Will competition save european railways?

by

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Overview

European railways in general, and the French railway network in particular, are not doing well. Is this because of competition, the trade unions, or the European Commission? Pierre Messulam thinks all of these have contributed to the problem, but that there are other factors. The troubles which have been highlighted by recent changes run deeper, and are intrinsically linked to the nature of this kind of transport which the State initially intended to be both a vector for industrial development, and a way of encouraging national unity. However, today this system is out of date and not only does it no longer meet the current economic and social needs of the country, but there are no ways of fixing it. Some rail transport sectors are faring better than others in the face of competition, but it is now necessary to rethink the role of the railway network and redefine the links which bind it to the nation.

Report by Pascal Lefebvre • Translation by Rachel Marlin

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Involvement of governments

The SNCF, France's national state-owned railway company, recently saw its assets depreciate by 12.5 billion Euros. The assets of the Deutsche Bahn, Germany's state-owned railway company, also depreciated by 2 billion Euros in December 2015. Obviously, the two largest railway operators in Europe are not doing well. Is this due to too much or too little competition? In Brussels, these opposing points of view are held by people who, on the one hand, underline the lack of dynamism in a sector which is too protected, and, on the other, by traditional operators who claim that competition will destroy them. My personal theory is that both these opinions are flawed.

Historically, the European railway sector has never been influenced exclusively by market forces, a fact which economists largely ignore. In the 19th century, railways were also designed to be used in war time: the European military commanders learned this from what happened in the American Civil War. The German rail network was created in order to transfer thirty divisions from the eastern front to the western front in less than four days. It was carefully designed by the Prussian military which influenced all the German rail companies. It has left its mark. Nowadays the German rail network still follows the grid system of parallel lines which run from east to west approximately every eighty kilometres.

Transport has also had a significant impact on the economic life of various regions, and because the rail companies could not satisfy all the market demands, governments traditionally intervened to find a solution by heavily subsidizing and nationalising partially the rail network.

In the 19th century, railway companies were already experiencing problems because of three major factors.

Firstly, because the most profitable parts were built first, any extension to the network meant that the profit rate experienced a downward trend.

Secondly, the railway system is incapable of anticipating correctly the replacement of its assets. In the majority of cases, the original installation was entirely subsidised by the government, and so, after thirty years, the concessionary, who had not made sufficient profit, was unable to renew his railway infrastructure and equipment on his own. This is why public authorities have always intervened, more or less willingly, in order to build railways or to secure the solvency of rail operators. In the 1880s, the Third Republic in France introduced a dividend system whereby the government guaranteed minimum profitability to shareholders of companies whose profitability was shrinking. Why go to such lengths to increase profit if eventually it is always the government which pays? Public money has always been involved in the economics of this sector.

Thirdly, even before the First World War, competition from other means of transport progressively reduced the dominance and competitive advantage which the railways had until then.

Public money

These three factors are still relevant, but curiously they are not taken into account. It is important to analyse the market and potential competitors.

Analysis of the sources of the financing of railway systems, in other words the infrastructure and all the operators, shows that sales revenues in France and in Germany only account for 50% of resources, and that in the best scenario in Europe, in Switzerland, they only account for 70%. This means that the remainder comes from public money.

Competition is undoubtedly possible, but today it is clear that the functioning of railway systems is largely due to the injection of public money which considerably moderates market forces. In addition, governments are both sources of funding and owners of the infrastructure management (the RFF, the *Réseau ferré de France*) and of the historical operators (the SNCF). Consequently, governments are 'helping' competitors of the operators which they be own! This is clearly desirable but it supposes nonetheless that the operators, whether they are new or well established, should have a chance to find an economic balance.

One must not forget something which is unique to the French market. Whereas in most European countries funding is largely guaranteed by public revenues and public money alone, in France it is also guaranteed by an increase in debt. As the government can no longer buy or renew the rail infrastructure, the RFF runs into debt by taking out loans. One might imagine that it does this in order to develop commercially, as long as this development is profitable.

We are faced with a system which is very dependent on public financing and which, until now, never made provision for its assets correctly, and went ahead with the notion that since it weighed so heavily on public finances and on the life of the country, that at some moment, the state would have to pay. This has been the case for the past 150 years. Therefore, despite Brussels wanting it to stop, there is no reason to think that it can.

Involvement of the European Commission

In France in the 1980s there was a stagnation of productivity per unit produced compared to the workforce. There are a number of explanations for this including the fact that competition from other means of transport lowered the rate of occupancy of passenger trains. In France, the oil crisis and the development of the nuclear industry contributed to the collapse of the transport of coal, in stark contrast to 1974 when coal was the commodity most transported by the SNCF. When one is in a system of growing returns and volumes start falling, stagnation in productivity has a disastrous effect.

The European Commission saw that Europe needed an efficient railway system, able to relieve traffic congestion while lowering pollution, and which was also a form of sustainable mobility. Since both national economic and social reforms appeared to have failed, it concluded that it should be open to competition.

In national monopolies which are regulated, management is caught between governments and trade unions, and finds it impossible to reform both the social framework and regional policy. The closure of certain lines, which are huge financial burdens, is inevitable and everyone knows it. Nonetheless, trade unions make threats that closures result in local unemployment, and governments invoke the continuity of public services in rural areas, leaving management to handle the contradictions and to find the necessary resources on its own. Railway operators are then encouraged to cross-subsidise allowing profitable sectors to offset deficits in others, which in hindsight merely justifies the decisions to maintain the aforementioned lines.

Over the past ten years, a new factor has emerged in the debate, namely the technical durability of assets over time. When a bridge in an area where there is little traffic threatens to collapse, should one close down the line or spend the equivalent of twenty years of revenues in order to rebuild the bridge? There are mixed opinions to this throughout Europe, and so the situation is getting worse. In the 1980s, the European Commission decided to get round the problems in this sector when monopolies were unable to solve the situation. However, it did not fully appreciate the nature of competition from other means of transport. As far as the Commission was concerned, there was only one railway market. This was a mistake because there are several. In some European markets, the railway sector is able to survive economically and has a market power which is considerable, whereas in other markets, the sector has taken a pounding from competition – other means of transport – which is much more efficient. This is not the result of actions by trade unions or by governments, but endogenous factors. Because the Commission did not realise that the problem lay with endogenous factors, it decided to put forward a simple solution, namely to open the sector to competition in order to shake up the system.

According to the Commission, for competition to exist, the original operator can no longer remain owner of the infrastructure as this will create barriers preventing rivals from entering the market. Therefore, the infrastructure must be for the good of the public, open to all potential competitors. This is the way we started, leaving our American colleagues, who had experienced a deregulated rail network in the 1880s, confused. The US core market is transcontinental freight transport. Public authorities play the role of regulator, and determine the rights of way