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Current Appraisal Issues from the SRA Perspective

Bob Stannard, Chief Economist, Strategic Rail Authority

University College London
26th November 2003

Roger Mackett introduced Bob Stannard as the Chief Economist at the Strategic Rail Authority. Before being seconded to the Office of Passenger Rail Franchising (OPRAF) in 1994, he had worked first in the old Ministry of Transport (then part of the Department of the Environment), then moving across to housing before joining HM Treasury in 1979. There he dealt with public expenditure, supply-side reforms, trade and nationalised industry policy and privatisation - a useful prelude to joining OPRAF in 1995. When the 1997 Labour government decided to form the Strategic Rail Authority (SRA) he was one of the first to join its 'shadow' predecessor the SSRA - the SRA was formally constituted in 2001.

The speaker started by itemising those aspects of his work at the SRA he intended to cover, including as a preliminary some thoughts on the background to the SRA's present appraisal criteria. He would then proceed to describe how appraisal work is organised within the SRA and to what kind of projects, studies and other work the criteria of appraisal are applied. Finally, he would say something on current issues and research. He added that this is not exclusively concerned with large infrastructure projects.

In 1994, which is early in the commencing period of privatisation, OPRAF was required to develop 'Planning Criteria'. These were required to inform any changes to the Passenger Service Requirement that might become necessary, which was one of the fundamentals of the franchising process. These criteria required the approval of the Secretary of State. Furthermore, consistency with the Treasury's advice on appraisal methodology (the 'Green Book') was obligatory.

The major change in prospect was from the quasi-commercial approach adopted and practised by BR to an approach that reflected OPRAF's role as a purchaser of service. At that time, the Department favoured relating subsidy to a calculation of external benefits alone. It was assumed that benefits to users would be captured through fares. This was consistent with the approach for

providing support to public transport projects in urban areas. Movement towards ‘a level playing field’ between modes of transport was an important objective. OPRAF undertook a consultation with interested parties in 1996, but the 1997 election interrupted any intention to publish agreed Planning Criteria.

After the 1997 election, John Prescott, the Deputy Prime Minister & Secretary of State for the Regions, Transport and The Environment (John Prescott) agreed to the publish Planning Criteria in an interim form. These were to be subject to review after the Integrated Transport White Paper was published, then scheduled for early 1998. OPRAF finally published its Planning Criteria, which included the “New Approach to Appraisal” (NATA) framework, in 1999. The SRA issued “Appraisal Criteria” in April 2003. This revision reflected changes in the Treasury guidance on appraisal, which had been published in January 2003. The SRA’s Appraisal Criteria differed in scope from previous Planning Criteria in that they covered freight for the first time.

The big step forward in this long process stretching from the onset of privatisation to the establishment of the SRA, was, in the speaker’s view, the move from the quasi-commercial criteria applied to BR to the routine acceptance of a cost-benefit analysis approach to freight and passenger support on services.

The speaker then went on to deal with his and his team’s responsibilities in project appraisal. First, the team is responsible for appraisal methodology, both generically and on a case-by-case basis. A Business Case Manual and an Appraisal Guidance Manual have been produced as formal aids to this process. Ad hoc support, as required, is available for the teams engaged in the appraisal of particular projects.

The Business Case for a particular project is in the ‘ownership’ of the sponsor within the SRA. Appraisal techniques are applied in three principal contexts: strategic scenarios[1], projects and programmes, and, finally, regulatory changes. ‘Projects and Programmes’ included large projects, franchise specifications (including appraisal of bids), and Rail Passenger Partnership (RPP) projects. The appraisal of regulatory changes included implications of changes in fares and applications to cases where the SRA is requested to take a view on the impact of an open access operator on subsidised services. The extent of the appraisal is adapted to the scale and complexity of the case under review.

The Treasury Guidance had and continues to have an overarching influence on the scope and nature of the appraisal techniques developed by the SRA and its

[1] In this context, scenarios meant 'packages' of services, and on fares and investment.

predecessors. The assessment of risk and counteraction against unjustified optimism was an important element of the 2003 Guidance. The Treasury Guidance also requires consideration of the distribution of benefits and costs across different income groups.

The speaker concluded by referring to current research issues. More work on the public sector appraisal of rail freight was needed, as there was not the same degree of understanding of this sector of the rail industry as for the passenger railway. The SRA was addressing this issue. It is intended that enhancements will be financed through "Special Purpose Vehicles" and this has led to consideration of the appraisal of alternative financing options, i.e. how one should appraise alternative allocations of risk between the providers of capital and the impact this might have on incentives. There was also need of further research on the impact of rail passenger service performance on the economy.

The SRA has recently approved a new series of publications, to share some of the results of studies that it has commissioned.

Discussion

There followed a number of questions and comments from the audience.

Roland Niblett: *What are the reasons for changing the system of fare increases from the established RPI-1% basis?*

Bob Stannard: A rationale for the original policy was to reassure those who feared steep price rises after privatisation. It was designed to give the customer a share in the benefits of privatisation, while, at the same time, facilitating the selling of the franchises to interested buyers, by providing certainty about the future structure of fares. The policy has been reviewed and changed. It had become less appropriate as the long term economic effects on crowding and finances of such a rigid system were not fully foreseen - for example: the increase in train-miles in the early years of the franchises

Peter Gordon: *Were the resulting variations between increases in regulated and unregulated foreseen*

Bob Stannard: Yes.

John Cartledge *was concerned about the problems of quantifying social benefits - in particular, casualties avoided, as differing values were applied to rail and road projects. There was the distorting effect on public perception of very few, but catastrophic and well-reported, accidents on the railway*

compared with the large number of, but comparatively small and less regarded, accidents on the roads.

Bob Stannard agreed that the present treatment of casualties across modes was unsatisfactory, and acknowledged Andrew Evans (in the audience) as the authority in this field. SRA applied values consistent with general DfT guidance.

Martin Higginson *raised the problem of changing geographical coverage and duration of individual franchises. Why had the SRA's view on franchise structure changed?*

Bob Stannard: The changes were natural developments. The BR train operating units were taken as a basis for creating franchises, as OPRAF needed a saleable proposition with a track record. The structure was bound to evolve and the arguments for more co-ordination had, for example, been strengthened by increasing congestion on the network.

Sir Christopher Foster: *The advantages of transport schemes should be emphasised. The long-term effects of traffic trends must not be forgotten. And there was undoubtedly a long-term effect on subsidy requirements, which had to be considered. All these aspects of future development needed to be integrated.*

Bob Stannard: The Department of Transport provides a common set of assumptions, including policy assumptions, to apply across transport modes. Models are constructed so as to reflect these common assumptions.

Andrew Evans: *Have there been any published case studies of rail project appraisals?*

Bob Stannard: Yes, the Thameslink 2000 case was published for the Transport and Works Act Inquiry.

