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Privatising Britain's passenger railway : expectations and outcomes of the 'free' market approach

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**PRIVATISING BRITAIN'S PASSENGER RAILWAY:
EXPECTATIONS AND OUTCOMES OF THE 'FREE' MARKET APPROACH**

by

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in partial fulfilment for the degree of

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ABSTRACT

The privatisation of the British railway industry was announced in 1992, and a central plank of the government's strategy was to liberalise British Rail's (BR's) passenger market at the time of its divestiture. Competition was to be introduced both *for* the market, through franchising, and *in* the market, by freeing up access to the rail network. This thesis examines the policy adopted to promote competition in the British passenger railway industry. Its central aim is to assess the extent to which the promotion of competition between passenger train operators was an appropriate policy goal. In pursuit of this aim, the thesis critically evaluates the evolution, outcome and future prospects of rail liberalisation policy and closely examines the translation of neoliberalism - the theory of political economy upon which rail privatisation was based - into practical policy measures. A significant original investigation, drawing upon the experiences of key personnel involved in framing, executing and operating within the policy, augments secondary data to provide an in-depth level of analysis not currently available within the literature. The study employs predominantly inductive, qualitative methods of data collection and analysis, which together constitute a relatively novel investigative approach within transport geography.

The empirical results are presented and discussed against the background of the other 'network' industry privatisations of the 1980s and early 1990s. The main findings are that, despite the sale of BR having been considered by the government for more than a decade, the privatisation and liberalisation strategy advanced by the 1992 White Paper, *New Opportunities for the Railways*, was not the result of a coherent policy analysis. The opportunities for, and even appropriateness of, a neoliberal agenda to promote competition between train operators were not sufficiently well understood by government when the proposals were adopted. Competition for the market, nevertheless, would appear to be a workable and 'successful' policy option, with the scope to offer long-term benefits to the rail industry should future governments choose to seek them. Competition in the market, on the other hand, is far less appropriate and continued emphasis on this aspect of rail policy could damage the industry's prospects in the coming years. Finally, the overall success of franchising seems to have occurred despite the muddled circumstances in which the Conservatives formulated rail privatisation policy, whereas the general failure of 'on-rail' competition seems to reflect them.

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LIST OF ABBREVIATIONS

ASI.....	Adam Smith Institute
ATOC.....	Association of Train Operating Companies
BG.....	British Gas
BR.....	British Rail
BRB.....	British Railways Board
BREL	British Rail Engineering Limited
BRIS.....	British Rail Infrastructure Services
BRML	British Rail Maintenance Limited
BT	British Telecom
CCICM.....	Controlled Competition in Contestable Markets
CE	Chief Executive
CEGB	Central Electricity Generating Board
CI	Compulsory Interavailability
CPS	Centre for Policy Studies
CRD	Conservative Research Department
DETR	Department of the Environment, Transport and the Regions
DoT.....	Department of Transport
DTI.....	Department of Trade and Industry
EWS	English, Welsh and Scottish Railway
GDP.....	Gross Domestic Product
GNER.....	Great North Eastern Railway
ITT	Invitation to Tender
LTS	London, Tilbury and Southend Railway
MBO.....	Management Buy-out
MEBO	Management/Employee Buy-out
MD	Managing Director
MMC.....	Monopolies and Mergers Commission
MP.....	Member of Parliament
MSR	Mode of Social Regulation
NAO	National Audit Office
NFC.....	National Freight Corporation
NRES	National Rail Enquiry Service
Offer	Office of Electricity Regulation

Ofgas	Office of Gas Supply
OforQ	Organising for Quality
Oftel.....	Office of Telecommunications
Ofwat.....	Office of Water Services
OIG	Objectives, Instructions and Guidance
OPRAF.....	Office of Passenger Rail Franchising
ORCATS	Operational Research Computer Allocation of Tickets to Services
ORR	Office of the Rail Regulator
PSBR.....	Public Sector Borrowing Requirement
PSO	Public Service Obligation
PSR	Public Service Requirement
REC.....	Regional Electricity Company
ROSCO	Rolling Stock Leasing Company
RPI	Retail Price Index
RPPF	Rail Passenger Partnership Fund
SR.....	Southern Region
TOC.....	Train Operating Company
WAGN	West Anglia Great Northern Railway

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AUTHOR'S DECLARATION

At no other time during the registration for the degree of Doctor of Philosophy has the author been registered for any other University award.

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Shaw, J (2000) Adopting a model for rail privatisation. In Freeman, R and Campbell Bannerman, D (eds) *British Railway Privatisation* McGraw-Hill, Maidenhead. Forthcoming.

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Date.....

Chapter One

Introduction

1.1 The privatisation of British Rail

The dominant political ideology in Britain during the 1980s and early 1990s was that of the New Right, whose economic beliefs, based upon neoliberalism, prioritised reducing public sector involvement in society and the economy by promoting a ‘free’ market driven by competition (Barry, 1987; Farnham and Horton, 1993; Green, 1987; Hayes, 1994). For this and other reasons, the privatisation of public sector industries was of central importance to successive Conservative governments in the 1979-1997 period (Foster, 1992; Heald, 1983), and the most recent major divestiture was that of British Rail (BR).

The Conservatives argued that selling BR was necessary in order to “see better use made of the railways, greater responsiveness to the customer, and a higher quality of service and better value for money for the people who travel by rail” (Department of Transport, 1992a). However, they acknowledged that rail privatisation was likely to be more complex than many earlier divestitures (Shaw, 2000). Although BR was one of the most efficient railways in western Europe (Nash and Preston, 1994), its passenger operations still made heavy losses. Many of BR’s routes, although unprofitable, were seen as socially and politically necessary, and any method of sale would need to maintain pre-privatisation service levels and therefore incorporate a means of providing the private sector with continuing subsidies from the state. Moreover, experience from previous sell-offs had convinced ministers that the liberalisation of BR’s market was essential if the potential benefits of privatisation were to be realised. A key objective of the Major administration was therefore to end BR’s monopoly and introduce a competitive structure into the railway industry. The White Paper *New Opportunities for the Railways* (Department of Transport, 1992a), published in July 1992, committed the government to radically restructuring BR in advance of privatisation. The method of divestiture adopted, the ‘track authority’ model, would resolve the subsidy question by franchising passenger rail services, and would promote competition by splitting BR into 92 companies to create an internal market (Department of Transport, 1996).

Academic interest in the BR sell-off has been widespread. Various studies have traced the evolution of policy from empirical and theoretical perspectives, whilst others have provided generalised policy analyses or focused upon specifics such as the economics of rail

privatisation.¹ The centrality of market liberalisation to the government's plans has also prompted a considerable amount of research. Studies in the early 1990s reviewed *ex ante* the theoretical prospects for, and implications of, competition among passenger operators (Dnes 1993; Jones *et al.*, 1993; Preston, 1997; Shires *et al.*, 1994a; Starkie, 1993; Williams, 1992) whilst Bradshaw (1997), Charlton *et al.* (1997) and Shaw *et al.* (1998) have described *ex post* where competition has materialised in the railway industry.

But despite the rapidly expanding literature on rail privatisation, there remain omissions and considerable scope for original investigation into the subject. This is particularly true with regard to railway competition, and there is certainly a need to further augment academic understanding of the policy adopted to promote it. Although the above studies have contributed significantly to current knowledge, they have tended to be narrow in focus, assessing the policy either in terms of economic theory or without extending their analyses much beyond the bounds of the railway industry. Little attempt has been made to examine the evolution of railway competition policy, or to discuss it in the wider context of political economy. Moreover, none of the studies has examined the outcome of the policy in any significant detail. Concern has instead revolved around general concepts rather than comprehensive reviews of specifics. Finally, those studies which review the policy's prospects of promoting competition in the future are now somewhat dated and need revisiting in the light of recent events.

This study therefore focuses on the policy adopted to promote competition in the British railway industry at the time of its privatisation. The research was designed in light of shortcomings in the literature and seeks to answer numerous research questions. Key among these are: Why did competition become central to the government's rail privatisation plans? How did policy makers' wish to liberalise BR influence the policy advanced in *New Opportunities for the Railways*? Precisely where do opportunities for competition now exist, and are they being exploited by the private sector? What are the future prospects for railway competition? Has the policy been, or is it likely to be, a success? In order to address such questions, it will be necessary to gain an in-depth level of policy understanding not currently available from the literature. A significant original investigation, drawing upon the

¹ On policy evolution: Gibb *et al.*, 1998; Grantham, 1988; Knill and Lehmkuhl, 1998; Truelove, 1991; Zahariadis, 1995, 1996. General critiques, see, for example: Bradshaw, 1996a; Curwen, 1997; Glaister and Travers, 1993; Knowles, 1998; Nash, 1993; Nash and Preston, 1993; Welsby and Nicholls, 1999. On the economics of rail privatisation, see, for example, Bradshaw, 1996b; Else, 1993; Foster, 1994; Harris and Godward, 1997; Helm, 1996; Jones *et al.*, 1993; Nash and Preston, 1992; Powell, 1997; Preston, 1996; Shires *et al.*, 1994a; Stittle, 1996; White, 1998. These and other studies are discussed later in the thesis.

experiences of key personnel involved in framing, executing and operating within the policy, will be needed to augment existing secondary data. As such, the study draws heavily upon interviews with former Secretaries and Ministers of State for Transport, senior and mid-level civil servants, government advisors, industry experts, British Railways Board (BRB) members and employees, industry regulators, franchise bidders and senior managers within the 'new' railway. The originality of this thesis lies not only in the fact that it seeks to answer the research questions outlined above, but also in its methodological approach. In-depth, qualitative interviewing of key actors is relatively novel in transport geography (although see Bird, 1982, 1988; Hoyle, 1993, 1994a, 1994b, 1995), and engaging such a range and number of actors in an academic study of rail privatisation policy has not yet been attempted (see Grantham, 1998; Preston, 1997).

1.2 Aims and objectives of the study

Against this background, the central aim of this study is to evaluate the extent to which the promotion of competition was an appropriate policy goal in the privatisation of British Rail. In pursuit of this aim, the thesis critically evaluates the evolution, outcome and future prospects of the policy adopted to liberalise BR's market, and closely examines the translation of neoliberal political philosophy into practical policy measures. As such, there are three key objectives:

- To establish why and how the liberalisation of the passenger train market became an important goal of rail privatisation policy;
- To assess the outcome of rail privatisation policy in terms of the extent to which the passenger rail market has been liberalised;
- To review the future prospects for competition developing between passenger train operators.

