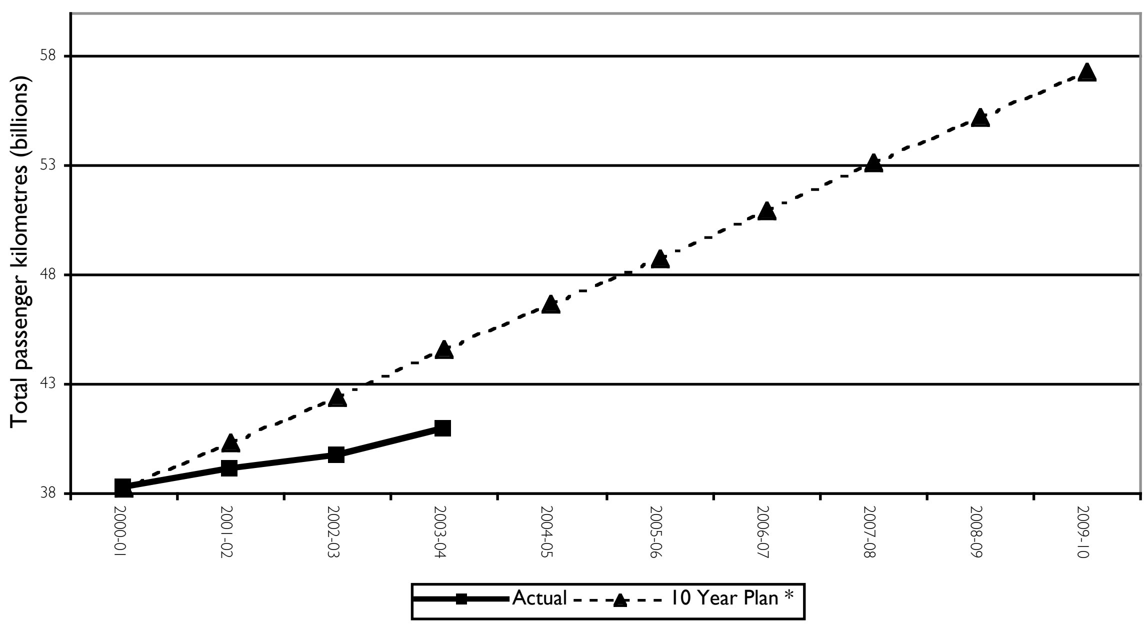
In consequence it is not surprising that passenger satisfaction on the railways, far from increasing as one would hope given the public money invested, is actually declining slightly – figures quoted in the Department for Transport's annual report of this year show that the percentage of rail passengers who were "fairly or very satisfied with the journey just completed" fell between spring and autumn 2003 (72).

Growth

Lack of progress on enhancing capacity and improving performance has of course impacted upon the government's hopes to see a historic growth in railway patronage as passengers and freight shift away from roads and private motor transport.

At the end of last year **passenger kilometres** travelled were just 5.8 per cent above their level at the start of the 10 Year Plan (73) – nowhere near the rate of increase needed for the government to be on course to meet its 10 Year target of raising passenger levels by 50 per cent.

Fig. 6: Growth in passenger kilometres



* The Ten Year Plan gave no interim growth targets so graph assumes an equal annual increase to reach 50 per cent target

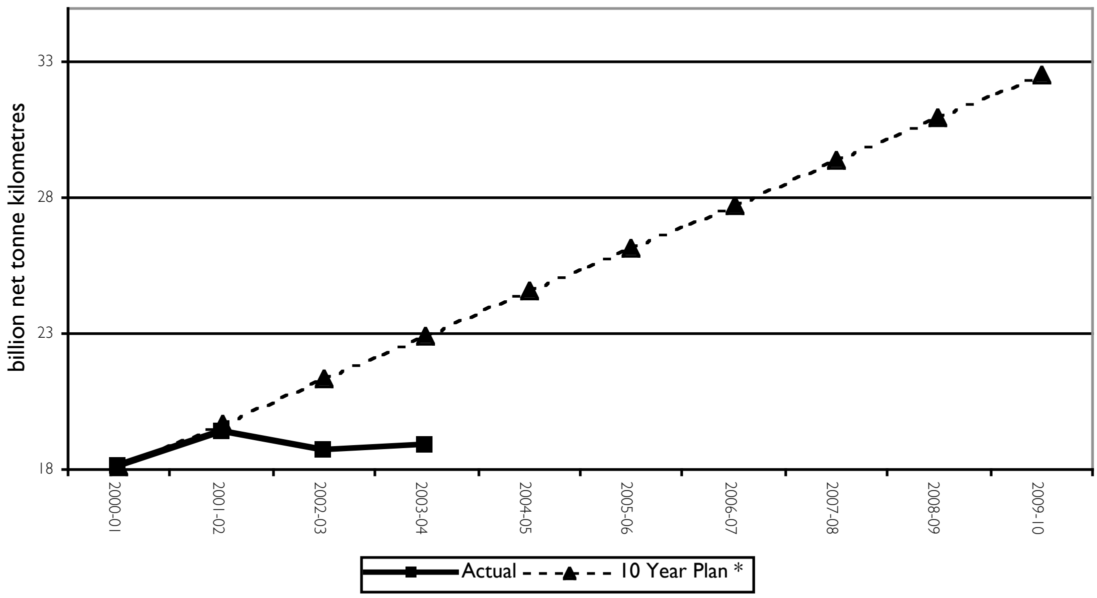
Source: SRA National Rail Trends 2003-04, p. 14, Table 2.1