Dick Dunmore: *Transport economists are significantly handicapped in their work by the dearth of data publicly available.*

Bob Stannard: The ownership of data is with the constituent companies. The permission of these 'owners' has to be sought, both to use and to publish this data.

Peter White: *Train Operating Companies operating in the London Area are not given incentives to provide additional capacity over and above that currently available.*

Bob Stannard: The incentives on operators are provided in the franchise agreements but major incremental investment is a matter for the SRA.

Don Box: *There seems to be great difficulty in appreciating the sometimes contrary interests of, even disbenefits to, the somewhat disparate elements of a fragmented industry, and reconciling these into projects of benefit to the industry as a whole, which should constitute the paramount interest. Crossrail springs to mind as an example. Why cannot there be economic appraisals of the industry as a whole, and a costed strategy based on the 'steady state' representing the situation when the renewal backlog has been overcome, and against which one can judge the worth of proposed long-term projects and strategies?*

Bob Stannard: The interests of the industry parties require them to be answerable to their shareholders or public stakeholders. The SRA is seeking to co ordinate action where it can but the structure of the industry is something we have to work within.

This concluded the 'question and answer' part of the meeting. The chairman thanked Bob Stannard for an interesting and comprehensive address and for the way in which he had answered a series of searching questions on the development of SRA appraisal policy. The meeting showed its appreciation of Bob Stannard's address in the usual way.

Report by Don Box

Commuter Services on Channel Tunnel Rail Link and the Integrated Kent Franchise

Christopher Clark, IKF Team Leader, Strategic Rail Authority

University College London
28th January 2004

Constraints

The competition for the Integrated Kent Franchise (IKF) was in progress at the time of the presentation, and the third round of consultations with stakeholders on the proposed service proposition due to start the following month (February 2004).

Consequently, the presentation would only reflect information that was already in the public domain in order to maintain an equitable process with regards to the dissemination of data to franchise Bidders.

Figure 1: Existing South East Train Services and the CTRL

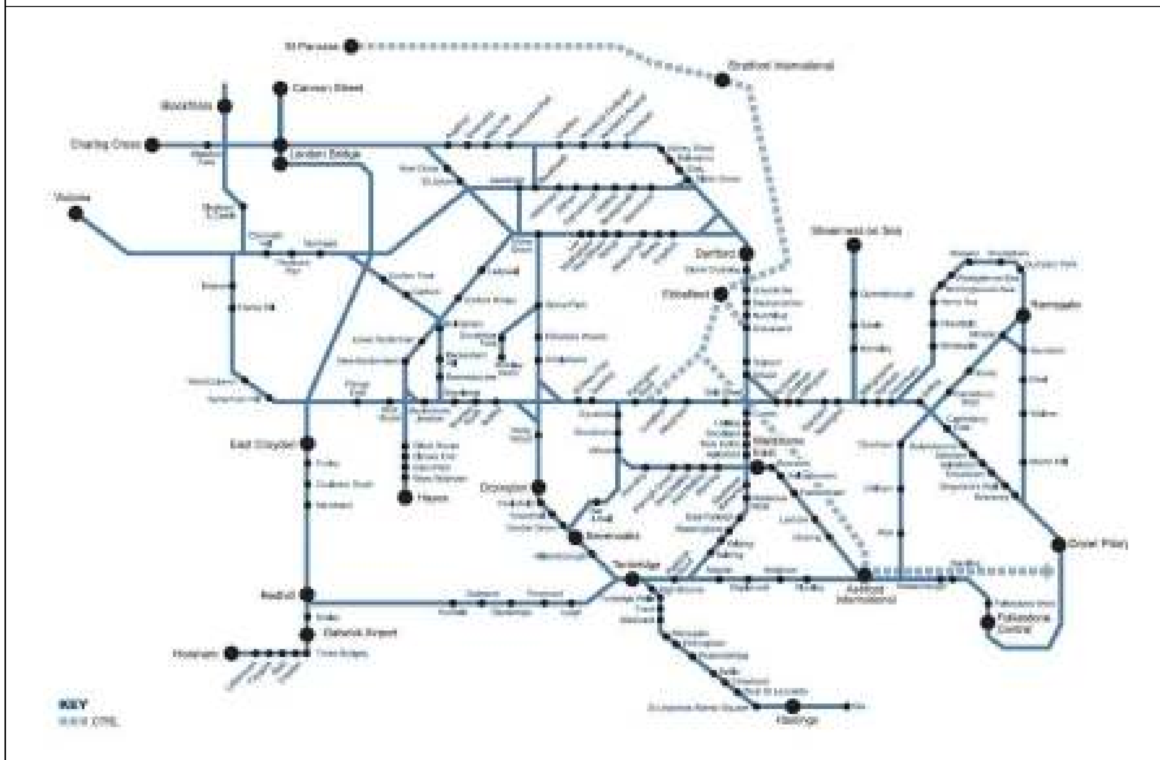
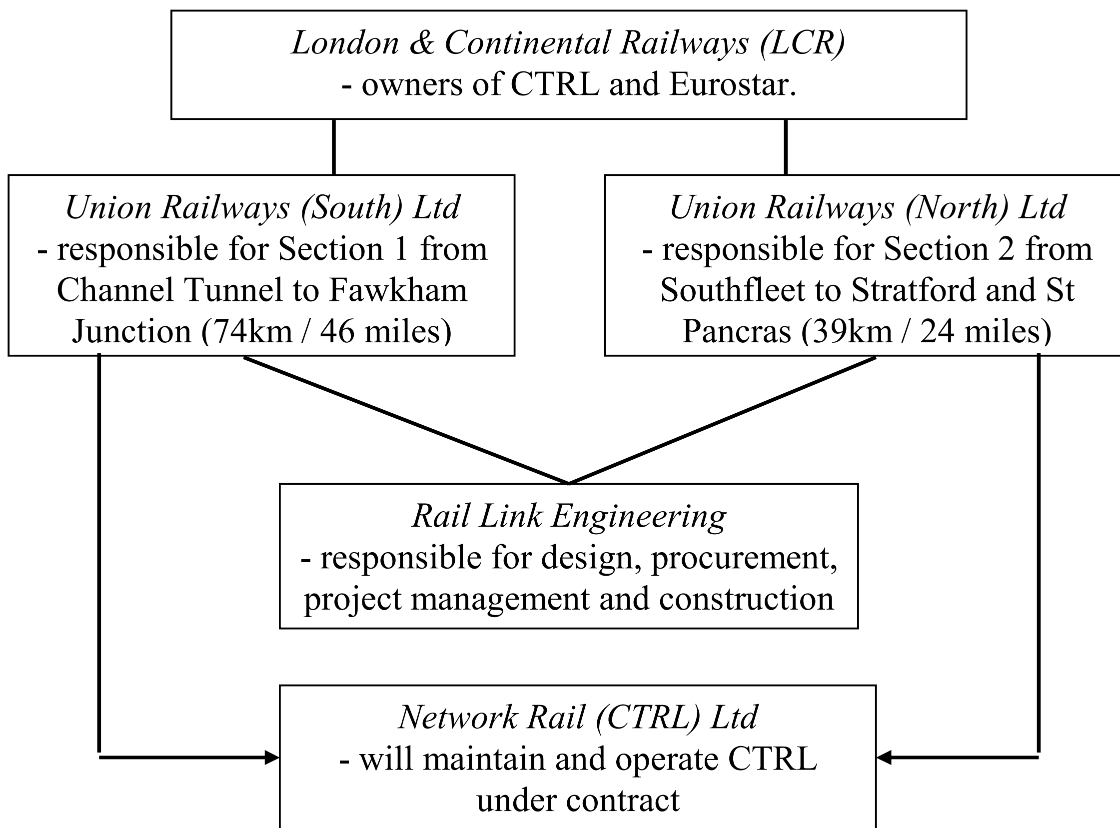