Although the potential for competition was introduced throughout much of the rail industry at the time of privatisation, this thesis focuses specifically upon competition among passenger train operators.² For the most part, the passenger railway was chosen as the principal object of study because of its relative importance to policy makers. As one

² In its broadest sense, the passenger rail industry includes infrastructure (track, bridges, signalling), the ownership of rolling stock, heavy maintenance depots and so on. However, as chapter four will show, BR was fragmented to such an extent that 'Train Operating Companies' (TOCs) now do little else than their name suggests. They own neither infrastructure nor rolling stock, and they must buy in almost all of the services upon which they depend. It is therefore the competition between these TOCs with which this study is primarily concerned.

commentator has observed, producing change in the delivery of passenger, rather than freight, services was uppermost in ministers' minds when they sold the railways (Clarke, 2000), and in this sense it is appropriate to review the passenger business before embarking upon a study of other industry components. In addition, however, it was crucial, given the limited resources available for doctoral studies, not to compromise the detail of the investigation by over-extending its scope.

It is also important to stress that the study does not attempt an exhaustive analysis of railway competition in terms of its impact upon service output. It is not the case, therefore, that operators' efficiency, investment records, and quality and frequency of service are scrutinised for comparison with pre-privatisation levels. Rather, the thesis seeks to identify precisely the circumstances in which competitive opportunities are now available in the new railway structure, whether or not they are being exploited, and why. The rationale supporting this line of investigation is that many of the opportunities for competition are subtle and/or complex - indeed, some are still being discovered by train operators at the time of writing - and it is argued that these must be revealed and understood before any large-scale survey of their impact upon service output can begin. Moreover, those which had been identified were in a rather embryonic stage of development when data for this thesis were being collected and no reasonable judgement about their impacts could have been made after such a short period of time. The central aim of the study does not demand a comprehensive review of the impact of service competition. Focus here is on the *viability* of promoting competition as a goal of rail privatisation policy, i.e. whether or not the railway industry is capable of supporting competition as an organising principle and why.

1.3 Scope of the study

The privatisation of BR followed the sales of numerous British transport concerns. Transport, particularly since World War Two, was perceived to be an industry which required the control and supervision of the state (Lowndes, 1997), but the Conservatives under Thatcher were more inclined to believe that the "best way to ensure the public interest is to promote free competition between the providers and free choice between the users" (Conservative Party, 1977: 364). The first Thatcher administration sold the National Freight Corporation to a management buy-out team and liberalised the long distance coach industry. BR's Hovercraft, Hotels and Holidays businesses were also disposed of.

Subsequent transport privatisations included those of Sealink, British Airways, the British Airports Authority, and the National and Scottish Bus Companies.³

Primarily because of the nature of their business, the transport companies sold by the Conservatives share key characteristics with BR. This is particularly true of the bus industry. Not only does it require continuing subsidy to fund its loss-making yet socially necessary services, but ministers also perceived the need to introduce service competition between operators. Both the National and Scottish Bus Companies were fragmented and the successor businesses were transferred to the private sector by competitive tender. Furthermore, the market was liberalised by way of the '42-day rule', which entitled new operators to compete with incumbents provided they gave six weeks' notice of their proposals (White and Farrington, 1998). Thus, from having been a statutory monopoly, the bus industry was restructured to allow competition *for* the market, through competitive tendering, and competition *in* the market, as a result of the 42-day rule. As will become apparent, the privatised railway industry was also restructured to accommodate both these forms of competition.

It is perhaps logical to assume that the model adopted to privatise BR was a direct descendant of that used for the disposal of the bus companies. However, it has been argued elsewhere that this may not necessarily be the case (Charlton *et al.*, 1997; Helm, 1996; Mountford, 1996). The track authority model of rail privatisation was originally suggested in the mid-1980s (Gylie, 1984; Starkie, 1984), but became influential after a variant had successfully been applied to the privatisation of the Central Electricity Generating Board (CEGB), part of a 'network' industry. Such industries - examples are telecommunications, gas, water and electricity - were viewed by some policy makers as analogous to BR in the sense that they share a network element: wires, pipes or, in the case of BR, track. The track authority model adopted to restructure BR can be seen as further experimentation with the method used to sell the CEGB (Charlton, *et al.*, 1997; Helm, 1996) and, in this sense, is based upon a model of privatisation adopted for other network industries rather than companies in the transport sector.

In light of these issues, the thesis is structured as follows. Chapter two examines the privatisation of the network industries. It begins by outlining the key assumptions of

³ The new Labour administration, elected in May 1997, is continuing the policy of privatisation in the transport industry. It has recently been announced that the National Air Traffic Control Service and parts of

neoliberal thought and continues by exploring the interaction between privatisation policy and abstract theoretical ideals. The network industry sell-offs are then assessed in terms of the extent to which they promoted a 'free' market driven by competition, whilst the chapter's conclusions establish the political and economic contexts in which ministers were to consider the privatisation of BR. However, before the study turns to address the railway industry, chapter three describes the methods used to collect and analyse the primary data used in the study. It emphasises the qualitative, inductive nature of the techniques adopted and, because of their relative novelty in transport geography, justifies their use and explains their characteristics in detail.

The remainder of the thesis documents and critically assesses the privatisation of BR in terms of the aims and objectives stated in section 1.2. Chapter four traces the evolution of rail privatisation policy in order to establish why and how the liberalisation of the passenger rail market became an important goal therein. The chapter shows that debates over rail privatisation within the Conservative Party can be traced back to the late 1960s, and that BR was considered as a candidate for divestiture throughout most of the 1980s. Potential policy options advanced from both within and outside of government are explained, and events leading up to the adoption of the track authority model are reviewed. Finally, the chapter outlines the structure of the 'new' railway industry and identifies key shortcomings in the policy contained in *New Opportunities for the Railways*.

Chapters five and six assess the extent to which the passenger rail market has been liberalised. Chapter five focuses on the passenger rail franchising process, or competition *for* the market. The chapter begins by examining the private sector's attitude towards the BR sale in the early 1990s and explains its potential impact on the outcome of rail privatisation policy. The development of franchising policy is then discussed in this context. The remainder of the chapter assesses the degree to which competition for the market developed among franchise bidders, suggests various reasons as to why this was so and concludes by considering rail franchising's contribution to attaining the neoliberal policy aims outlined in chapter two. Chapter six is concerned with competition *in* the market, or 'on rail' competition between train operators. Field interviews for this chapter were undertaken in early 1998, four years after the railway industry was restructured, and results presented in the chapter pertain to that period. The chapter first reviews the appropriateness of on-rail competition in the new railway industry and highlights several weaknesses in the

case for such liberalisation. The opportunities for competition in the passenger rail market are then identified and compared with those which the government originally envisaged. The chapter concludes by comparing the policy outcome of rail privatisation with those of the telecommunications, gas and water industry divestitures in the 1980s.

Finally, chapter seven summarises the findings of the above chapters, before moving on to evaluate the prospects for competition developing between passenger rail operators in the future. Overall conclusions pertaining to the central aim of the study are then presented in a discussion which re-evaluates, in light of potential future trends, the fundamental themes addressed throughout this thesis. As noted above, the text now turns to examine the privatisation of the network industries in order to establish the political and economic bases on which this thesis will proceed.

Chapter Two

Privatisation and the network industries

2.1 Introduction

The sale of BR was the last in a series of network industry privatisations undertaken by Conservative governments in the period 1992-1997. When ministers considered various means of divesting the rail industry, and establishing a competitive regime therein, their decisions were in large part informed by experience gained from the sales of BT, British Gas (BG) and the water and electricity industries. For this reason it is appropriate to place the forthcoming assessment of rail privatisation policy, which develops during chapters four through seven, in the context of issues arising from other network industry privatisations. In turn, these issues are best discussed with regard to the theoretical assumptions upon which privatisation *per se* is based. Why and how did a policy of privatisation arise in the first place? Why was competition considered to be so important? What was the outcome of the network industry privatisations and what lessons were learnt as the programme developed? This chapter will address such questions.

The privatisation programme was a central plank of the New Right political philosophy, whose economic strand, based upon neoliberalism, prioritised reducing public sector involvement in the economy by promoting a free market driven by competition (Barry, 1987; Farnham and Horton, 1993). Although it began slowly, the programme was enthusiastically endorsed by government, with one policy advisor suggesting that denationalisation would help ministers succeed in “halving the size of the state sector” (Mount, quoted in Letwin, 1988: 11). At first glance, as Graham and Prosser (1988) point out, the policy of privatisation would appear to have contributed significantly to reducing the role of government and replacing it with market forces: by the mid 1990s, more than two thirds of the state’s industrial sector - 50 major businesses - had been sold, raising over £65 billion in sale receipts; around one million jobs were transferred from the public to the private sector; and almost one in four adults, compared to less than one in ten in 1979, had become shareholders as a result of privatisations (Conservative Party, 1996).

However, it can be argued that such figures are misleading, and that in certain cases, most notably the network industries, privatisation has in fact done far less than the above figures suggest to alter the role of government in industrial affairs. The monopolies enjoyed by the

utilities whilst they were in the public sector were, to a large extent, conferred upon the private sector following divestiture. In the absence of market forces to protect consumers, the government was forced to create a host of regulatory mechanisms and institutions in order to prevent the utilities from abusing their monopoly powers. Thus, although utility privatisation reduced the physical *size* of the state, it is questionable how far its *influence* was diminished. Following an introduction to the theoretical assumptions which underpin privatisation, and a discussion of how they influenced initial policy formulation, this chapter seeks to explain why the network industries were sold as “virtual monopolies” throughout the 1980s (Moore, 1985a: 94). The nature and scope of utility regulation is then considered, and the extent to which this enabled the state to maintain a continuing role in the companies’ affairs is assessed. The privatisation of British Telecom is used as a case study, although references are made to BG and the water industry where appropriate. Finally, the chapter concludes by reviewing the key issues which arose from the privatisation of the utilities throughout the 1980s, and suggests that they prompted a notable reorientation of policy in the 1990s which resulted in market liberalisation being accorded a new priority in the privatisation of BR.