In March 2002 Richard Bowker was already backing away from the 50 per cent passenger target, suggesting instead that "40 to 50 per cent" might be a more reasonable range. As academic commentators suggested, "That the bottom end of this range is fully 10 percentage points below the target in the 10 Year Plan would seem to indicated that Bowker is less confident of achieving 50 per cent growth than he was prepared to admit" (74). The government's own December 2002 progress report made no mention of the freight target and mentioned the passenger target only on page 51.

The SRA Strategic Plan of January 2003 explicitly renounced the 50 per cent passenger growth target and substituted a new "planning forecast that by 2011, passenger rail travel will be 25-35 per cent greater in passenger kilometre terms than it was at the beginning of the 10 Year Plan Period". This was ascribed to "the recent slowdown in growth and uncertainty about the pace of project implementation" (75).

Even more disappointingly, freight levels, which the government had proposed to increase by 80 per cent in 2000, are now actually falling according to the latest figures (76), mainly as a result of the government's acquiescence in the Royal Mail's decision to phase out its use of rail for postal distribution.

Fig. 7: Growth in freight moved



* The Ten Year Plan gave no interim growth targets so graph assumes an equal annual increase to reach 80 per cent target

Source: SRA National Rail Trends 2003-04, p. 14, Table 2.1

The Ten Year Plan target of increasing rail freight levels by 80 per cent is now rarely raised – astonishingly, it did not receive a single mention in the government's own "progress report" on the Ten Year Plan published in December 2002.

Shaw and Farrrington conclude that "if rail is to continue to play an expanding role in the future of Britain's transport system, the level of long-term investment required in the network will far outstrip the amount 'budgeted' between now and 2010" (77).

Conclusion

All in all, these figures show the true costs of the government's failure to take radical steps at the very beginning of its period of office. If steps had been taken to bring cost escalation and cash leakage under control at the start, then the money committed to delivering the 10 Year Plan might have been well spent. Instead increasing levels of public money have been spent on simply maintaining a system in the far from satisfactory state that Labour found it. As Jon Shaw and John Farrington have concluded, "the government has ended up having to pay significantly more than it did in 1997 for effectively the same railway (or arguably a worse railway since the state of the infrastructure has deteriorated)" (78).

Putting the point graphically, the House of Commons Transport Committee noted that the estimated cost of building an entirely new railway network from scratch was in the range of £11 to £27 billion, and that the government was already well on its way to spending this with very little to show to it. "The sums which have been used ineffectively by the Government's railway structure in propping up the present, poorly performing system, could have paid for a large proportion of a new railway network" (79).

Meanwhile academic commentators have suggested that the Transport Ten Year Plan and in particular its ambitious but wholly necessary targets for reducing congestion and developing public transport are now looking highly doubtful.

> Despite ministers' wish to … offer "the potential for a railway renaissance", developments within the industry and government transport policy have cast doubts over the likelihood of this being achieved in the terms set out in the 10 year plan. Uncertainties over the availability of the finance and skills to procure necessary capacity enhancements will be compounded by the failure to develop a range of complementary policy initiatives capable of increasing rail patronage and modal shift from cars and lorries. (80)

6
Towards a public service railway

It is clear that we still do not yet have a railway industry capable of delivering the performance levels and capacity growth that will be required by an integrated transport policy adequate to the challenges of the twenty-first century.