Figure 1 shows the potential scope of the IKF, which is a composite of existing services operated by South Eastern Trains (SET, previously Connex South Eastern), and new high-speed domestic services to operate on the Channel Tunnel Rail Link (CTRL) , following its completion in 2006, with links to the existing rail network in the south east at Ebbsfleet and Ashford. It is expected this will assist the planned regeneration of the Thames Gateway and growth in Ashford.

Channel Tunnel Rail Link

Responsibility for the construction and operation of the CTRL lay with London & Continental Railways (LCR) under the provisions of the Development Agreement between Government and LCR.

CTRL Organisation: The diagram below shows how LCR discharges its obligations under this Agreement:



LCR advise that the CTRL is on course for completion by the end of 2006 and opening in 2007.

Basic facts about the CTRL:

- Maximum design speed of 300 km/h
- Estimated construction cost of £5.2 billion
- Reserved paths on the line for eight International and eight Domestic trains per hour in each direction
- Estimated Eurostar journey times on completion of Sections 1 and 2:

St Pancras to Channel Tunnel	35 minutes
St Pancras to Paris	2 hrs 15 minutes
St Pancras to Brussels	2 hrs

CTRL Domestic Services

The Development Agreement reserves domestic capacity for the following services to/from St Pancras:

Peak	2 North Kent trains per hour (tph) 2 Ebbsfleet tph 4 East Kent tph
Off-peak	2 North Kent tph 2 East Kent tph

New station facilities are being provided on the CTRL at St Pancras, Stratford and Ebbsfleet.

Approximate average journey times to/from St Pancras are:

Table 1: Journey times to St Pancras

From	Travel time	Time saving
Gravesend	23 minutes	29 minutes
Canterbury West	63 minutes	27 minutes
Folkestone	57 minutes	37 minutes
Ashford	40 minutes	35 minutes
Ebbsfleet	15 minutes	Not applicable
Stratford	7 minutes	Not applicable

CTRL Domestic rolling stock will have unique characteristics as it will be required to:

- Meet specified sectional running times;
- Operate at least at 225 km/h to latest safety standards;
- Achieve maximum 1 min dwell time generally with 1.5 minutes at Ebbsfleet;
- Operate on three different electrification and signalling systems; and
- Provide high standards of passenger comfort.

A ROSCO has been selected through open competition and discussions with several manufacturers progress with a view to awarding a contract in spring 2004. The proposed service specification, on which stakeholders consultations begin shortly, suggests a requirement of between 28 and 33 six-car sets. It is expected that commissioning of the new trains will start in 2006, with these entering passenger service in 2007 once the CTRL is opened.

The Integrated Kent Franchise

SET has taken over the operation of existing services in the south east on a short-term basis although it is proposed to return operations to the private sector as soon as possible. The new IKF is planned to start in 2005 and have a two-stage implementation. Initially, services will remain broadly as presently operated by SET, with a major timetable change planned for December 2007 upon the introduction of CTRL Domestic Services.

The draft Invitation to Tender (ITT) has been issued to four qualifying bidders:

1. DSB International
2. GNER Holdings Ltd
3. First Kent Integrated Railways Ltd (First Group plc)
4. London & South Eastern Railway Ltd (a consortium of Go-Ahead Group and Keolis).

It is anticipated that the Final ITT will be issued in the summer following the completion of rolling stock contracts.

The first iteration of the Train Service Specification (TSS) has been developed based on feedback from stakeholder consultations held last year.

- It assumes no significant infrastructure enhancements or changes in track capacity apart from completion of the CTRL and the South Eastern power supply upgrade project associated with the replacement of Mark 1 rolling stock.
- Network Rail is developing a Feasibility Timetable based on the TSS for inclusion in the Final ITT.
- Stakeholder consultations on the TSS will start in February.
- Parallel clarification meetings will be held with Bidders.
- An appraisal was prepared last year in accordance with the SRA's Business Case Manual and Government's Appraisal Methodology ('The Green Book')
- This demonstrated a high benefit to cost ratio (BCR) of around 3.5:1

The Timetable for IKF Franchising

The process will take about a year to the completion of a Franchise Agreement (February 2005) with the start of operations as soon as possible after that. The indicative timetable is:

IKF consultations start	February 2004
Consultation closes	April 2004
Final Invitation to Tender issued	June 2004
Bids submitted	August 2004
Bidders shortlisted	October 2004
Preferred Bidder selected	December 2004
Franchise Agreement signed	February 2005

Discussion

Peter Gordon (AEAT): *since the stock will be very expensive do you expect there to be a high subsidy because the leasing costs are high?*

Christopher Clark: the business case for the IKF, inclusive of CTRL DS, shows that an incremental subsidy will be required to that needed to support the operation of existing services in the south east.

Andrew Evans (UCL): *if the 3.5:1 is true, this is unheard of for rail; does this assume there is no infrastructure?*

Christopher Clark: the business case assumes limited infrastructure works, principally the fit-out of the CTRL stations and the provision of depot and turn back facilities. Government has already committed to meet the Domestic Capacity Charge, equivalent to the Fixed Track Access Charge, for the initial 17 years. This is thus excluded from the business case.

John Cartledge (LTUC): is *the speaker happy that the onward distribution modes are capable of providing an acceptable service from London stations?*

Christopher Clark: the study of passenger dispersal at St Pancras is being reviewed to ensure the findings are still valid. The preliminary view is that passenger dispersal will be sufficient.

David Starkie (Economics Plus Ltd): *the time savings shown on the slide (table 1 above) will be less since commuters will already have aligned themselves with the London termini that is most convenient. Have you built into the savings the time it takes for commuters to go south from St Pancras?*

Christopher Clark: the average journey times (and savings) shown in the presentation are headline figures. The modelling for the business case takes into account overall journey times.