2.2 Neoliberalism

Neoliberalism draws upon the works and ideas of economists (Friedman, 1962, 1980; Hayek, 1944, 1960, 1976), public choice theorists (Buchanan *et al.*, 1978; Mueller, 1979; Niskanen, 1971) and political scientists (Lindblom, 1977). It emphasises the importance of three key concepts: individual liberty, a minimal role for the state in society and the ‘free’ market. The first of these ideas is held most sacred, with the other two being seen as essential to its existence and defence (Atkinson and Savage, 1994; King, 1987). As Ashford (1991: 185) summarises, neoliberalism “argues that the consequences of allowing individuals the freedom to pursue their own interests... will generally be more beneficial than government action.” Following a brief overview of its history, this section discusses each of neoliberalism’s three main concepts. It should be noted, however, that what follows is intended neither as a critique nor an exhaustive review of neoliberalism. Such discussions are beyond the scope of the present thesis and, in any case, have been extensively rehearsed elsewhere: see, for example, Barry, 1983, 1987; Gray, 1995; Hayes, 1994; King, 1987; Peck and Tickell, 1994. Rather, the aim here is to provide an understanding of the theoretical basis from which the policy analysed in this thesis arose.

Neoliberalism is a restatement of classical liberal values (Gray, 1995; Green, 1987). The roots of classical liberalism stem from the individualistic beliefs of radical Protestants in the seventeenth century, which maintained that everyone should be free to choose their own path to eternal salvation rather than be bound by the wishes of the church (Bradley, 1985; Hardin, 1993). Since that time, liberals have fought to protect the status of the individual confronted with the demands of larger social groups: they have supported movements to emancipate people from political, economic and other constraints upon their activities, and they have campaigned for a society which is open, tolerant and diversified, rather than paternalist and authoritarian (Eccleshall, 1994). Despite a commitment to the sanctity of the individual, however, liberals are not anarchists and have always recognised the need to set certain, defined, limits to people's freedom in order to prevent them from abusing it and harming others. Thus, as *The Economist* (1996a: 20) notes, "perhaps the individual is the best judge of his own interest, perhaps not; but, unless the well being of others is jeopardised, he should be the judge."

Although its defining characteristic is a commitment to individual liberty, it is insufficient simply to refer to neoliberalism as the 'philosophy of freedom' because there are ambiguities associated with the concept. To illustrate, many interventionists would claim to support a 'free' society, yet they disagree with neoliberals about many fundamentals (Farnham and Horton, 1993; Gray, 1995; King, 1987). Such ambiguities are best resolved by drawing a distinction between two kinds of freedom, positive and negative. The former relates to interventionist notions of liberty, whereas the latter describes the neoliberal conception. Positive freedom is a *moral* concept. It suggests that individuals have the right to expect a given standard of material wealth to enable them to participate fully within society (Heald, 1983). Social matters such as poverty, ill-health and poor education are identified as coercive factors in addition to harm imposed by other individuals. In consequence, it is argued that the state should provide social services such as education and healthcare, and establish a redistributive wealth allocation system capable of achieving a 'just' apportionment of income (*The Economist*, 1996). Positive freedom is thus so-called because it provides individuals with opportunities which the state is duty-bound to enhance and secure - positive outcomes are not the sole responsibility of the individual (Heald, 1983).

In contrast, the negative conception of freedom employed by neoliberals overlooks material considerations entirely, and is concerned solely with minimising harm, or 'coercion', from

other human beings. Hayek (1960: 20-21) accords coercion a highly specific definition, arguing that it is:

“...such control of the environment or circumstances of a person by another that, in order to avoid greater evil, he is forced to act not according to a coherent plan of his own but to serve the ends of another. Except in the sense of choosing the lesser evil in a situation forced on him by another, he is unable either to use his own intelligence or knowledge to follow his own aims and beliefs. Coercion is evil precisely because it thus eliminates an individual as a thinking and valuing person and makes him a bare tool in his achievement of the ends of another.”

Because to Hayek coercion is a personal attribute, manifested solely by other individuals, his conception makes no mention of the range of *physical* options available to someone at any given time (King, 1987). This allows him to contend that even where individuals are not controlled by others, but in fact have no real choices available to them, they are still free. This point is illustrated with reference to a rock climber:

“Freedom refers solely to a relation of men to other men, and the only infringement on it is coercion by men. This means, in particular, that the range of physical possibilities from which a person can choose at a given moment has no direct relevance to freedom. The rock climber on a difficult pitch who sees only one way out to save his life is unquestionably free, though we would hardly say he has any choice” (Hayek, 1960: 12).

Thus negative freedom carries with it no worth or value in any moral sense and, unlike its positive counterpart, does not assure individuals of any material opportunities. Negative freedom requires only that individuals are able to act for a purpose of their own choosing. Whether or not individuals achieve their goals, or even have a selection of realisable goals from which to choose, is irrelevant from Hayek’s standpoint (Newman, 1984). In this sense wealth inequalities within society, for example, are not viewed as assaults on freedom because they do not preclude choice, however unpalatable it may be. As Joseph and Sumption (1977: 49 and 52) point out with “impeccable liberal logic” (Hayes, 1994: 34):

“...a person who cannot afford to buy food may well have a justifiable grievance... but it would be wrong to describe his grievance as lack of freedom... [L]iberty is liberty, not something else. And a slave is a slave, you do not set him free by feeding him.”

The role of the state is central to maintaining and defending a neoliberal free society, because government can promote liberty through the enforcement of law. To Hayek (1960), the law upholds impartial rules of just conduct, which are based on the traditions and customs of a society. As such, the law is not a tool with which the government can or should secure its own objectives - instead, it represents end-independent values which delimit the scope of freedom and protect the realm of private activity (Hayes, 1994): one

person's freedom to murder his neighbour must be sacrificed in order to preserve the freedom of the neighbour to live; likewise, "my freedom to move my fist must be limited by the proximity of your chin" (Friedman, 1962: 26). The law therefore provides individuals with known and predictable rules around which to build their lives and, because everything which is not prohibited by law is allowed, the existence of a vast number of diverse individual purposes is recognised and facilitated (Hayek, 1960). Beyond law enforcement, however, neoliberals are deeply sceptical of the state because, somewhat paradoxically, it in fact constitutes the greatest threat to the freedom which it promotes (Atkinson and Savage, 1994). The relationship between the state and individuals is viewed as personal in character - decisions are taken by individuals on behalf of other individuals - and a potentially unlimited scope therefore exists for a government to coerce its citizens. For example, every time a government programme is implemented, it necessarily involves a subjective (coercive) allocation of resources which often benefits the few at the expense of the many. Although it is acknowledged that each new programme may harm individuals only a little, it is argued, most forcefully by Hayek (1944), that the cumulative effect will inevitably be totalitarianism - the widespread coercion of all.

Neoliberals therefore favour the free market as the most effective means of organising economic and social affairs to protect individual liberty (Lindblom, 1977). The market is embraced almost uncritically because, unlike those of the government, its mechanisms are viewed as being entirely impersonal. The market itself has no ends and purposes, and market phenomena are merely what emerge from the actions of individuals pursuing *their own* ends and purposes by voluntarily exchanging private property. Goods and services are thus allocated 'objectively' according to supply and demand (Hayek, 1976). The need for coercive, statutory co-ordination of economic and social affairs is negated because markets "harmonise as far as possible diverse individual purposes and leave maximum scope for non-conformity, voluntary experimentation and personal fulfilment" (Harris, 1978: 240-241). The market system works so well, according to neoliberals, because it allows risk-taking entrepreneurs to seek profit whilst simultaneously benefiting others - the so-called *invisible hand* principle (Smith, quoted in Friedman, 1980).

In the same way that the state upholds the rule of law in relation to non-market transactions, so it also should in the economic sphere. Thus, the law should enforce contracts, protect private property, prevent fraud, inhibit restrictive practices and grant people authority to control their own labour (Lindblom, 1977). In addition, and of specific

relevance to this thesis, the law has a role to play in promoting competition. Competition is seen as a spur to increase the efficiency, quality and diversity of services offered to consumers. It is also believed to prevent coercion by maximising choice: the consumer is protected from coercion by the seller because of the presence of other sellers from whom he can buy, and the seller is protected from coercion by the consumer because of other consumers to whom he can sell (Friedman, 1962). If entrepreneurs become monopolists, they could become inefficient and, more worryingly from the neoliberal point of view, coerce consumers because the latter lose their ability to engage in voluntary transactions.

Hayek (1960) has argued that market imperfections such as monopolies will arise, but that they are acceptable so long as market entry is not restricted - especially by government - because monopolists will be subject to *potential* competition. For Friedman, however, this position is too simplistic. He notes that if a monopolist is large enough, it can engage in anti-competitive practices - such as heavy internal cross-subsidisation - to prevent market entry and maintain its market dominance (see section 2.4). Friedman (1962: 132) stresses that, because of monopolists' effect upon liberty, not only must governments not restrict market entry, but they must also uphold vigorous anti-trust laws as a "first and most urgent necessity." That said, Friedman accepts that some industries do possess unavoidable 'natural' monopoly characteristics. Natural monopoly occurs where a single firm can produce total industry outputs more efficiently than two or more firms (Yarrow, 1994). A traditional example has been a utility: the cost of building, say, a second national grid to compete with the existing one would be prohibitive. In such situations, Friedman (1962) concludes that the natural monopoly should be conferred upon a private sector firm subject to regulatory control.

Neoliberals concede that the state also has a limited market role pertaining to the provision of public goods. King (1987) defines these as goods and services which have the characteristics of indivisibility (their use cannot be meaningfully divided among individuals) and nonexcludability (individuals or groups cannot be excluded from using them). An example is national defence. As Friedman (1962: 23) points out, "I cannot get the amount of national defense I want and you [cannot get] a different amount." The armed forces protect everyone to the same degree whether or not they pay for, or approve of, their existence. Externalities, such as pollution, are also categorised as public goods. Car owners do not necessarily intend to pollute the environment, but they inescapably force everyone to

exchange clean air for dirty (Pearce *et al.*, 1989). In this example, the government might insist that certain anti-pollution measures are adhered to by motorists.