This was the conclusion was arrived at by the House of Commons Select Committee, who concluded a major investigation into the future of the railways earlier this year. While noting the most recent gestures toward the need for better cooperation and coordination in the industry, the Committee concluded

> there is no evidence that this effort of coordination is mitigating industry fragmentation, or improving service performance. We have seen no evidence, since our predecessors reported two years ago, that fragmentation in the rail industry has reduced. Indeed, our evidence has suggested that it is getting worse. In addition, industry costs are increasing; performance remains in the doldrums; and the SRA appears utterly incapable of managing significant improvements… (81)

The rail review

The government has recognised the inadequacy of the current position in its announcement of a major review of the railway system in January 2004. The purpose of the review, according to Transport secretary Alastair Darling, would be to "look at the structural and organisational changes we need to allow the railways to improve performance".

> Taxpayers and farepaying passengers alike need to know that their money is being well spent and that increased spending will improve performance. Cost control is essential … the £64bn public and private investment announced in 2000 is making a difference … But … there remains a further and very serious difficulty facing this industry – that is its structure and organisation. The way in which it was privatised has led to a fragmentation, excessive complication and dysfunctionality that have compounded the problems caused by decades of under investment." (82)

This recognition that the status quo is not delivering and the situation needs to change is an important step forward.

But the White Paper that has now emerged from the review process is a disappointment, indicating that the government still is not yet prepared to take the measures necessary to address these problems once and for all. The government has now proposed to close down the Strategic Rail Authority, transferring its strategic role to a new agency at the Department for Transport and its operational functions to Network Rail which will now have a clearer responsibility for services (83). Such incremental steps may help to "streamline" regulatory structures at the margins but in the light of recent experience there is little reason to think that they will make a major difference to the problems of industry fragmentation that the government's review rightly identified and that the White Paper does little to address directly.

A new public agenda for rail

The White Paper is explicitly premised on an acceptance of "rail's status as a public service, specified by the Government and delivered by the private sector" (84). But it is precisely this "public private partnership" that has proved to be unworkable over the ten years since privatisation. As transport analyst Francis Terry has noted, it is the government's continued faith that the market can deliver an effective railway system that is "undermining much else that is done to achieve better integration and stronger coordination of transport services. It is a principle whose practical worth needs urgently to be re-evaluated." (85).

Similarly, the recent evaluation of the progress of the Ten Year Plan by Gerald Crompton and Robert Jupe concludes that "the government was over-confident in believing that a defective privatised structure could deliver the expansion it wanted" and that "[t]he situation is unlikely to improve unless the rail industry is restructured and its ownership structure simplified" (86).

What could such an approach mean in practice? Amid the chaos and confusion of the current situation, a new agenda is now coming into view that could provide the way forward towards a railway running efficiently and effectively in the wider public interest. A number of pressing issues are raised by the current predicament of the industry:

- the status of Network Rail
- reintegrating infrastructure renewal
- reintegrating train operations
- rolling stock regulation
- providing for rail freight growth
- maintaining high safety standards
- devolution and democratic planning

These points are addressed in turn below.

The status of Network Rail

There is no doubt that the establishment of Network Rail as the new track authority was a major improvement on Railtrack. But questions remain as to whether this hybrid form of "public interest company" is indeed the most effective model of ownership for the railway network. Advocates of this solution argued that its advantages over traditional state-ownership would be "accountability to stakeholders" and "access to private finance" (87). But both these advantages can be questioned.

The question of Network Rail's accountability is a vexed one. There seems to be some confusion as to whether Network Rail as a "public enterprise" can be presumed to act in the public interest or whether it remains a private monopoly that must be subject to regulation. According to the IPPR, the public interest is protected by Network Rail's public members so that "there is no need for the same kind of economic regulation to protect taxpayers from shareholders in the new Network Rail environment" (88). Meanwhile the Rail Regulator clearly regards Network Rail as "the monopoly provider of an essential service" who should be expected to try to extract the maximum sum from the taxpayer for the minimum return (89). The National Audit Office report into Network Rail also notes that "[t]here is an issue as to how effectively the SRA can effectively provide the industry with a strategic lead … [when] the SRA is wholly reliant on Network Rail's own commitment to the strategic objectives" (90)

The New Economics Foundation, a think tank closely associated with the development of "non-profit" models for restructuring public services, has been highly critical of Network Rail's governance structures, describing them as "a closed loop of accountability – the directors are accountable to members who are effectively chosen by directors" (91). The Transport Select Committee reported that

> Network Rail did not convince us that the members of the company were exercising an effective control of the company. We were also concerned that industry members were virtually self appointing. These members include contractors, and while members have a duty to the company, there was always some possibility of the appearance of a conflict of interest. (92)

It has also been questioned whether Network Rail provides the most efficient way of financing investment in the railway infrastructure. Network Rail's loans are guaranteed by government standby credit of up to £21 billion. Because of this guarantee many have concluded, including the Comptroller and Auditor General, that Network Rail should be counted as an effectively renationalised subsidiary of the Strategic Rail Authority, but the government has battled to keep it classified as private so that its debts do not appear on the public balance sheet (93).