Michael Schabas (GB Railways): *how much of the passenger traffic is diverted or newly generated?*

Christopher Clark: the modelling undertaken for the business case shows both. It is acknowledged that both markets will take time to develop and adjust.

John Segal (MVA): *have premium fares been assumed?*

Christopher Clark: the SRA published its Fares Policy in June 2003 providing for the application of RPI+1 to regulated fares. The SRA has not proposed any specific alternative fares policy for CTRL DS or IKF as a whole. In the light of emerging affordability considerations, it may be necessary to review fare levels as part of the overall specification of IKF. This might involve an element of premium pricing to fund the ongoing provision of an enhanced level of service.

Robert Johnson (University of Westminster): *how is the rolling stock to be procured?*

Christopher Clark: the rolling stock procurement process was started by the SRA because of the long lead-time on the delivery of bespoke rolling stock. As mentioned in the presentation, a ROSCO has been selected through open competition and discussions with several manufacturers progress with a view to awarding a contract. It is expected the contract will be transferred to the incoming franchisee.

Robert Cochrane (Independent Consultant & Visiting Professor, Imperial College): *has account been taken of the need for a prototype since the trains will be very complex?*

Christopher Clark: this has been recognised and the provision of suitable testing/training facilities form part of the discussions with manufacturers.

John Grainger (RSM Moorgate Associates): *is the power to be upgraded in the existing network?*

Christopher Clark: there is a separate upgrade in hand as part of the Mark 1 rolling stock replacement programme. This is not included as a cost in the IKF business case.

Don Box: *the biggest millstone is the size of the subsidy because it continues year on year. Is there some sort of assurance that there will be a net beneficial effect?*

Christopher Clark: the business case shows an incremental subsidy requirement for the IKF. Part of the rationale for taking over the South Eastern franchise from Connex was the escalating subsidy and the need to test this through open competition in the market.

Although the business case shows that an incremental subsidy is required for the IKF, inclusive of CTRL DS, it makes no allowance for increased revenues that may result from regeneration.

Gregory Marchant: *why is the franchise integrated since private enterprise could give a real choice between fast and expensive or slow and cheaper?*

Christopher Clark: the economic reality is that migration will occur between the classic services and the new high-speed services. The physical proximity of the existing south eastern network and the CTRL means that trains will need to operate on, and be maintained and berthed on, the existing network. Such activity is better managed by a single operator.

John Segal (MVA): *one of the benefits must be a reduction in outer suburban and an increase in inner suburban services.*

Jeremy Drew (Drew Management Consultants): *what are the timetable changes in 2005 and the 2007 wholesale change?*

Christopher Clark: the new IKF will broadly operate the existing timetable from 2005 until the availability of the CTRL. The new timetable will be introduced once the full DS fleet is available, currently expected in December 2007, although transitional services may be introduced as the new rolling stock enters service.

A questioner asked: *will bidders have the option of introducing premium pricing?*

Christopher Clark: there is a general recognition that the introduction of CTRL DS represents a step change in service provision which carries with it the potential for related premium fares. As mentioned earlier, the SRA has not proposed any specific alternative fares policy to its existing general fares policy for CTRL DS or IKF as a whole. However, in the light of emerging affordability considerations, it may be necessary to review fare levels as part of the overall specification of IKF and this might involve an element of premium pricing to fund the ongoing provision of an enhanced level of service.

Michael Schabas: *subsidy increases because of fare regulation. Passengers would begrudge paying more but would pay for some reduction in crowding and faster journey times. Premium fares were proposed for the DLR extension to Lewisham but politicians lost their nerve.*

Report by Laurie Baker

Making Markets Work in Rail Freight

Julia Clarke

University College London
25th February 2004

Julia Clarke, Lady Berkeley, is a former Director, Rail Freight Group, and former Executive Director, Freight at the Strategic Rail Authority. She is currently a Senior Advisor at 'The Waterfront Partnership'.

Theme and Key Messages

Julia Clarke spoke about the changes and development of markets in rail freight from 1993 – 2003. Her key messages were that:

- There has been significant and substantial change in the underlying market economics of rail freight since privatisation
- Gradual introduction of market forces has lead to a more efficient, more productive, growing sector and significant private investment
- The change was underpinned by the 1993 Railways Act's establishment of Open Access and the role of the Regulator combined with the outright sale of the freight businesses
- Subsequently important changes to track access charges, the SRA's freight strategy and the introduction of new financial support mechanisms facilitated further change
- Some of the successful features of the rail freight sector could be replicated in the passenger rail sector
- The success of rail freight points to harnessing market forces and creating appropriate incentives rather than regulatory or structural change as the way to improve performance.

Introduction

This talk represented Julia Clarke's first public presentation since leaving the SRA over a year ago. She explained that one of her main motivations for working in the rail sector was annoyance at freight transport decisions being

made by comparing a competitive and efficient road freight sector with a monopolistic and inefficient rail freight sector. To her mind the 'wrong' decisions were being made and she saw structural change as part of the solution. She was interested in just how much like the road freight industry - perhaps the closest thing the UK has to perfect competition - rail freight could get.

Rail freight, in market economics terms, now bore little relation to the rail freight of 10 years ago. While the casual observer may see trainloads of aggregates, cars, coal or containers hauled by powerful diesel locomotives looking very similar to the trains of a decade ago the economics of those trains and the economic environment in which they operate has changed beyond recognition.

The Beginning

In the pre-privatised railway world rail freight was declining inexorably as manufacturing and extractive industries declined. In a world of nationalised railway, nationalised power generation and nationalised mines, market mechanisms had little relevance. Rates, volumes, wages were negotiated on the basis of relative bargaining power. Rail freight was in no real sense competing with road transport in these markets of high volume, heavy, concentrated, constant flows.

BR treated rail freight increasingly as a cash cow. Forays into general distribution such as the Speedlink service were doomed to failure and eventually withdrawn. Costs were too high and in a market where there was real road competition the margins were far too low.

The nascent Rail Freight Users Group was formed of an alliance between bulk customers who felt they were being over-charged and terminal operators and businesses dependent on BR's Speedlink service. Both complained about BR's take-it-or-leave-it attitude, high prices and high handed decisions about levels of service. None of these parties felt they had any negotiating power with a monopoly provider. The prospect of privatisation changed all that.

Early Vision – the need for competition

While rail freight was provided by a single monopoly supplier there could be no choice for customers other than switching from rail to road. Monopolies tend towards inefficiency, poor customer service and lack of innovation. However; on the other hand there are significant economies of scale involved in running capital intensive complex operations - particularly where nation-wide

coverage is required with the concomitant need for a strategic network of yards, sidings depots and extensive route knowledge among drivers.

Whilst the Government appeared to accept the competition argument and divided BR's freight businesses into 6 pieces for sale, the market determined that a higher price was to be had by reuniting the pieces into a single unit. Ultimately all but Freightliner went to the Wisconsin-led consortium headed by Ed Burkhardt. Nevertheless the seeds of a competitive rail freight market were sown.