Although they accept the case for government provision of public goods, neoliberals remain suspicious of such action even in this diminutive incarnation. In addition to concerns regarding freedom, Friedman (1962, 1980) asserts that, because it is not subject to market forces such as profit, risk and competition, the public sector lacks motivation to satisfy consumers and will therefore perform inefficiently. Furthermore, Buchanan *et al.* (1978) contend that public servants seek to manipulate government activities to maximise their own interest rather than those of consumers. Such bureaucratic self-interest is regarded as particularly dangerous because it can result in a stealthy and rapid expansion of government activity beyond that which is judged appropriate (Friedman, 1980). Accordingly, neoliberals seek to extend the rule of law to constitutionally circumscribe government activity (Hayes, 1994). In this way it is argued that, with the few exceptions noted above, the politicisation of society can be prevented, and its citizens do not have to surrender their liberty by “putting [their] heads under a yoke imposed by bureaucratic bunglers” (*The Economist*, 1919: 472).

The defining characteristic of neoliberalism is its commitment to a negative conception of individual liberty. This, it is believed, is best defended and maintained by limiting the role of the state and maximising that of the competitive, free market. However, these abstract concepts are of limited value without some indication of how they might be translated into practical policy measures. Hayek (1960) urged that government policies should primarily have regard to promoting freedom through the minimisation of coercion. By neoliberal standards, government in the late 1970s constituted a powerful coercive force. The welfare state consensus, based on Keynesian economic principles, had involved successive administrations assuming a prominent responsibility for economic and social planning. By 1979, nationalisation programmes had brought the major basic industries - coal, steel, gas, electricity, healthcare, the airlines, the buses and the railways - under government control, and many of these were statutory monopolies; around seven million people were employed in the public sector, and many millions more in the private sector were dependent upon government contracts, funding or subsidies for their employment; other government schemes, particularly those in the welfare state, had grown rapidly and state spending as a proportion of gross domestic product (GDP) stood at 40.5 per cent (Veljanovski, 1987; Farnham and Horton, 1993). Policies designed to promote freedom would therefore need to

reverse the trend of government intervention in the economy and society by transferring power from the state back to liberated, risk-taking, competitive individuals. Key among these policies was the privatisation of state-owned industry.

2.3 Neoliberalism and the initial development of privatisation policy

Privatisation has been variously defined (see, for example, Beesley and Littlechild, 1983; Wiltshire, 1987). In essence, it is the transfer of at least part of the operations of a state-owned enterprise to private control (Heald, 1983). As Pirie (1988) points out, privatisation can be accomplished in numerous different ways, although the three most practised have been: *denationalisation*, which involves the direct sale of public assets; *contracting out*, where the production of state-financed goods and services is franchised to private firms, usually for a finite period; and *liberalisation*, which requires the abolition of statutory monopoly to promote competition in markets previously characterised by restricted entry (Kay and Silbertson, 1984; Kay and Thompson, 1986). Each of these policy strands can be pursued separately - for example, the denationalisation of BT in 1984, the contracting out of municipal services throughout the 1980s and the liberalisation of long distance coach services in 1980 (Foster, 1992; Vickers and Yarrow, 1988; White 1995) - or together, as was the case with the privatisation of British Rail in the mid 1990s (see chapter four).

Supporters of privatisation now offer political and economic experience, as well as theoretical assertions, to justify pursuing the policy. In terms of politics, studies have shown that people who bought shares in denationalised companies, or council houses under the 'Right to Buy' scheme, have been, in the short term at least, more likely to vote for the government in office (Saunders, 1991). In addition, revenue raised from privatisation can be used - in some cases explicitly - to fend off tax increases or public expenditure reductions (Jenkins, 1995; Segall, 1998). From an economic perspective, private firms have often performed more efficiently than their nationalised counterparts as they were subjected to market disciplines and 'freed' from government involvement in their day to day operations (*The Economist*, 1995a).

However, the welter of attention paid to the political and economic experience of privatisation has tended to result in many authors downplaying the role of neoliberal theory in the development of privatisation policy. Kay and Thompson (1986: 18) refer to the latter as being "in search of a rationale," and Jenkins (1995: 24) suggests that the Conservatives' initial endorsement of privatisation was "hardly a ringing ideological crusade." Atkinson and

Savage (1994: 7), whilst acknowledging the influence of neoliberalism within the academic community, have questioned whether the theories of Hayek, Friedman and Buchanan had “real effects upon ‘pragmatic’ politicians such as Thatcher who were primarily concerned with achieving and retaining power.” Farnham and Horton (1993) rightly point out that it would be naive to assume that the Conservatives were hijacked by neoliberal radicalism throughout their time in office and, as this chapter will show, key neoliberal goals were undoubtedly marginalised as privatisation policy unravelled in practice. Nevertheless, without falling into an Enlightenment trap and believing, like Keynes (1964: 383), that “the world is ruled by little else” than the ideas of economists and political philosophers, the influence of neoliberalism on the initial development of privatisation policy during the 1970s should not be discounted (Atkinson and Savage, 1994). Key to this argument, of course, is that the Conservatives did not *have* much political and economic experience of privatisation at that time. Although a handful of small concerns, such as the Thomas Cook travel agency, had been sold by previous administrations, nothing approaching a sustained programme of divestiture had ever been attempted.

Support within the Conservative Party for a sustained programme of privatisation began to materialise in the late 1960s (Conservative Research Department (CRD), 1968), although it was concentrated initially around a small group of politicians on the right of the Party. Keith Joseph in particular became obsessed with the ‘ratchet effect’ of British politics - essentially, that the influence and power of the state was continuously increasing because new Conservative governments were unwilling to reverse nationalisations undertaken by previous Labour ones (Joseph, 1976). In 1968, a secret report of the Policy Group on Nationalised Industries, chaired by Nicholas Ridley, explicitly objected to public sector corporations and went on to suggest a policy strategy which amounted to the beginnings of a coherent privatisation programme:

“...we have listed a number of small concerns which should be denationalised - £60 million worth - and these should be tackled at once. Steel, the airlines and road haulage represent £900 million worth of assets. We believe it is possible to sell them back... [but denationalisation] should be a continuing process of which our proposals are only the first stage” (CRD, 1968: iv and 20).

Following Ridley’s report, Conservative MP Rhodes Boyson edited a book, *Goodbye to Nationalisation*, which argued that public sector industries had been a political and social failure, and that there was a need to return them to a competitive framework (Boyson, 1971). Suggestions were made regarding how this might be done (see Lewis, 1971), although they were not elaborated upon in any great detail and Foster (1992: 108) has

accused *Goodbye to Nationalisation* as being “less than penetrating in its arguments.” Nevertheless, Boyson’s book can be regarded as important if only because it was one of the first public expositions of large-scale privatisation from a Conservative MP.

The official Conservative Party position on denationalisation in the early 1970s was not swayed by right-wing fringe opinion. The 1970-74 Heath administration was committed to the welfare state consensus, and the 1970 *Campaign Guide* (Conservative Party, 1970), although emphasising the belief that political interference in the affairs of public corporations was deleterious, was unsympathetic to a sustained programme of privatisation. A noticeable shift in the Party’s official stance did not occur until the election of Thatcher as leader in 1975. Shortly after becoming Conservative Party leader, Thatcher attended a policy seminar at the CRD in London. During the seminar, a researcher presented a paper which argued that the Party believed in, and should continue subscribing to, the welfare state consensus. However, before the researcher had finished,

“...the new Party leader reached into her briefcase and took out a book. It was Friedrich von Hayek’s *The Constitution of Liberty*. Interrupting our pragmatist, she held the book up for us all to see. ‘*This*’, she said sternly, ‘is what we believe’, and banged Hayek down on the table” (Ranelagh, 1991: ix. *Italics added*).

Official Conservative Party literature published between 1975 and 1979 (see, for example, Conservative Party, 1976a, 1976b, 1979a; Fowler, 1977; Howe *et al.*, 1977) began to emphasise key neoliberal ideas. Echoing Joseph’s earlier concerns regarding the ratchet effect, the Conservative Right warned that the decades of welfare state consensus had resulted in governments making unacceptable infringements upon individual liberty, and that nationalisation was in large part responsible for this (Johnson, 1978). Official party statements restated the key themes of *The Constitution of Liberty* (Hayek, 1960): “[We] need to enlarge freedom of choice for the individual by reducing the power of the state” (Conservative Party, 1979a: 1); “Our purpose is to restore and defend individual freedom and individual responsibility” (Conservative Party, 1976b: 1). Johnson (1978) asserted, quoting Hayek (1944), that Britain was driving at speed along ‘the road to serfdom.’ Central to the case for privatisation was that it would apply the brakes:

“We shall [restore individual freedom] by reducing the proportion of the nation’s wealth consumed by the state [and] by taking the first steps towards making this country a nation of worker-owners” (Conservative Party, 1976b: 1)

“The long term aim must be to reduce the preponderance of state ownership and to widen the base of ownership in our community. Ownership by the state is not the same as ownership by the people” (Howe *et al.*, 1977: 47).

The Conservative Right also began to draw upon the work of Buchanan (1978) and Friedman (1962) to justify its support for privatisation. First, the nationalised industries were portrayed as being run for the benefit of politicians and bureaucrats rather than consumers (Veljanovski, 1987). For instance, as the Conservatives suspected in opposition and were to find when they took office in 1979, many of the profitable corporations were required to forego important capital investment programmes because their cash surpluses were siphoned off by government to help fulfil its macroeconomic objectives (Heald and Steel, 1981). Second, because some of the nationalised industries were monopolies, and none were subject to true market forces, it was argued that they were complacent, inefficient and offered poor standards of service (Conservative Party, 1974, 1977). As such, emphasis was placed upon the need for the privatisation programme to foster a competitive free market and remove government involvement from industry altogether:

“... Conservatives reject the idea that [for example] transport ought to be regarded primarily as a social service to which the taxpayer must be forced to contribute huge and continuing subsidies in order to secure social and political objectives selected by government... [T]he best way to ensure the public interest is to promote free competition between the providers and free choice between the users” (Conservative Party, 1977: 364).

That said, a confidential report leaked to *The Economist* in 1978 accepted as had Friedman that some industries, particularly the utilities, were natural monopolies and were likely to remain so (Veljanovski, 1987).