But the price of its classification as a private company is that it is more expensive for Network Rail to borrow than if it were in the public sector. As the National Audit Office says, Network Rail's "short and medium term funding is supported by the SRA at a higher cost than pure government funding" (94). The view of the Transport Select Committee is that "what has happened is that the Government has accepted the risk of the Network Rail operation, but on more expensive terms than it need have had it direct ownership of the company". (95) Jean Shaoul of the Manchester School of Accounting and Finance has put the point in stronger terms:

> Despite the fact that the government will have no control over the company and its loans will therefore be scored as private sector debt, it is hard to disguise the fact that Network Rail is a *de facto* nationalised company where the beneficiaries are the banks, contractors, rolling stock companies and, to some extent, the train operators … There is insufficient value added, relative to the amount of capital invested in the industry, to meet all the numerous claims consequent upon private ownership … It can only be increased by raising fares and subsidies, which in the context of private finance, whether debt or equity, means subsidising the providers of finance. (96)

Thus, as Crompton and Jupe conclude, "[e]ven after the collapse of Railtrack, the government continued to deny itself the advantages to be derived from re-nationalisation in implementing the 10-year plan. This would allow it to direct investment in the railways, reduce the cost of borrowing and enable the railways to regain the public sector ethos lost at privatisation" (97).

It is for these reasons that the Transport Committee concluded "that it is time for the Government to cut through this tangle of responsibilities and take direct ownership of Network Rail on the grounds that a Railways Agency, incorporating the rail infrastructure, will ensure both the lowest borrowing costs to meet the necessary funding requirements and direct, democratic accountability" (98). **Direct public ownership through a unified railways agency combining the functions of Network Rail, the Regulator and the Strategic Rail Authority would offer clearer accountability to the public interest and better value for money for the taxpayer.**

Reintegrating infrastructure renewal

As we have seen, the cost spiral unleashed by privatisation has yet to be brought under control and has indeed accelerated in the recent period. It is widely accepted that the basic cause for this escalation has been the fragmentation of industry knowledge, leading to poor contingency planning and project management, and the multiplication of subcontractors each looking to extract a surplus from their involvement.

An important first step towards bringing infrastructure costs back under control was taken last October when Network Rail announced that it would bring track maintenance back "in house". This is already producing impressive results. It is estimated that around £300 million a year will be saved through the resulting improvements in efficiency and coordination. In the Thames Valley Area, where Network Rail took over direct control of maintenance from Amey in June last year, delays caused by infrastructure faults have fallen by 31 per cent in the past six months (99). A spokesman explained:

> Previously, when the maintenance guys needed to get on the track, they had to negotiate with a signalman … now it's the same person responsible both for operations and maintenance. That means we can respond much more quickly to any incident.

In addition Network Rail would now be investing any profit which would have been absorbed by Amey (100). Will Hutton has described this experiment as "a case where public enterprise is so palpably more efficient than private enterprise it should provoke a national rethink" (101).

The obvious next step is to extend this lesson to renewals, which make up around 70 per cent of Network Rail's budget. The separation of "maintenance" from "renewal" was in any case always an artificial one, another arbitrary fragmentation produced at privatisation (102). If it makes sense to do one yourself it makes sense to do the other. Virgin Trains chief executive Chris Green has read the writing on the wall:

> The message on renewals is that they will go the same way unless the contractors get their act together … the railways have been fragmented too much – a bit of command and control will do no harm.

All the evidence and experience of recent years tells us that reintegrating track renewals as well could have a huge impact on the efficiency and cost-effectiveness of the railways and be a major step in beginning to reverse the fragmentation and malcoordination wreaked by privatisation.