The Foundations

The modern rail freight industry was, to Julia's mind, built on foundations consisting of three pillars. These were:

1. The outright sale of the BR freight businesses
2. Open Access provisions of the Railways Act 1993
3. The establishment of the Office of the Rail Regulator

Privatisation of the BR freight businesses was quite different from what happened to the passenger businesses. The freight businesses were sold outright to private bidders. Apart from a few transitional arrangements such as a track access grant package for Freightliner and certain guarantees in respect of Channel Tunnel traffic, the freight businesses, like all commercial businesses in the private sector, were on their own – with no safety net.

As a result the companies were prepared to work hard to use industry processes and the regulatory structure, which had been put in place to protect their interests. Combined with commercial pressures from customers and alternative service providers, the incentives were also there to improve efficiency, drive out cost and enhance customer service.

The second pillar was Open Access. With most of the freight business and all of heavy haul capability re-united in EWS, traditional captive customers still had little immediate alternative. What such customers did have was the opportunity to establish their own operation, and BNFL and National Power both did this, although NP later sold their operation back to EWS. In the meantime, prices to customers had come tumbling down even though significant barriers to entry remained. What Open Access did was to put pressure on operators to behave as if there was competition even where there

wasn't. The threat of market entry was sufficient to have a significant impact on the market.

The third pillar was the Regulator and, in particular, his statutory duty to promote the use of the railway for freight and to behave in a way, which enabled persons providing railway services to plan their businesses with a reasonable degree of assurance. While the Regulator's actions and decisions could not be predicted with 100% accuracy, these two duties gave rail freight operators considerable comfort that their interests would be protected through the Regulatory structure.

All holders of the office of Rail Regulator have both stated and demonstrated their commitment to independent economic regulation and have clearly recognised their special duty to freight. It was on this very firm foundation that freight companies initially felt able to purchase the businesses and later to invest.

The 1993 Act laid the foundations for the competitive rail freight sector the UK has today with currently four active operators and more to come, over £1.5 billion invested and substantial improvements in efficiency, performance and customer service. But more was needed.

Track Access

At privatisation it was decided that Railtrack would determine track access charges for freight customers by negotiation on a flow by flow basis. The idea was that charges should reflect what the market would bear and that funds would therefore be retained in the rail industry through Railtack's monopoly power rather than flow out to customers of the railway in reduced prices. Railtrack could negotiate down to the avoidable cost of each freight flow if necessary to secure it on rail and, beyond this, the new track access grant could safeguard freight, which could not afford even this level of charge, provided there were sufficient environmental benefits.

This system of negotiation soon proved unworkable. It was time-consuming and the outcome unpredictable. It did not sit well alongside customers demanding a quick response time to enquiries for new and changed traffic flows. While the two privatised rail freight companies remained in different market sectors the danger of distorting competition between them was limited but it was a real danger from the start between competing customers of the railway, for example in the coal or aggregates sector. Once EWS and Freightliner and the new operators began to compete directly for the same traffics, the system became unsustainable.

EWS unilaterally renegotiated its own track access agreement early, replacing it with a much simpler fixed plus variable formula designed to encourage growth. This agreement also tried to tie down the extent of and capability of the network Railtrack was to make available. Many of the provisions of that groundbreaking agreement have now been formalised as part of the Regulator's Model Clauses for Freight Access Contracts.

That EWS agreement was superseded by the Regulator's Review of Freight Access Charges in 2001, which recognised the changing economic and market environment for rail freight. In particular, there had been erosion of revenues available to freight operators as a result of on-rail competition and structural changes to the UK's heavy industries. These heavy industries were by now unrecognisable from the nationalised industries with which BR had previously negotiated and on which the previous level of access charges had been based.

The Regulator determined, with the agreement of the SRA, that rail freight should no longer be required to contribute to the common costs of the railway but should pay only the additional costs freight imposed on the network - predominantly wear and tear. He also recognised that in a competitive market with multiple operators bidding potentially for the same or similar traffic the track access charges had to be simple, transparent and based on objective criteria.

This resulted in a much-needed reduction in freight operators' costs but also increased confidence among customers, by moving rail freight towards road freight in terms of the visibility and the structure of costs.

The SRA's Freight Strategy

The SRA's Freight Strategy sought to build on these foundations and to create the conditions in which rail freight could flourish on a commercial basis. The Strategy also clearly set out the main markets in which the SRA felt rail freight could be competitive and/or delivers significant public interest benefits. These were:

- heavy haul / trainload;
- containers to/from deep sea ports;
- short sea / Channel Tunnel traffic; and
- UK domestic primary distribution.

First, it was clear that neither operators nor customers were in a position to fund major network improvements, but they needed a clear understanding of the network on which they could expect to operate in the future. Therefore a clear strategy was required, and this was set out in the SRA's Freight Strategy – to be funded publicly on the basis of environmental and other public benefits. It consisted of:

- capacity on key routes;
- loading gauge improvements on routes to the ports and Channel Tunnel; and
- Gradual systemic improvement to the network to support efficiency, such as permitting longer trains or improving performance through operational changes.

Julia noted that much of this aspect of the strategy had now, regrettably, been shelved.

Secondly, the strategy sought to tackle any remaining barriers to entry and constraints on competition, for example by encouraging and supporting the provision of new terminals or terminal capacity in areas where it was insufficient; or (either through persuasion, negotiation or investment) by opening access to ports with a single dominant operator. This part of the strategy also required influences on the planning system to improve the chances of success for terminal / interchange proposals and a new approach to land resources held by Network Rail and the SRA.

Thirdly, the strategy offered a new set of financial incentives. It proposed removing the existing constraint whereby public support to rail freight was limited to the two pre-existing grant schemes. Instead the SRA's much broader powers were to be available, although still subject to EU State Aid rules and normal value for money requirements.

Innovation Scheme

The Innovation Scheme consisted of a £5 million fund for schemes, which could demonstrate innovative solutions in rail based logistics. This scheme provided up to 30% of the cost of the project, which to qualify had to be sponsored by a grouping of two or more companies. Three projects were supported. The Lafarge piggyback system for secondary distribution of cement - equally applicable for other bulk powders or liquids - this full-scale commercial trial demonstrated piggyback within the UK's existing loading

gauge. The second project was the Exel freight multiple unit concept trial and the third a smaller award to Minimodal. The Lafarge trial is ongoing and much has been learnt from the Exel experiment.

In addition to the value of the supported projects, the bidding competition for the fund resulted in 40 proposals involving well over 100 companies, of which a number of these have been taken forward without public assistance. As an exercise to raise awareness and generate innovative thinking, the scheme was a great success. In a more profitable sector these kinds of innovations and alliances would be a normal part of the market activity. In a market with very thin margins, a significant element of subsidy and high regulatory risk, an incentive was required to help things along.