Thus it can be argued that the Conservative Right approached the 1979 general election with limited practical experience of privatisation, but with an expectation derived from neoliberal ideology that it should deliver enhanced individual freedom by: a) promoting competition, rather than monopoly, in an industry's market to allow voluntary exchange between individuals, and b) genuinely reducing the powers of the state to manage an industry and the production/distribution of its goods and services.¹ In addition, promoting competition and downsizing the state were expected to stimulate industrial efficiency, encourage risk-taking and refocus corporate activities on the interests of consumers. It is important to note, therefore, that although each of the three means of privatisation listed above - asset transfer, liberalisation and contracting out - can be executed separately, an

¹ It is important to recognise that the government will always retain a degree of control over any enterprise. Companies are subject to law, taxes, safety legislation and so on. Although pure neoliberal theory argues

effective combination of these might be necessary to achieve a *genuine* reduction in the power of the state over an industry. To illustrate, simply transferring the assets of a monopolist would do nothing to liberalise the market in which it operated, and could necessitate a continuing role for government as an industry regulator.

Given Thatcher's "vehement... wish to roll back the borders of the public sector" (Foster, 1992: 109) and the enthusiasm of the Conservative Right for privatisation, it is perhaps surprising that the Party's 1979 manifesto (Conservative Party, 1979b) was distinctly circumspect regarding the idea. Indeed, the word 'privatisation' did not appear, and pledges were made only to sell shares in the National Freight Corporation (NFC), to relax bus-licensing controls and to reconsider the ownership of British Aerospace, British Shipbuilders and the British National Oil Corporation (BNOC). The Queen's speech of 1979 was equally vague, outlining only "proposals [to] reduce the extent of nationalised and state ownership and increase competition" (quoted in McLachlan, 1983: 21).

Two key reasons seem to explain why the manifesto did not reflect the Conservative Right's enthusiasm for privatisation. First, the concept was at this stage still unpopular with the majority of the population (Heath *et al.*, 1985). Opposition was also forthcoming from public sector industry, Conservative backbenchers and especially some quarters of the civil service, who regarded privatisation as dangerously radical (Foster, 1992). Thatcher, despite her often belligerent outward appearance, was politically cautious (Jenkins, 1995) and was determined not to lose the election before it even took place.² As Howe (1994: 254) recalled, Thatcher "had been fearful that a more extensive catalogue might frighten the floating voter." Although the privatisation programme gained momentum throughout the 1980s, Thatcher's political caution, as chapter four will show, was to resurface during debates over the BR sell-off. Second, the Conservatives had not actually formulated privatisation policy in any great detail during their time in opposition. Although the Party's right wing had embraced privatisation as a corollary of neoliberal theory, a blueprint regarding how it could actually be executed in practice - which companies could be sold and how, for example - had not been produced. Oliver Letwin, one of Thatcher's policy advisors, admitted in 1988 that although:

that safety laws are generally superfluous - choice is said to protect the consumer and the worker (see Friedman, 1962; 1980) - the Conservatives never claimed that they accepted this line of thought.

“... we had a fundamental distrust in the state running things... we had no coherent policy. It was not the case that we knew that privatisation would bring in millions of new shareholders. It was not the case that we knew all these shareholders would benefit from premiums. It was not the case that we knew companies would do better in the private sector. Almost nothing that has happened since was known in advance” (quoted in Foster, 1992: 109).

The combination of widespread opposition and the lack of a policy blueprint resulted in the privatisation programme developing slowly during Thatcher's first term in office. A dedicated Cabinet committee, E (DL) (Economic (Disposal)), was set up although Thatcher remained cautious. According to Ridley (1991: 83), the Prime Minister would not risk embarking upon a major privatisation programme because “she didn't want to stir up the lobbies in the public sector. She felt we could come to that in a few years' time.” As a result, the first industries to be privatised were the most convenient to dispose of - such as those which had only recently been nationalised - not necessarily the most strategically important. Shortly after the election, five per cent of British Petroleum (BP) was sold, which reduced the government's share to 46 per cent and thereby officially returned the company to the private sector (Letwin, 1988). Before the election in 1983, a further nine firms had been sold by asset transfer to the private sector (see table 2.1). The industrial privatisations of the early 1980s were complemented by the initiation of the ‘Right to Buy’ scheme, which entitled sitting tenants to purchase their council houses at a discounted rate, and the contracting out of local authority services such as street cleaning and refuse collection (Bishop and Kay, 1988). Liberalisation of the long-distance coach industry also took place following the 1980 Transport Act (White, 1995).

The early results of the privatisation process were encouraging from the viewpoint of the Conservative Right. The policy was promoted as having reduced or virtually eliminated the government's powers to control the divested companies.³ As a result of their new-found ‘freedom’, the companies had become more competitive and achieved major efficiency gains - the NFC, for example, increased its profitability sevenfold (Vickers and Yarrow, 1988; Grimstone, 1990). Although in retrospect the 1979-83 programme of divestiture seems relatively unambitious, it was important to the policy's subsequent development. The effect of its perceived success was to convert many Conservative backbenchers, who had initially regarded privatisation with some scepticism, to the Right's ideological cause. The policy's

² This was also attested to by a number of her former Cabinet colleagues interviewed during the course of this thesis. Throughout the chapter, some references are made to respondents' comments. The means of their collection and analysis are detailed in the next chapter.

³ In reality, it was not always the case that the government forswore as much control as it might have done. Golden Shares, for example, were often retained to prevent ‘undesirable’ (i.e. foreign) takeovers or to

radical image with civil servants and voters was also softened considerably (Foster, 1992). The Conservative Party’s 1983 election manifesto confirmed that privatisation would be extended to embrace the utility industries (Conservative Party, 1983), and that the first such candidate for divestiture would be BT.

Date	Company sold	Proceeds (£m)
November 1979	BP	290
June 1980	Fairey Engineering	22
June 1980	Ferranti	54
February 1981	British Aerospace	149
November 1981	Cable & Wireless	224
February 1982	Amersham International	63
February 1982	National Freight Consortium	7
February 1983	Associated British Ports	22
March 1983	International Aeradio	60
March 1983	British Rail Hotels	45

Table 2.1. Companies privatised by asset transfer during the first Thatcher administration.
Source: Bishop and Kay, 1988; Wright and Thompson, 1994.

2.4 Privatising the network industries

The utilities were significantly different in character to those industries previously divested. First, they were much bigger companies. At the time, for example, the BT sale represented the largest transfer of assets from the public to the private sector in world history (Veljanovski, 1987). Second, they traded as vertically integrated monopolies. As already noted, until the late 1970s it was assumed that almost all of the utilities’ business constituted natural monopoly because competition was only feasible if second networks were constructed (Harrison, 1982). However, technological developments began to challenge this assumption, and it was realised that any number of different companies could in fact compete via the same pipes or wires to supply consumers with gas, electricity or telecommunications services. Thus, although the networks themselves remained natural monopolies, the rest of the utilities’ activities were exposed as a collection of *artificial* monopolies. The Conservatives acknowledged this (Moore, 1983a), and indicated that, if re-elected, they would seek to break them:

“...our aim is that BT should become a private sector company... [but] merely to replace state monopolies by private ones would be to waste a historic opportunity... we shall continue our programme to expose state-owned industries to competition” (Conservative Party, 1983: 292).

restrict third parties’ voting rights (see Graham and Prosser, 1994; Howe, 1994). Nevertheless, ministers could no longer control the management of the companies, or influence production/distribution matters.

Following the Conservatives' election victory, the minister then in charge of privatisation, John Moore, added that:

"The long term success of the privatisation programme will stand or fall by the extent to which it maximises competition. If competition cannot be achieved, an historic opportunity will have been lost" (Moore, 1983b: 92).

The simplest way to liberalise statutory monopolies is to remove legal barriers to market entry. The 1982 Oil and Gas (Enterprise) Act and the 1983 Energy Act undertook this for the gas and electricity industries respectively and allowed competing energy suppliers to gain access to the nationalised distribution networks. However, as Veljanovski (1989) points out, and as Friedman (1962) had predicted (see section 2.2), competition failed to materialise because the Acts made no attempt to restrict the nationalised industries from engaging in anti-competitive practices. Both BG and the electricity industry manipulated their accounting procedures to make it economically unattractive for potential new suppliers to enter their markets. In the case of telecommunications, the government commissioned a report (Beesley, 1981) which concluded that BT should be forced to sell spare capacity on its network to potential competitors. However, reactions to this suggestion were mixed. Although generally favoured by users' groups, BT and the trades unions were hostile, with the Post Office Engineering Union noting that Beesley's work "was widely criticised as being rushed, and inadequate in its evidence and conclusions" (quoted in Harrison, 1982: 17). In the event, the 1981 Telecommunications Act maintained BT's call monopoly but introduced some competition into 'fringe' areas of its activities such as equipment supply. A promise was made to review this decision in 1989 (Foster, 1992).

A chance for the government to conduct an early re-evaluation of this policy came with the decision to sell BT. The failure of previous legislation to affect the gas and electricity monopolies led Treasury ministers, in particular Nigel Lawson, to press for a different method of breaking BT's monopoly. One such method would have been to complement the removal of entry barriers with a strengthening of competition law to prevent BT from abusing its position. However, Lawson favoured a more radical alternative - a full-scale reorganisation of the telecommunications industry (Jenkins, 1995). A logical outcome of Lawson's idea would have been to split BT into a number of enterprises. One would have retained control of the network, and thus kept its natural monopoly status, whilst others would have competed amongst each other to provide telecommunications and related

services to the public. Academics such as Kay and Silbertson (1984: 15) sided with Lawson and urged the government to take its commitment to competition seriously. Aside from considerations of liberty, evidence had emerged to suggest that the key to improving industrial performance was not a simple change of ownership, as might have been concluded from the earlier divestitures, but competition. Thus, as Kay and Silbertson (1984: 15) argued, it was imperative to break BT's monopoly because "the benefits of privatisation are likely to be small, or non-existent, in the absence of measures to create a more competitive environment within which the newly-privatised concerns will operate." Although they acknowledged that the government would encounter resistance if it tinkered with the structure of BT, not least from vested interests such as management and the trades unions, Kay and Silbertson suggested that a competitive environment would be easier to create before privatisation than after.