Reintegrating train operations

It is widely accepted in the industry that one of the basic flaws of the Tories' privatisation model was its separation of "wheel from steel" – having train operations run by independent companies who contract with the track authority for use of the network. As Christian Wolmar has written:

> the best railways in the world, such as those in Japan and Switzerland, are run in a vertically integrated way, and experienced railway managers like Ed Burkhardt, the former head of EWS, argue it is essential for efficient operation. Most railway managers, too, reckon that command and control is the best way to run a railway, something that is incompatible with the current structure. (103)

This has given rise to two alternative suggestions currently being debated. One is to reintegrate train services with infrastructure management by allowing train operating companies control over their own stretches of track. For obvious reasons this is attractive to the train operating companies themselves and has been proposed by the Association of Train Operating Companies that represents them. But there are real difficulties with such a scheme, which would make the price of vertical reintegration the further fragmentation of infrastructure management and control. As we have already seen, an essential component of any plan to bring railway costs back under control must be to reintegrate infrastructure maintenance and renewal across the whole network, allowing the industry to benefit from the economies of scale and superior coordination that such consolidation would bring.

Such a scheme would also fail to address the question of whether the Train Operating Companies themselves are effective and efficient contributors to the railway. Certainly they make a healthy return from their activities – the latest figures from the National Express Group show operating profits of £32 million from their rail division in 2003, while those for Go-Ahead show profits of £19 million for only the second half of 2003. The RMT union has calculated that in the ten years since privatisation began the Train Operating Companies have taken over £1 billion out of the industry in profit. But these profits are only made possible by a constant flow of subsidy from the taxpayer – in 2003-4 TOCs received a gross subsidy of £2 billion from the taxpayer (104.)

But if much is being taken out in subsidised profit, it is not clear what the private operators actually bring to the industry. The train operating companies are a prime example of the product of public service privatisation identified by Professor Colin Crouch – contractors whose only specialty is winning and managing contracts:

> a number of firms are emerging who are specialists in the general art of government contracting, and pursue contracts across a wide diversity of sectors … Clearly such firms have no initial expertise and therefore no particular substantive value to added to offer within a new field … when they first enter it. Indeed, it is notable that they almost always recruit their professional staff from the very public authorities … to which they then contract back their services. What they possess rather is a specialist skill in winning and possibly managing government contracts from politicians and civil servants. This is not necessarily a skill which passes value added and service quality to the ultimate consumers. After all, the need for the skill could have been avoided simply by not bringing in the private agent at all. (105)

This description applies a fortiori to today's train operating companies, most of whom, as we have seen, were initially bus companies. As Mark Casson has noted:

> The main factor that explains why bus operators acquired franchises is that they had previous experience of the privatisation process when it was applied to the bus industry. Their special skills were in bidding for franchises, rather than in operating railways. (106)

But analysis of the TOCs' performance by Jean Shaoul has demonstrated that "the private train operators are no more efficient in either financial or non-financial terms than their publicly owned counterpart" (107).

An opportunity to test the TOCs' performance arose last year when Connex (recipient of more than half a billion in public subsidy since 1996) was taken off the South Eastern franchise, the operation of which reverted automatically to the public sector in the form of the SRA-owned subsidiary South Eastern Trains, pending re-franchising. The latest figures from the SRA show that the franchise is performing just as well in the public sector as it did in the private sector, and compares well with other private operators on the network (108).

Given that retention of the service within the public sector avoids the considerable cost and disruption involved in the franchising process itself as well as precluding any dividend payout and ensuring that any surplus is invested back into services, this adds up to a clear case for letting South Eastern Trains get on with the job rather than pointlessly reprivatising it. Under the Transport Act 2000 the Secretary of State can instruct the SRA to run services directly if it is believed that "services could be provided more economically or efficiently than under a franchise agreement". In the case of South Eastern Trains this already seems to be the case.

There simply is no justification for continuing with the franchising of train operations to private providers if, as independent analyses and the practical experience of South Eastern Trains indicates, the service can be provided just as well by the public sector without the extra costs and disruption of privatising them. The government should retain South Eastern Trains in public hands to serve as a public sector benchmark and take other services back in-house as their franchises expire or earlier if immediate improvements in performance can be gained.

The experience of South Eastern Trains strongly suggests that this will be the most effective way of controlling costs and cash leakages. Indeed, as more franchises were brought back under public ownership, there would be further benefits to be gained from the resulting economies of scale.

Regulating rolling stock

Rolling Stock has been claimed as one of the "success stories" of privatisation. It has certainly been a success for the companies concerned – the profit margins achieved by the three firms who now control all train leasing continue to raise eyebrows in many quarters. In 2000 Angel, Porterbrook and HSBC recorded pre-tax profit margins of 29 per cent, 35 per cent and 38 per cent respectively. The TUC has calculated that between 1996 and 2002 the ROSCOs have taken a combined pre-tax profit of £1.8 billion out of the industry.