Company Neutral Revenue Support (CNRS)

The clumsily named Company Neutral scheme was devised in order to provide an alternative to individually negotiated track access grants. Initially aimed at the deep-sea intermodal sector, the idea was (and still is) to extend the scheme to other areas where there are significant public benefits in keeping non-commercial traffic on rail. The scheme has recently been approved under State Aids legislation by the EC and a launch date has been announced by the SRA.

Like Track Access Charges in a competitive environment, bespoke grant arrangements negotiated with individual companies must raise issues of distortion of competition. Because the apparent financial need is larger such arrangements can lead to grant being awarded to an inefficient rather than to an efficient operator. Also, the pre-existing Track Access Grant arrangements for Freightliner contained an element of service specification – services could not therefore respond in a fully commercial way to market demand.

Hence, the SRA decided to take the courageous step of defining the value of transferring goods from road to rail and offering a tariff-based subsidy adjusted to reflect the improving economics of longer distance movements. Grant per unit would therefore be limited at shorter distances by the environmental and other benefits of shifting a short distance movement from road to rail, and at longer distances by the estimated 'financial need' for assistance. Necessarily the rates were based on a theoretical model and in practice could over or underestimate actual financial need by a margin of error.

The step was courageous because a policy-led approach like this can produce unexpected results in terms of the volume of rail freight and the pattern of services. However, Government can be sure it is not paying for anything it doesn't want and it is not paying more than it would wish to for any given unit

transferred. Also it is not taking any risk because grant is paid ex-post – after the units have been moved.

Another attractive feature of the scheme is that grant is payable to either the operator of the service or a third party if that party is taking the commercial risk on running the service. For example, where the third party is paying the operator his costs regardless of whether or not the train runs empty or full. In this way the scheme encourages freight users to be the risk taker, and in so far as it encourages shipping lines or ports interests to sponsor services, better aligns the incentives to fill the trains with those parties best able to ensure trains run full.

Where we are now

Julia Clarke expressed great pride in the rail freight industry today. Whilst there remains plenty of room for improvement, the UK rail freight industry:

- Has increased its carryings by 50% over the past 10 years, reversing four decades of decline.
- Has invested over £1.5 billion in new equipment, facilities and systems.
- Has significantly improved its performance, productivity, efficiency and customer service.
- Is no longer protected from on-rail competition and offers customers genuine choice of operator and approach.
- Is a mature industry engaged in constructive debate about industry issues?
- Offers a product which is easier to understand and more transparent in its costing, hence giving greater confidence to its customers.

What is left to do

For the freight sector Julia Clarke saw the key issues as:

- Capacity allocation for freight – both for freight as a whole and between competing operators on capacity constrained routes;
- Dealing with the curtailment of the SRA’s freight infrastructure programme, and financing network improvements;

- Land-use planning, which remains a problem especially where new port and/or terminal capacity is required and land availability remains an issue;

- Sorting out Channel Tunnel finances; and

- The need for Government and the SRA to get back to focussing on strategic not short term issues.

Lessons from the Success of Rail Freight

Julia Clarke's first lesson from the experience of rail freight was that market forces really could work positively, if the framework is arranged so that Regulatory and other incentives go with the flow rather than against it. That is regulation and incentives either gets out of the way to let the market work or mimic market forces where alternative outcomes are desired.

In the case of rail freight, the opening up of the network to on-rail competition combined with a gradual reduction in barriers to entry and adjustments to track access charges (reducing them to affordable levels and making them fully variable) had resulted in significant efficiency improvements through investment in new equipment, new operating methods and more flexible working.

Exposure to genuine commercial risk has led to Freight Operating Companies taking a much more proactive stance in terms of engagement in Regulatory and industry processes, as well as in improved internal management and better customer service. In comparison TOCs find it much easier to go back to the SRA and ask for more money.

Julia Clarke suggested this outcomes might be replicated in the passenger sector by a combination of some the following initiatives.

- Reductions in access charges to affordable levels, say, by direct grants to Network Rail, thus making much more of the passenger sector profitable and eliminate subsidy from InterCity and commuter TOCs.

- Being prepared to see TOCs who fail and go under, with the SRA making clear that no bail out was available.

- Selling franchises outright or letting rolling franchises to give long term security for investment, perhaps retaining a golden share or surrender clause to protect the public interest.

- Where subsidy is required and desirable, Government paying only for what it wishes to buy (i.e. passenger journeys of a particular kind, such as peak commuter journeys, which relieve congestion) on the basis of a tariff per journey.

This last point would eliminate the 'define what you want and pay whatever it costs' approach and replace it with 'define what you are prepared to pay and accept the outcome'. It would also have the advantage of eliminating the current huge discrepancies between the levels of subsidies enjoyed by customers of different TOCs around the country. The private sector was good at responding to market signals, and much better at devising and developing profitable service patterns than Government officials.

Julia Clarke considered that the lesson of rail freight for the current review of railway structure was that the system can be made to work and to work well. However, the roles of the SRA and the Regulator are both crucial. If Government wants to tackle performance and costs, then the way passenger services are franchised and the incentives and risks faced by Network Rail are the areas to focus on, rather than structural change.

Finally, Julia Clarke wished to emphasise that vertical integration of the railway would do nothing to help harness market forces either for Network Rail or for TOCs. She considered that it was the introduction of market forces into rail freight, which has largely contributed to its success.

Discussion

Don Box (BR Retired & former TEG Treasurer) *welcomed the speaker's ideas that the privatised freight and passenger train operators should only be asked to pay track access charges on the basis of "Wear & Tear". However, such an approach required someone to pay for the remainder of the infrastructure costs, which probably meant central government footing the bill. An alternative approach would be to ensure that those train operators with higher margins were asked to contribute more than "Wear & Tear" towards track costs. Overall, simplification of infrastructure charging seemed a laudable aim.*

Gregory Marchant (Formerly BR Railfreight Distribution & SRA) *pointed out that the nature of railway infrastructure meant that capacity tended only to be incremental in large lumps at high cost. Hence, over any short-term period, some agency would always need to ration use of capacity on the trunk routes. How would the speaker suggest such rationing be determined?*

Julia Clarke did not have any simple or straightforward answer to this predicament. Her experience suggested there was capacity for more trains on the network than many railwaymen believed. The main requirement for freight operators was regularity and predictability of paths. Even on a substantial freight flow trains might not always run every day. However, this was only equivalent to lightly loaded passenger services, which ran every day.

Michael Schabas (GB Railways) *wished to know the speaker's views on how seriously the Central Railway proposals should be taken.*

Julia Clarke preferred not to express a personal opinion in public on this specific proposal. To her mind the main issue was a lack of any clear "process" by which government could assess such a scheme. In this respect railways compared unfavourably with road or other major transport developments.