In the event, the government made only minor revisions to the telecommunications policy it had announced in 1981. BT was sold as a "virtual monopoly" guaranteed by statute for at least six years (Moore, 1985a: 94), and only one competitor, Mercury Communications, was allowed to enter the market. Mercury had been licensed to build its own long distance network in 1982, but from 1984 it was allowed access to BT's network in an attempt to generate some realistic competition (Veljanovski, 1989).⁴ However, its disadvantage was huge. Although it was hoped that Mercury would be carrying around five per cent of total telecommunications traffic from the outset, it in fact took until 1991 to reach this figure, and even by 1996 around 10 per cent of residential and business customers were unable to access the Mercury network (Foster, 1992; Conservative Party, 1996).

Why should the Conservatives, driven by a philosophy of "personal freedom, individuality, choice and opportunity" (Conservative Party, 1984: 1), choose to divest one of its largest industrial concerns as a virtual monopoly? Thatcher (1993: 67) suggests that a full-scale reorganisation of BT would have been delayed to an unacceptable degree by obstacles such as the lack of modern accounting and management systems. Thompson (1990) and Marsh (1991) suggest in addition that BT's management did not favour a break up and advised Thatcher that it would not be in the industry's interests. Thus the Conservatives concluded that, although overlooking competition, a monopoly sale was advantageous in that it could be achieved quickly and with relative ease:

⁴ The cost of this access was regulated by the Office of Telecommunications (see below) in order to ensure that BT could not discriminate against Mercury.

“...if it was a choice between having the ideal circumstances for privatisation, which might take years to achieve, and going for a choice within a politically determined timescale, the second was the preferable option” (Thatcher, 1993: 676).

To a certain extent this version of events is plausible. Restructuring BT would, based on subsequent experience, have taken two or three years, and a lack of management co-operation would have created a host of difficulties for ministers during this period, not least in terms of public relations. Given that the privatisation of BT was breaking significant new ground, it might be argued that the government was wise not to create unnecessary obstacles for itself in a prominent policy area.

However, whilst these considerations may have been influential, further evidence suggests that they were not decisive. It can forcefully be argued that the government's primary motivation for selling BT as a monopoly was financial (*The Economist*, 1995b).⁵ During her first term in office Thatcher had learnt that not only could privatisation roll back the frontiers of the state and increase competition, but it could also produce a number of other benefits. Key among these was that its proceeds could be used to reduce the public sector borrowing requirement (PSBR) (Mitchell, 1990). The Conservatives had committed themselves to reducing the PSBR in their 1979 election manifesto as part of a wider neoliberal policy agenda (Conservative Party, 1979) but, partly because of pledges to increase spending on defence and health, and partly because of rising unemployment, the government found itself unable to reduce public expenditure. Indeed, rather than falling, it actually rose from 40.5 per cent of gross domestic product (GDP) in 1978/79 to 43.5 per cent in 1982/83 (Veljanovski, 1987).

Ministers had realised in 1980 that privatisation could be used to restore some order to public finances. Sales proceeds, combined with the transfer of the nationalised industries' investment requirements to the private sector, could offset reductions in public expenditure as a means of cutting public borrowing. As Jenkins (1995) has dryly remarked, selling public assets was politically much easier and more popular than cutting public expenditure. The then Chancellor of the Exchequer, Sir Geoffrey Howe (1994: 254) has admitted that, in the early 1980s, “the sensible disposal of public sector assets had grown in urgency, not least as a short-term way of helping reduce the PSBR.” But whereas the early privatisations had impacted only modestly on public finances (see table 2.1), the potential contribution of

⁵ In fact, Foster (1992) also believes that this was the most important reason why BT was privatised *per se*.

BT was huge - the company was valued at around £5.5 billion. BT's high market value was strongly connected to its significant market dominance, however, and had the Conservatives broken BT into a host of competing parts the sale price would have fallen and its contribution to the PSBR deficit would have been reduced (*The Economist*, 1995b; Veljanovski, 1989).

Brittan (1984: 113) asserts that it is "ludicrous to suppose that major industrial decisions such as whether to denationalise the telephone system" were taken to massage public finances. Nevertheless, there is a strong case to be made for interpreting the monopoly sale of BT as a pragmatic solution to an economic problem. Given the expanding PSBR in 1983/84, and the government's realisation that this could be tackled by privatisation, it seems likely that financial advantage is the most plausible explanation for competition being marginalised in the BT sell-off. It is ironic that the cash surpluses of privatisation - just as those of nationalisation beforehand - had come to make such a major contribution towards fulfilling the government's macroeconomic objectives.

Following the sale of BT, government statements regarding competition in the utilities were contradictory. On the one hand, responding to charges similar to that presented above, ministers re-emphasised the importance of market liberalisation. John Moore noted that:

"[Labour] argue that we are selling off assets because we desperately need the money. Nothing could be further from the truth... [O]pening up nationalised industry to competition is not about balancing the books. It is about choice" (Moore, 1985b: 1).

On the other hand, it was admitted that BT faced practically no competition, and privatising BG and the water industry as monopolies was advocated. Revising earlier claims that the utilities' monopolies were in large part artificial (see section 2.4), Moore (1985a: 95) now suggested they were natural, and argued that it would be "wasteful or impractical to break them up." Subsequent government policy developed adopting this latter view. BG was sold as a statutory monopoly in 1986 and, although some limited competition existed with the electricity industry (Adamson *et al.*, 1991), any threat of competitive entry into the gas market, however unlikely, was removed. The water industry was restructured before privatisation, but little genuine competition resulted because a series of regional monopolies was created.⁶ Arguments advanced by opponents of liberalisation claimed that

⁶ Although technically this provided scope for some direct competition around the 'borders', and some indirect competition by way of 'emulation' (see chapter six), the principal theoretical benefit of this restructuring was that it would ease the regulator's task by providing yardsticks for him to judge

contemporary technology, in both the water and gas industries, was insufficient to allow competing suppliers access to the domestic markets (Foster, 1992), although the validity of such claims is difficult to determine because the government did not extensively investigate the range of options available.⁷

It has already been noted that the simple transfer of a monopoly from the public to the private sector, aside from doing nothing to liberalise the market, necessitates an industry role for government as a regulator to prevent the monopolist from abusing its position. Section 2.2 pointed out that theorists such as Friedman (1962) do not object to governmental regulation of natural monopoly because they recognise that consumer protection measures are necessary where competition is impractical. However, the regulation of artificial monopolies - of which many of BT's activities were examples - exceeds that which is acceptable for most neoliberals because it results in unnecessary state activity. As Littlechild (1983: 7) points out, competition is believed "indisputably [to be] the most effective means - perhaps ultimately the only effective means - of protecting consumers against monopoly power. Regulation is... not a substitute for competition." Nevertheless, in the absence of competition the Conservatives were forced to devise suitable regulation prior to the divestiture of the utilities, and a dedicated regulatory body was assigned to each utility.⁸ The next section reviews the nature and scope of utility regulation and assesses the extent to which this enabled the state to maintain a continuing role in the companies' affairs.

2.5 Regulation, surrogate competition and the continuing role of the state

An all encompassing definition of regulation has eluded politicians and scholars alike, although Hancher and Moran (1989) suggest two uses of the term which predominate over all others. First, regulation *theory* is a political economy approach to the theorisation of capital accumulation, sometimes advanced from a neo-marxist perspective (Aglietta, 1979, Lipietz, 1993; Jessop, 1997). It integrates the patterns of production, consumption and exchange (the regime of accumulation) with the role of political and social relations (the mode of social regulation, or MSR) which serve to secure the integrity and cohesion of the

comparative performance. However, as Foster (1992) argues, comparisons have proved difficult because the greatly varying characteristics of each company have resulted in considerable differences in costs and other measures of efficiency (although see Williams, 1992).

⁷ One respondent, who was directly involved in selling both industries, claimed that competition in the domestic market would have been feasible in both industries.

⁸ BT is regulated by the Office of Telecommunications (Of tel); BG by the Office of Gas Supply (Of gas); the water industry by the Office of Water Services (Of wat); and the electricity suppliers by the Office of Electricity Regulation (Of er).

accumulation process (Tonts and Jones, 1996). Therefore the principal contribution of regulation theory is its conception, based on the integration of political, economic and social relations, of capitalist industrial society being founded on a regulatory system or form of governance which guarantees the reproduction of the regime of accumulation (Michalak, 1994).

Second, and of specific relevance here, *statutory* regulation describes a specific framework of legal and/or administrative rules determining acceptable courses of action to be followed by economic agents (Hancher and Moran, 1989).⁹ Various ways exist of achieving such regulation, from the one extreme of flexibility or procedural formality, to the other of legislation enforceable through the courts (Foster, 1992). Foster (1992) notes that a useful distinction within statutory regulation is that between *economic* regulation, which is primarily concerned with monopoly and competition, and *social* regulation, which revolves around safety and environmental issues, notions of 'fairness' and product quality. Both economic and quality of service regulation were used in combination to provide the utilities with a form of 'surrogate' competition, that is to say the regulation was designed to replicate the effects of actual competition by forcing prices down and efficiency up (*The Economist*, 1995c).

Unlike in the United States, where utilities have been in the private sector for a considerable time, the economic regulation of industry was long-neglected in Britain (the railways were regulated in the late 19th and early 20th centuries - see Parris, 1965 - but, following nationalisation, the practice was largely abandoned). Economic regulation in the US follows the 'rate of return' model, which limits the profits a firm can make to an agreed rate of return on its employed capital. However, various weaknesses were identified with this type of regulation, not least that it often leads to over-capitalisation and regulatory capture (see, for example, Thompson, 1990), and this experience led the British government to seek an alternative. A report, *The regulation of British Telecommunications' profitability* (Littlechild, 1983), was commissioned to address the issue and suggested a novel price-capping mechanism, RPI minus 'x'. This requires regulated firms to restrict their price increases to a fixed level below the rate of inflation for a given number of years. In this way, firms are incentivised to increase efficiency as they are allowed to retain any profits they

⁹ The two interpretations of regulation - theory and statutory - are by no means separate and distinct. As noted by Leyshon (1992: 250), the form of "systematic equilibrium in operation at any one time will influence the drafting and administration of a system of legal rules and guidelines which are used to define

make within their price cap over the specified period. The difference between rate of return regulation, which revolves around profit, and RPI minus 'x', which focuses on price, is fundamental. As Hillman and Braeutigam (1989: 37) point out:

"A shift from profit to price level regulation effects a shift of risks and benefits between the firm and its consumers... [P]rofit level regulation assigns to consumers the risks of cost increases and the benefits of cost reductions, while price level regulation reassigns them both to the firm."