Annual net profit margins in the region of 30 per cent become understandable upon examination of how their leasing business works. It has been reported that TOCs are being charged £144,000 a year for use of two-coach pacers, which cost £350,000 to build and lasts for 20 years. The government has questioned this, claiming that a Pacer "will have cost about £500,000 to build at present prices and is likely to cost an operator in the region of £50,000 per year to lease" (109). Even so this would ensure substantial profit margins over the twenty year period.

Most of this money comes from the public purse, through the subsidies paid by the SRA to the Train Operating Companies. The subsidy paid to Govia South Central (now Southern) franchise from 2002-03 to 2009-10 is to be doubled to £670.2 million. 80 per cent of the extra will be passed to rolling stock company Porterbrook for new trains (110).

Defenders of the Roscos cite the investment in new rolling stock that is now taking place. Certainly the average age of rolling stock is now falling, but questions are being raised about the quality of the new trains now coming into service. A new National Audit Office report has found that "Most have been late entering service and are not as reliable as they should be; often, they are less reliable than the old trains they have replaced" (111)

Again, a key reason cited by the NAO was the fragmentation of the industry:

> There is a lack of organisational coherence within the railway industry; not all of the key public and private sector parties involved have common interests in, or have been sufficiently incentivised for, the smooth introduction of new trains. Nor do the various organisations involved have a collectively agreed programme, route map or timetable for trains' introduction. (112)

Given the level of profits that are clearly derived from public subsidy, strong case exists for regulation of the Roscos, the only major arm of the industry currently outside any regulatory framework. It is only when their role and performance has been carefully scrutinized that we can really decide if their transfer to private hands has been of benefit to all.

Any consideration of railway rolling stock needs also to be integrated within a wider strategy of development and support for British manufacturing jobs. Train manufacturer Bombadier's presence in the UK is currently in question, threatening thousands of jobs, while trains are being ordered for use on the UK network from plants on mainland Europe. A public interest railway could provide stability for the industry by ensuring that a proportion of its trains were built in Britain. This could be written into any regulation of the rolling stock leasing sector, though in the short-term a quicker route would be through the SRA's powers to direct train operating companies.

Supporting rail freight growth

The UK is one of the only European countries to have reversed a long-running decline in railfreight, which still is now 43 per cent up on the levels of 1995. This offers an exciting opportunity that needs to be seized, not squandered. Rail freight currently removes over 300 million lorry miles from the roads every year and that further growth will be a crucial factor in reducing overall congestion.

Against this background it is disappointing that the government has not been more proactive in its support for the sector. Despite its strategic importance government investment in rail freight stands at only around 4 per cent of its support for passenger services, and is dwarfed by comparison with its commitment to motorway widening, which is far less cost effective and far more environmentally damaging. A great missed opportunity was the inexplicable failure of the government to use its position as a majority shareholder to prevent the Royal Mail from taking mail off rail – cited in the Department for Transport's latest annual report as if it were an external factor hitting rail freight growth over which it had no control (113).

The Freight on Rail campaign has argued for an increased investment of public resources in key freight infrastructure projects. Modification of the Southampton – West Midlands corridor would cost the same as widening two kilometres of motorway, and will keep 1000 daily lorries off the A34 as well as allowing for growing demand for rail container services. Modification work is also needed on key port routes due to international standardisation on high cube maritime containers.

Though for obvious reasons receiving less publicity and political attention, exploiting the potential for a rail freight renaissance should be a central plank in an integrated transport policy that can respond to the social, economic and environmental requirements of the day. It needs to be placed firmly back on the government's agenda.

Maintaining high safety standards

The government's White Paper proposes to transfer the function of safety regulation in respect of the operational railway from the Health and Safety Executive to the Office of the Rail Regulator, to "allow decisions which touch on both economic and safety regulation to be brought together" (114). This is the wrong solution to the problem of cost escalation and one with extremely worrying implications.

There has been much talk in and around the rail industry at the moment of safety standards as a key driver in increasing costs, and this seems to have been reflected in the government's review. However, it is an idea that needs to be treated extremely carefully.

It first needs to be pointed out that there remain areas where the rail industry is arguably still under-regulated when it comes to safety – train drivers union ASLEF have pointed that there is currently no upper limit on driver hours or cabin temperatures, for example. While the general trend for passenger safety is one of improvement the incidence of major worker injuries has increased noticeably since infrastructure maintenance and renewals were contracted out – most recently, the tragic deaths in Cumbria of four rail workers killed by a runaway wagon in February of this year.