Chris Savage (Central Railway Group) *endorsed the speaker's comments about lack of a planning process for assessing major new railway developments and how this disadvantaged the industry. In regard to marginal costing of infrastructure use by train operators, he felt that if there were vertical integration the 'owner' of a particular route might have the incentive to ensure capacity utilisation were maximised in order to increase his track user charges. What were the speaker's views on vertical integration?*

Julia Clarke was not in favour of vertical integration in the industry. Freight flows rarely fitted neatly to the sort of lines of route relevant to passenger operations. Hence most freight operators would be faced with negotiating paths and performance regimes across a host of infrastructure owners. As the questioner had observed, there was a need to give the infrastructure owner the incentive to maximise capacity utilisation and all suggestions about mechanisms for this warranted further thought.

Jim Hailstone related the difficulties experienced by Freightliner in gaining approval to run coal wagons at 90 mph in order to expedite pathing. Track engineers in Network Rail had been supportive, but eventually the proposal was defeated after concerns were raised at a late stage by their structural engineers.

Julia Clarke saw this as an example of how knowledge relating to the capability of the network was buried far too deeply within specific offices or departments. In such an environment it was difficult for freight operators to make progress and represented a management issue which Network Rail needed to tackle seriously.

Robert Johnson (Student, University of Westminster) *wondered whether the degree of political interference to which the railways were subject, tended to frightened away potential private sector investors.*

Julia Clarke agreed in general with this proposition. The private sector wished to invest for the long term in order to have the prospect of making a return. Hence, it did not like uncertainty or opportunities for unforeseen change. It was more relevant to the private sector whether government and the SRA were consistent in pursuing a long-term strategy, than the amounts of money available in any one year for network development. The uncertainty over whether and when the SRA might proceed with its previous announced loading gauge strategy was a prime example.

Robert Cochrane (Independent Consultant & Visiting Professor, Imperial College) *asked for the speaker's views on how best to appraise freight-related infrastructure schemes, such as Felixstowe to Nuneaton.*

Julia Clarke believed such schemes could only be appraised in the round, including assessing the benefits to passenger services through improved capability and performance. This had been the approach adopted by the Freight Group within the SRA to the Felixstowe-Nuneaton proposals. Unfortunately, there did not appear to be a straightforward mechanism for identifying and quantifying the benefits to passenger services in operational terms, which could then be readily appraised.

Jeremy Drew (Independent Consultant) *noted the speaker's earlier comments that "Train operator revenues had been eroded by on-rail competition". How had on-rail competition in the freight business evolved?*

Julia Clarke explained that at first EWS and Freightliner had been the only operators and had not competed very much. This had led some very large customers to either set up, or threaten to set up their own operations. Also, other customers had used potential new entrants as 'stalking horses' to negotiate down their prices with the existing operators. Most competition had been in the Heavy Haul sector. Here Freightliner had adopted an interesting approach, whereby customers are effectively offered a complete train-set to use as they wish. New entrants had substantial advantages in being able to set up their operations from scratch and not being lumbered with traditional operational and cost structures.

Alan Woodburn (University of Westminster) *wondered whether tonne-km was still an appropriate measure of rail freight activity or whether some other yardstick should be adopted.*

Julia Clarke felt that some concept of 'loads' would now be a better measure of activity. Coal remained a large proportion of the rail freight business and tended to dominate the tonne-km statistics. To her mind highlighting new developments always represented a significant measure of activity and success.

Nigel Harris (The Railway Consultancy) *noted that whilst there was clearly competition in the bulk market, there was far less competition in the wagonload market.*

Julia Clarke saw road haulage as the principal competitors to the existing wagonload and intermodal rail operators. Since switching between modes was fairly easy in these markets, road haulage acted as the price setter. Establishing a rail wagonload or intermodal network had high entry costs, which effectively prohibit on-rail competition other than at the margin. There had been criticism of rail operators for not serving certain parts of the country, but if the market price was too low the private sector could not be expected to respond.

Andrew Evans (University College London) *asked whether the speaker saw the loss of the Royal Mail business as the proper working of market forces.*

Julia Clarke, whilst disappointed at the decision, defended the right of Royal Mail as a commercial entity to make its own commercial judgements. The decision might have been prompted by complicated internal factors within Royal Mail's business and might turn out to be a mistake, but they must be allowed to make their own choices.

John Crawford (Freelance Consultant) *was disappointed to note that, at a time when the government was trying to encourage the transfer of freight traffic from road to rail, the tariff for environmental benefits for removing lorry journeys from motorways had been reduced from 30p per mile to 20p per mile.*

Julia Clarke saw the main thrust of government policy as trying to get lorries off the most congested stretches of road, which in general were not motorways. Hence, the tariff had to be less for motorways than for other roads. However, a much bigger question was whether the environmental benefits of transfers from road to rail were being fully valued. On this she had serious doubts.

Report by Gregory Marchant

Letter to the Editor

The Editor
The Transport Economist
13 April 2004

Sir

The meeting last June on the multi-modal studies seems to have been a fascinating occasion and I am sorry that I was not able to attend. But what is striking from the report in *The Transport Economist* (Volume 30 No 3) is that although Geoff Copley, who gave the paper, bemoaned the Government's lack of commitment to road pricing as a means of modifying travel behaviour, neither he nor any one who spoke afterwards mentioned speed control.

There are several reasons why lower and better-enforced speed limits are preferable to road pricing as a means of traffic restraint outside towns. They would be both fairer and more effective. Road pricing would lead to some traffic generation, though not to a net generation, on the part of those people who are rich enough not to mind the charge but who value, for example, being able to live in a nice country area far from their work in the grimy city. In addition, lower speeds would reduce danger, pollution and other costs per vehicle mile, whereas, road pricing, because it would increase speeds, would also increase these rates.

Speed control could also play some part in restraining traffic in towns, not so much by acting as a deterrent to car use as by removing, or mitigating, a deterrent to cycling. To change the default urban speed limit from 30mph to 20 mph would both influence the modal split between cars and bicycles and get rid of some car trips, notably some escort trips, altogether. But in towns speed control would certainly have to be supplemented by other means of restraint, though not necessarily by road pricing. Parking control, including taking out, rather than just charging for, some parking spaces, is potentially a very fair, powerful and discriminating means of restraint. At least in larger towns, it would need to be combined with the reallocation of road space away from cars in order to prevent traffic generation by through traffic.

Many transport economists seem to believe that road pricing is always and everywhere the ideal method of traffic restraint and that other methods are second best, to be employed only when technical or political obstacles preclude the use of pricing. There is no rational basis for this belief: every method of restraint has its own particular advantages and limitations. The problem for

transport planning is to find the right combination of measures to suit a given town or area, and the particular role of transport economists should be to devise objective methods to compare and evaluate the alternatives. The present prejudice in favour of road pricing prevents economists from doing that job. I appeal to economists to shake off this prejudice, which has had, and will continue to have, very serious consequences.