Littlechild suggested that only the monopoly elements of BT's business - for example, local calls, connection charges and rentals - should be subject to RPI minus 'x', and that areas where the potential for competition existed - in particular, long-distance calls - should not. Although the logic of his position might have suggested the need for a range of individual price caps, one for each monopoly service, potential complexities led him to recommend a tariff 'basket', within which BT's monopoly elements should be placed and whose *average* price level must not rise over RPI minus 'x'. The tariff basket approach was adopted by the government. Interestingly, however, perhaps illustrating ministers' apprehension regarding the size of the competitive threat posed by Mercury, long-distance calls were included (Foster, 1992).

RPI minus 'x' was retained as the means of economic regulation for BG and the water industry. However, the formula was modified slightly to account for certain costs which were regarded as being subject to fluctuation beyond management control. These costs - North Sea gas in the case of BG and unpredictable government commitments to, for example, EU anti-pollution directives in the water industry - are passed directly on to consumers. The revised formula for the gas industry was RPI minus 'x' plus 'y' (where 'y' was the cost of North Sea gas), whereas for the water industry it became RPI plus 'k' (where 'k' represented the sum required for new investment 'y' less the efficiency gains 'x') (Helm, 1987; Beesley and Littlechild, 1989). However, such modifications tend to compromise the fundamental difference between rate of return regulation and RPI minus 'x' because they re-assign costs to the consumer. Because BG can pass on the cost of any North Sea gas contract to consumers, it need not concern itself with securing the best price for that gas. Likewise, the water industry is not forced to 'shop around' among suppliers when it undertakes government-required enhancement schemes. Of course, it could be argued that the 'y' and 'k' factors were necessary regulatory characteristics in the gas and

the range of permissible practices open to economic agents." However, it is beyond the scope of the chapter to explore this connection (although see, for example, Leyshon, 1992).

water privatisations in order to introduce a degree of stability into the industries. Equally, however, they can be interpreted as further evidence of the government's desire to maximise sales revenues because the new factors removed considerable financial risks for potential investors.

Social regulation has been imposed upon the utilities both through conditions in their licences and action by their respective regulators. BT, BG and the water industry are all required to satisfy certain safety requirements, in particular regarding the well-being of their workers, and fulfil environmental responsibilities where appropriate. The water industry, for example, is obliged to provide unpolluted water and the Director General of Ofgas is required to promote, as far as possible, the efficient use of energy (Foster, 1992). The utilities' licences also stipulate that a 'fair' level of service should be provided for consumers. Such an obligation is not concerned with notions of social justice in the sense that utility prices should in some way seek to redistribute income (Of tel, 1986; Burns *et al.*, 1995). Instead, because monopolists are in a position to deprive consumers of their only means of obtaining a particular good, the utilities are generally required to provide universal service without discriminating their prices, terms or conditions. Finally, certain customer groups, such as the disabled or poor, have been protected. BT, for example, must provide various services for the blind at no extra cost, and has agreed to provide rebates on line rental for those with low bills.

Explicit provisions to regulate service quality were not included in plans to privatise BT and BG. The government's initial lack of attention in this area is perhaps surprising given that deteriorating service quality is a potential side-effect of the RPI minus 'x' method of economic regulation. As Foster (1992) observes, once an 'x' value has been fixed, a firm must cut costs in order to maintain its profitability, and a simple way to achieve this is by lowering its output standards. Immediately after privatisation, BT stopped publishing performance data it had been required to disseminate as a public corporation, and public sentiment - in the absence of hard data - suggested a decline in service standards. An Of tel investigation confirmed this to be the case, and BT was required to accept some financial liability if it failed to provide certain services to a given standard (Rovizzi and Thompson, 1992). Complaints about BG's service standards also increased following privatisation (Chapman, 1990) and, in the light of this experience, quality of service regulation including a financial liability scheme was formally established prior to the divestiture of the water industry (see table 2.2).

Service	Performance level	Payment if not achieved
Appointments to visit customer	(i) Specify morning or afternoon on relevant day	£10
	(ii) Keep specified appointment	£10
Responding to written account queries	Within 20 working days	£10
Responding to requests to change payment methods or arrangements if it is not possible to meet the request	Within 10 working days	£10
Responding to written complaints:		
(a) No further action necessary	(i) Substantive reply within 10 working days	£10
(b) Further action	(ii) Holding reply within 10 working days, and substantive reply within 20	£10
Warning notices of a planned interruption to water supply	At least 24 hours' notice to be given for interruptions lasting more than 4 hours	£10
Restoring supplies:		
(a) Planned interruptions	By the time specified in a warning notice	£10
(b) Unplanned interruptions (e.g. bursts)	(i) Within 48 hours for strategic main	£10, plus £10 for each additional 24 hours
	(ii) Within 24 hours in all other cases	£10, plus £10 for each additional 24 hours
Installing a meter at customer's request	Within 15 working days of payment	£10
Flooding from sewers	No waste water to enter customer's building	Refund of year's sewage charges (up to a maximum of £1,000)

Table 2.2. Summary of quality of service regulation in the water industry (certain complexities are omitted here for the sake of clarity). Source: Gray and Ramanadham, 1994.

It is not the purpose of this chapter to assess the efficacy of the above regulatory mechanisms and institutions in terms of their consumer protection outcomes (a thorough review can be found in Lowndes, 1997). Rather, emphasis here is placed upon the consequences of such regulation in terms of the state's continuing role in the utilities' affairs. Of course, as discussed in section 2.3, a key objective of privatisation initially identified by the Conservatives was to reduce the powers of the state to control an industry. Senker (1989: 179) has claimed that the utility privatisations represented a "triumph of ideology over economics," implying the above objective was fulfilled, although it is difficult to see how he arrives at this conclusion. As Kay and Thompson (1986: 31) point out:

“Privatisation in the United Kingdom... increasingly [came] to emphasise the virtues of denationalisation over, and even at the expense of, the promotion of competition... The conflict between privatisation and liberalisation... is no longer a conflict but a rout.”

In the absence of meaningful competition, the state could not withdraw in any simple sense from the privatised sectors. The introduction of regulatory mechanisms to act as surrogate competition represented continued statutory involvement in the affairs of the utilities despite a change of ownership. For example, quality of service regulation represented control over the production of goods and services, and universal service obligations amounted to a degree of control over their distribution. Thompson (1990) suggests that privatisation swapped a previously ‘close’ form of intervention - nationalisation - for intervention ‘at a distance’ - regulation. However, Thompson might be understating his case. According to Foster (1992: 124), the system of regulation adopted following privatisation was not at all distant; in fact, it was more systematic and penetrating than that which it superseded. Regulation under nationalisation was “rubbed smooth to achieve consensus, ...reflected mainly administrative and some political considerations, quickly ran into difficulties and ended by pleasing no-one.” Certainly, the constitutional relationship between government and its public corporations was such that effective regulation was difficult to enact. In a speech in 1981, Howe (quoted in Foster, 1992: 114) explained that the government was empowered only to issue instructions of a ‘general character,’ and that:

“... any specific command like ‘make sure the 8.15am from Victoria runs on time’ would be legally unenforceable. The government’s only real weapon is the threat to reduce or cut off external funds. This is far too drastic to be effective. It is like equipping traffic wardens with anti-tank guns but depriving them of the right to leave parking tickets.”

Privatisation gave ministers the opportunity to address this constitutional loophole. The regulatory briefs of Oftel, Ofgas and Ofwat were very much moulded by objectives and guidance issued by central government acting in the light of previous experience (Jenkins, 1995; Thompson, 1990), and regulators were given powers to address specific areas of poor utility performance. As has already been noted, these were used in the cases of BT and BG.

Moreover, despite the technical independence of the regulators, the utilities were not protected from potential and actual governmental interference in their affairs. Because the government retained the right to change the regulators’ briefs through legislation, ministers could overrule, say, an Oftel decision regarding the appropriate value for ‘x’ in the RPI

minus 'x' formula. As Veljanovski (1987) points out, this introduced a degree of uncertainty into the utilities' businesses, and gave the government potential influence over the companies' profitability, share prices, investment plans and so on. Evidence also indicates that government pressure was sometimes used to 'inform' the regulators' day to day decisions. For example, following Ofwat's decision to force a price reduction in the South West, it was Conservative ministers and politicians who claimed credit for having brought this about (Jenkins, 1995). On a separate occasion, Nicholas Ridley (1991: 83), boasted revealingly that "the utilities which we have privatised... are more easily controlled when they are in the private sector."

At stake in the utility privatisations was the *form* of government intervention rather than its existence (Kay and Vickers, 1988; Thompson, 1990). Hancher and Moran (1989: 131) suggest that what began as an intent to withdraw from the intervention arena resulted in "not so much a change in the content of rules, or a departure from regulatory objectives, [but simply] an adjustment to the means of enforcement." Letwin (1988) concurs, noting that the state retained powerful control over the network industries following their divestiture. The privatisation of the utilities throughout the 1980s was as much - if not more - of an exercise in the formulation of regulatory mechanisms and institutions as it was an attempt to promote competition and reduce state control over the utility industries.

2.6 Utility privatisation reviewed - lessons for the 1990s

This chapter has examined the development of utility privatisation policy throughout the 1980s. It began by reviewing the key characteristics of neoliberalism and argued that, despite the tendency in recent literature to downplay the theory's role in privatisation policy development, its influence - at least initially - was considerable. It was suggested that the Conservative Right saw privatisation as a means of enhancing individual liberty, the fundamental concern of neoliberal theory, by: a) promoting competition, rather than monopoly, in an industry's market to allow voluntary exchange between individuals, and b) genuinely reducing the powers of the state to control an industry and the production/distribution of its goods and services. In addition, market liberalisation and state downsizing were expected to result in improved industrial efficiency, innovation and customer care.