Secondly, the attempt to link rising costs to new safety standards frequently misses out, for obvious political reasons, a crucial link in the chain. It is the fragmentation of the industry consequent upon privatisation that means safety standards are expensive to meet, because the absence of shared knowledge and effective coordination means that planners and managers are much less able to assess real risk. Recent examples of such over-reaction include the blanket speed restrictions imposed during last summer's heatwave or Silverlink's withdrawal of its entire fleet upon discovery of loose brake disc fixing bolts. Where such a link can be observed, it is clear that the appropriate policy response should be to reduce fragmentation in the industry, not relax safety standards.

The suggestion that safety regulation function, in respect of the operational railway, should be removed from the Health and Safety Executive and transferred to the Office of the Rail Regulator implies that safety standards should be applied only insofar as they are deemed affordable to the industry, effectively adjusting the seriousness with which safety is taken to the current state of the balance sheet. It is for this reason that Lord Cullen rejected such a move in his consideration of the implications of the Ladbroke Grove rail disaster. The TUC has recently warned of the dangers of attempting to make up for the failings of privatisation by compromising on safety:

> It is important that the Rail industry is regulated on the same basis as other industries, and that safety is not used as an excuse for the underling problems within the industry … the major drivers of cost escalation in the rail industry are poor

> scoping and management of projects an a lack of basic cost controls … In the longer term there is a real risk that rail safety performance might be adversely affected, as the new safety regulator became isolated from the national source of expertise in the regulation of safety management with the HSC/E. (115)

It would be ironic if the government's response to the problems brought about by the fragmentation of the rail industry were to subordinate to commercial imperatives the one function that needs to remain strictly independent and objective. Moreover, the possible retention of occupational health and safety within the Health and Safety Executive will simply create more fragmentation and confused responsibilities.

Devolution and decentralisation

Reintegrating the rail industry under public ownership and control should not mean a return to top-down, "Whitehall knows best" centralisation. As Alastair Darling noted in his announcement of the rail review, there is an opportunity to consider "how we can devolve more decisions on public transport – including rail – to the Scottish Executive and Welsh Assembly Government and at a regional level to PTEs within a nationally coherent framework".

There are real dilemmas and challenges in moving forward such an agenda, throwing up the localism/centralism issues that have been discussed in other areas of the public services (116). But the important point is that this is a form of decentralisation in which all agencies to whom decision-making is devolved are oriented to the needs of their communities and the wider public interest, and not their profit margins and the needs of their shareholders.

A good example of how this can be done is given in the new White Paper's proposals for increasing the role of the London Mayor, Scottish Assembly and Welsh Assembly Government in designing services needed by local and regional populations and economies.

However, as with other public services, there is a danger that a proclaimed agenda of decentralisation can serve as a cover for confusing and passing down responsibility for cuts in service levels. The White Paper implies that Passenger Transport Executives will be encouraged to control costs by cutting back on rail services and engaging in what has become known as "bustitution". As Transport 2000 warned in response to the proposal,

> public transport needs to be much more sensitive to the needs of the communities it serves. These proposals for devolution are a welcome and overdue step in the right direction. However, … this devolution of power must be met by a devolution of resources. Devolved institutions should not be forced to choose between vital rail services and equally vital bus or tram services. (117)

Certainly decisions must be based on "robust evidence that rail is the best way of meeting transport need" as the White Paper says, but the importance of maintaining a comprehensive national rail network must be taken into account in all such decisions and not left hostage to the finances of local agencies.

Conclusion: public investment for a public return

All in all, the issues and options sketched above amount to the beginnings of a new public interest agenda for rail – one which is prepared to take steps to reintegrate and restore public control over the railways not for ideological reasons but on the basis of real practical experience and the needs of passengers, tax-payers and society at large for a high-performing, cost-effective and socially valuable railway service.

The government has committed substantial funds for public investment in the railways, and the indications of the recent spending review are that this commitment is not waning. It is right that the government should seek to ensure that the public receives an adequate economic, social and environmental return on that investment. The most appropriate model for achieving this is a railway that is publicly owned and accountable.

6
Conclusion: the opportunity for rail

New Labour's starting point in 2000, the promise of and need for a "rail renaissance" in Britain, was the right one.