Stephen Plowden

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TEG NEWS

REPORT OF AGM MARCH 2004

Chair's report for the year 2003

The TEG continued its series of meetings on topical subjects in the field of transport economics. The programme for 2003 was as follows:

January	The Croydon Tramlink Impact Study (Mary Thomas, Faber Maunsell and Neil Georgeson, TfL)
February	Improving decision-making for major urban rail projects (Roger Allport, Halcrow)
March	Strategies for low cost airlines (Simon Smith, SDG, presented by Dick Dunmore)
April	Recent developments in the modelling of peak spreading (John Polak, Imperial College London)
May	'Oyster' and 'Pre-Pay' (Malcolm Fairhurst, TfL)
June	Multi-modal studies and the 10-year Plan (Geoff Copley, Faber Maunsell)
October	Congestion charging – is it working? (Michèle Dix, TfL) (joint meeting with ICE, London Association)
November	Current appraisal issues from an SRA perspective (Bob Stannard, SRA)
December	Pricing runway use in the peak and off-peak (David Starkie, Economics-Plus Ltd/RPI Oxford)

The meetings, except the joint meeting with the ICE, have been held in the Chadwick Building at UCL. Attendance at meetings continued at a high level, averaging 28, with a range of 14 to 45 compared with an average of 27 the previous year (range 19 to 43), excluding the joint meetings. The policy of sending out e-mails to remind members has continued and seems to be appreciated by members.

I would like to thank the other members of the committee for their help and support over the year. Emily Bulman built on the previous efforts by Peter Gordon to ensure that we now have an operational website

(http://www.transecongroup.org.uk/). After a number of years Don Box handed over his responsibilities as Membership Secretary and Treasurer to Gregory Marchant. Don took over as Vice-chair of the Group. Rebecca Graham took over from Joanna Hase as Administrative Assistant and helps to ensure smooth running of the Group's affairs.

Roger Mackett
22 March 2004

Treasurer's Report for Year Ended 31st December 2003

1. In this, my first report as Treasurer and Membership Secretary, I would like to begin by recording my appreciation for the superb work done by Don Box over many years in looking after the finances and membership affairs of the Group. His efficiency and thoroughness has considerably helped me on taking over these tasks during the summer of 2003.

2. It is fortunate that in this first report I am able to announce that the Group made a surplus of £804 for the year 2003. This stems from the collective actions of the committee in:

    a) Encouraging and recruiting new members – at the end of 2003 the Group had over 140 members;

    b) Keeping expenditure under control – particularly in terms of printing and meetings; and

    c) Deciding not to renew the Group's Public Liability Insurance – see below.

3. For many years the TEG has purchased insurance cover against the risk of a claim by members (or speakers) for a mishap whilst attending its meetings. Whilst initially the costs of such cover were minimal, over the years insurance prices have risen steeply, until in autumn 2003 we were asked to pay a premium of £525, equivalent to almost £3.75 per member. After checking the stance adopted by other similar groups, noting that there had never been a claim and re-assessing the likely risks, together with a consideration of the responsibilities of the meetings' venue, the committee decided it could no longer justify this expenditure.

4. An Income & Expenditure Account for 2003 and Balance Sheet as at 31/12/03 accompanies this report. Essentially the Group has a fairly fixed set of expenses, which vary only slightly with membership numbers. In contrast, income is directly dependant on the number of members, both

new and renewals. Hence the risks associated with planning the Group's finances. However, thanks to the surplus for 2003, I feel confident enough to keep subscription rates the same for 2004. My intention remains though to try to build a healthy bank balance just in case it is needed to tide the Group over any lean times at a later date.

5. As in previous reports, I give below a summary of the trends in major expenses for the Group. The big change in meeting costs is the insurance mentioned above.

	2001	*2002*	2003
Administration	*£897*	*£1,030*	£907
Publications	*£953*	*£1,013*	£736
Meetings	*£1,136*	*£844*	£255

Gregory Marchant
24 March 2004

INCOME & EXPENDITURE ACCOUNT FOR 2003

			£	**£**	*Notes*
Income					
	Subscriptions:	2002	20		
		2003	2,689	2,709	
	Interest			15	
	Other			5	*(1)*
	TOTAL			**2,729**	
Expenses					
	Meetings			255	
	Administration:	Admin Assistant	748		
		Other	159	907	
	Publications			736	
	Other			28	*(2)*
	TOTAL			**1,925**	
Excess of Income over Expenses				**804**	

BALANCE SHEET AS AT 31st DECEMBER 2003

	£	£	
Accumulated funds at 31/12/2002	2,437		
Plus Surplus for 2003	804	3,241	
Creditors		1,035	*(3)*
		4,276	
Represented by:			
Deposit Account	2,582		
Current Account	1,892	4,474	
Less: 2004 Subscriptions Prepaid		-84	
Less: Uncleared cheques (3 no.)		-114	
		4,276	

Notes on 2003 Accounts

(1)Other Income comprises	
Refund of Corporation Tax	£5
(2)Other Expenses comprise	
Leaving Presentation	£22
Tax	£6
(3)Creditors comprise	
(a) Hire of meeting room	£80
(b) Admin Assistant Fees	£473
(c) Admin Expenses	£32
(d) Journal printing - 1 edition	£200
(e) Journal postage - 3 editions	£250
Total	***£1,035***

REPORT OF THE AUDITOR

To members of the Transport Economists Group: I have examined the books and records of the TEG, together with any other necessary information from your Treasurer. In my opinion the Balance Sheet gives a true and fair view of the TEG affairs as at 31st December 2003, and the Income & Expenditure Account properly reflects the trading result for the Group.

Signed: G.R. Carson, Transport Consultant

Graham Carson was re-appointed as auditor, Laurie Baker proposed and Peter Gordon seconded. This was agreed by the meeting.

Committee Elected at AGM

Peter White offered his resignation from the committee and Robert Cochrane moved a vote of thanks for his many years of excellent work for the Group, which was agreed unanimously.

The following were elected to the Committee, proposed by Chris Castles and seconded by Aileen Hammond:

Laurie Baker	Don Box	Emily Bulman
Robert Cochrane	Dick Dunmore	Peter Gordon
Martin Lawrence	Roger Mackett	Gregory Marchant

At the first Committee meeting following the AGM, positions were assigned:

Chair: **Roger Mackett**

Deputy Chair: **Don Box**

Secretary and Deputy Editor: **Dick Dunmore**

Publicity and Deputy Secretary: **Robert Cochrane**

Treasurer and Membership Secretary: **Gregory Marchant**

Editor: **Laurie Baker**

Webmaster: **Emily Bulman**

Programme Co-ordinator: **Peter Gordon**

Committee Member: **Martin Lawrence**