While we have no doubt seen some backsliding from this early ambition in the time since the Ten Year Plan was set forth, there is no question that the only way forward for transport policy in the twenty-first century is a significant "modal" shift from private to public modes of transport and, most importantly, from road to rail. The social, economic and environmental arguments for this agenda have not gone away – indeed they have only strengthened – even if the government's political appetite for taking the steps needed to move it forward may have faltered.

The poor punctuality on Britain's railways has been estimated to directly cost the UK economy £3 billion every year. Road congestion, estimated by the CBI to cost the UK economy £20 billion a year, is expected to get 15 to 20 per cent worse by the end of the decade. The success of the London Congestion Charge, and the increasing likelihood that serious traffic management measures will come back on the agenda for other cities and parts of the country, raises a major challenge and opportunity for rail as the key mode of transport to which excess traffic will have to be displaced.

The projected growth of the population and economy of London and the South East over the coming decades will require substantial injections of public funds into the transport network upon which such growth depends. At the same time rail will need to play a key role in regenerating communities and economies in other cities and regions. Urban and regional planning experts see the railways as crucial to the future shape of the country: "Passenger rail travel has huge potential for solving some of the critical problems of urban and regional development, and the national rail system should be geared to addressing this" (118)

The government have let the railways slip down the political agenda, hoping that their disappointing performance will not be held against them at the ballot box. But with the right policies the railways could provide a political opportunity – an issue that the government would want to push up the political agenda because they could be presented as one of its greater success stories. It would also be an important symbol of the kind of change a progressive government wants to bring about – a tangible advance in social justice, quality of life, economic efficiency and environmental sustainability gained by a legitimate and evidence-based assertion of democratic public control over a service that the private sector has shown it cannot deliver effectively.

Appendix
Chronology of key events

1825	first run of Stephenson's *Locomotion* along Stockton & Darlington railway
1921	Railway Act amalgamates 120 railway into 4 regional monopolies
1948	creation of British Rail
1963	Beeching Report
1979	election of Tory government
1986	buses deregulated
1989	launch of "Roads to Prosperity" programme
1990	privatisation of British Rail first announced
1993	Railway Act receives Royal Assent, beginning privatisation process
1996	Railtrack shares go on sale
1997	Labour government elected
Sep 1997	7 die in Southall train crash
July 1998	Integrated transport White Paper promises "rail renaissance"
April 1999	Sir Alastair Morton appointed chairman of shadow SRA
Oct 1999	31 die in Ladbroke Grove train crash
July 2000	10 Year Plan projects £26b public spending and 50 per cent passenger increase
Oct 2000	4 die in Hatfield train crash; emergency track replacement programme plunges network into chaos
Nov 2000	Transport Act renames OPRAF the Strategic Rail Authority
2001	Cullen Report into management of railway safety and the regulatory regime
Feb 2001	Strategic Rail Authority begins work under Alistair Morton
Oct 2001	Railtrack forced into administration by Stephen Byers
	Richard Bowker takes over from Alistair Morton as Chairman of SRA
Dec 2001	SRA sets out new franchising policy
Jan 2002	SRA strategic plan includes additional £4.5b public spending
Mar 2002	Bowker suggests 50 per cent target be reinterpreted as "40 to 50" per cent
May 2002	7 die in Potters Bar derailment

Oct 2002	Network Rail takes over ownership of infrastructure
Dec 2002	SRA gives Connex extra subsidy of £58m
	Train companies announce 2.5 per cent fare rises
Jan 2003	SRA renounces 50 per cent target for more modest 25 to 35 per cent
May 2003	Fare increases across the network, new summer timetable cuts 100 trains a day
June 2003	Above inflation increases announced for January 2004, some going up 4 per cent
June 2003	SRA serves notice on Connex South Eastern franchise
Sep 2003	Kings Cross derailment
Oct 2003	Network Rail brings all rail maintenance back in-house
Nov 2003	South Eastern Trains takes over franchise from Connex
Dec 2003	Rail Regulator's track access charges review projects increased infrastructure spend
Jan 2004	Alastair Darling announces rail review
Feb 2004	4 rail workers die at Tebay
July 2004	White Paper proposes to divide SRA functions between DfT and Network Rail

Notes

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11 A form of Thatcherism so extreme that, it must be admitted, Margaret Thatcher herself had balked at the idea – it was John Major and his ministers who drove through the idea to prove their post-Thatcherite mettle. See Wolmar, C, (2001) Broken Rails: How Privatization Wrecked Britain's Railways, London, Aurum Press.

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