However, Gamble (1994) rightly points out that the 1980s did not see the unfolding of a New Right ideological masterplan. Key neoliberal goals were undoubtedly marginalised as

privatisation policy unravelled in practice, and this is evidenced by the privatisation of the network industries as regulated monopolies. When BT, BG and the water industry were divested, the Conservatives failed to meaningfully liberalise their markets and, as a result, were forced to create regulatory mechanisms and institutions to prevent the utilities from abusing their positions. Such regulation, it was contended, resulted in a significant and continuing role for the state in the utilities' affairs despite the transfer of ownership to the private sector. Evidence also showed that the utilities' performance, in the absence of competition, had not matched those of companies such as the NFC which had been sold into an already competitive market place.

It was against this background that ministers considered the privatisation of the electricity industry. The Conservatives' 1987 election manifesto (Conservative Party, 1987) stressed the importance of freedom and individualism, and asserted that these could be achieved by checking state power. With specific reference to forthcoming privatisations, the manifesto noted that:

“Competition forces the economy to respond to the needs of the consumer. It promotes efficiency, holds down costs, drives companies to innovate and ensures that customers get the best value for money” (Conservative Party, 1987: 30).

Although this statement was a move away from John Moore's previous assertion that market liberalisation might not be practical or desirable in the case of the utilities (see section 2.4), previous experience suggested that a shift in policy would not be forthcoming - the rhetoric of competition had not prevented BT, BG and the water industry being sold as regulated monopolies. However, in a notable reorientation of policy, plans were unveiled in 1988 to liberalise the electricity generating industry before divestiture at the turn of the decade (Veljanovski, 1989).

The electricity industry can be divided into three components - generation, transmission (the network element) and supply. Prior to divestiture, the Central Electricity Generating Board (CEGB) controlled generation and transmission, and 12 Area Boards supplied electricity to customers via their own local distribution systems discrete from the transmission network. Industry restructuring did not provide for much immediate competition among the Area Boards, with only the largest customers set to benefit from a choice of supplier, although plans to relax market entry in the future were advanced (see below). The principal achievement of the electricity divestiture was to remove the transmission component from

the CEGB's control (to become the National Grid) and to further split the CEGB into two generating companies (see figure 2.1).¹⁰ Coupled with the removal of entry restrictions, this restructuring created a genuinely competitive generating industry. Because National Grid was separated from the CEGB, the potential for any one generator to deny others access to the network, as had happened following the 1983 Energy Act, was removed. By 1993, 14 licences had been issued to new generators (Littlechild, 1993). As a result, the need for surrogate competition was eliminated and, with the exception of anti-trust measures to prevent discriminatory practice from National Grid, the industry is now free from statutory economic and social regulation. The privatisation of the electricity generators therefore not only achieved a transfer of ownership, but also liberalised the market and reduced the degree of state control over the industry.

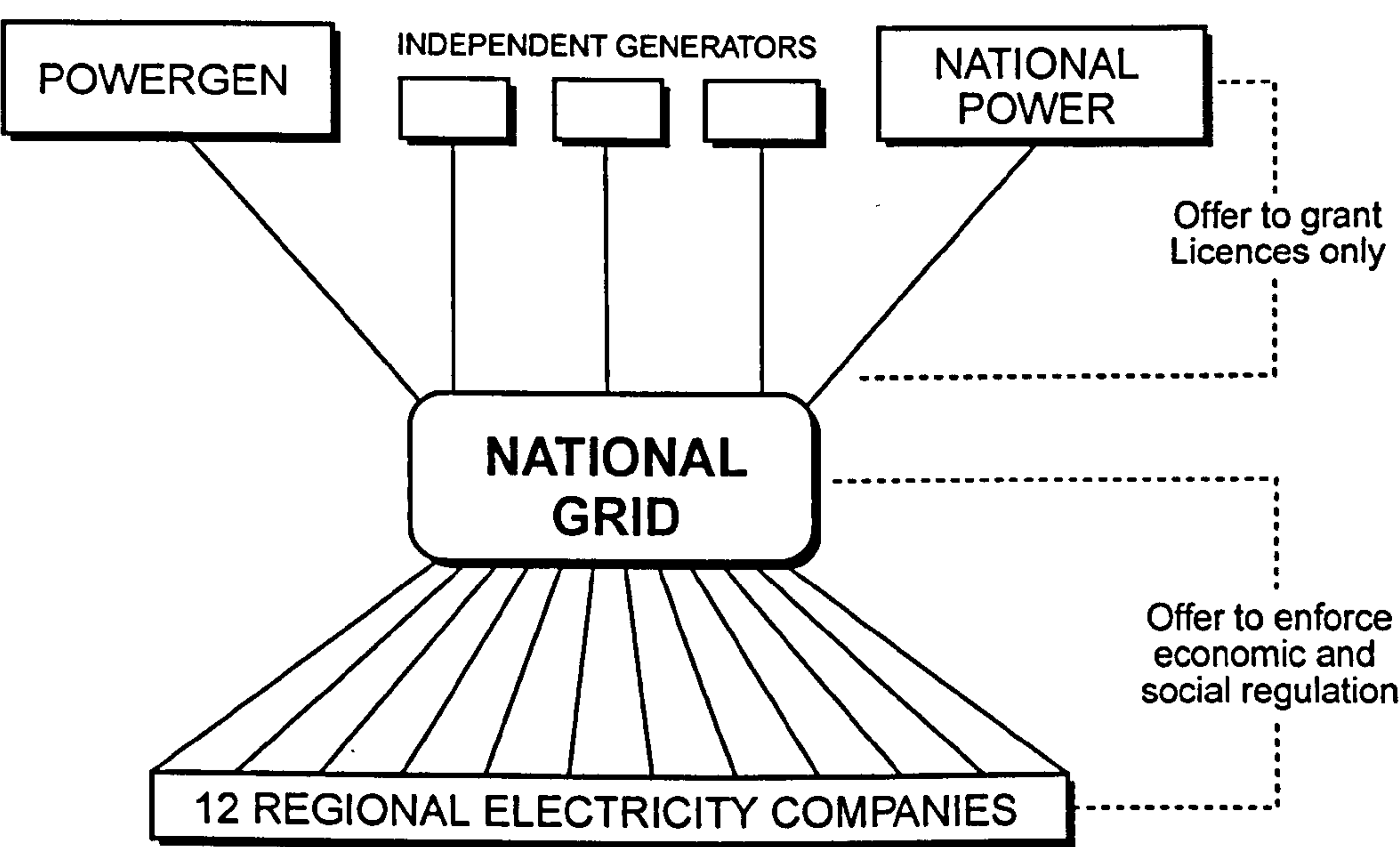


Figure 2.1. The structure of the privatised electricity industry in England and Wales.
Source: Electricity Association, 1998.

The electricity generating industry has not been the only utility market which has seen significant liberalisation in the 1990s. The ‘duopoly policy’ in telecommunications, which had restricted entry beyond BT and Mercury, was ended in 1991. The gas supply market was liberalised in 1996, when a pilot scheme in south west England allowed all business and domestic customers to choose from a range of suppliers - competition has now been extended throughout the country (*The Guardian*, 1997a) - and the electricity supply industry was made fully competitive during 1998 (*The Guardian*, 1997b). Considerable

¹⁰ The two generating companies were later to become three as financial difficulties arose over the nuclear generators (see Bowdery, 1994). It is also important to note that the industry description given here relates

efficiency gains and customer service improvements have resulted in all these industries following the introduction of competition (Lowndes, 1997; Offer, 1999; Ofgas, 1999). The liberalisation of the telecommunications and gas industry did not result from an enforced reorganisation of either BT or BG. Instead, network ownership has remained with the former utility monopolies.¹¹ Following the model employed when Mercury was connected to BT's network in 1984 (see section 2.4), Oftel and Ofgas have been charged with the additional responsibility of ensuring non-discriminatory access for potential competitors. In the electricity industry, the Area Boards (now termed Regional Electricity Companies (RECs)) have retained ownership of their local distribution networks and thus Offer has a similar task. Whilst this extra regulatory activity undoubtedly increased governmental influence over the utility industries, it is in fact consistent with neoliberal ideology because it essentially constitutes a kind of anti-trust law. Over time, and as actual competition increases, the aim is that the regulators can cease many activities *inconsistent* with the free market, in particular those designed to act as surrogate competition (although at the time of writing there is little evidence of this taking place).

It is not clear why the Conservatives chose to re-emphasise the ideological values of competition and freedom when they came to privatise the electricity industry. After all, the reasons cited by Thompson (1990), Marsh (1991) and Thatcher (1993) as to why BT was privatised as a monopoly applied equally to the electricity industry in 1988: 'modern' accounting and management systems did not exist in the sense that they were incapable of underpinning a restructured industry without revision; top-level management argued passionately against a break-up of the CEGB, and the plans ultimately led to the resignation of its chairman, Walter Marshall (Jenkins, 1995); and the sell-off plans were advanced with a similar amount of Parliamentary time remaining before a general election was required. Nevertheless, as Thatcher (1993: 684) recalls, she "again and again insisted that whatever structure [was created had to] provide genuine competition."

One possible explanation is backbench pressure. Some MPs who were initially sceptical of the privatisation programme had, over time, come to embrace it with a degree of ideological fervour seemingly absent from government circles. One backbencher noted that it was unacceptable to transfer a public monopoly from public into private hands, and that "what

to England and Wales only. Scotland and Northern Ireland have their own, slightly different, industry organisation (see Electricity Association, 1998).

¹¹ BG has split into BGplc (network) and Centrica (supply), although they are still owned by the same holding company.

Conservative members want is competition” (*Hansard*, 1986a: Col. 6). A former Secretary of State interviewed during the course of this thesis did note that ministers were aware of such sentiment among the rank-and-file Parliamentary Party. A second possibility is the influence of Cecil Parkinson as Secretary of State for Energy. Parkinson’s predecessor, Peter Walker, had presided over the BG sell-off and was known to favour another monopoly sale (Jenkins, 1995). However Parkinson, according to a respondent, had “very strong views” that the government should “never again ‘do a BT,’” and was convinced that the lack of competition and continuing government involvement in the telecommunications and gas markets was responsible for BT and BG’s limited efficiency gains and poor customer service. Parkinson’s appointment enhanced the credibility of Lawson’s original case for competition (see section 2.4) and resulted in a forceful argument for market liberalisation being presented to the Cabinet. (Moreover, as will be further evidenced in chapter four, Parkinson seemed to enjoy considerable influence over Thatcher regarding privatisation policy.)

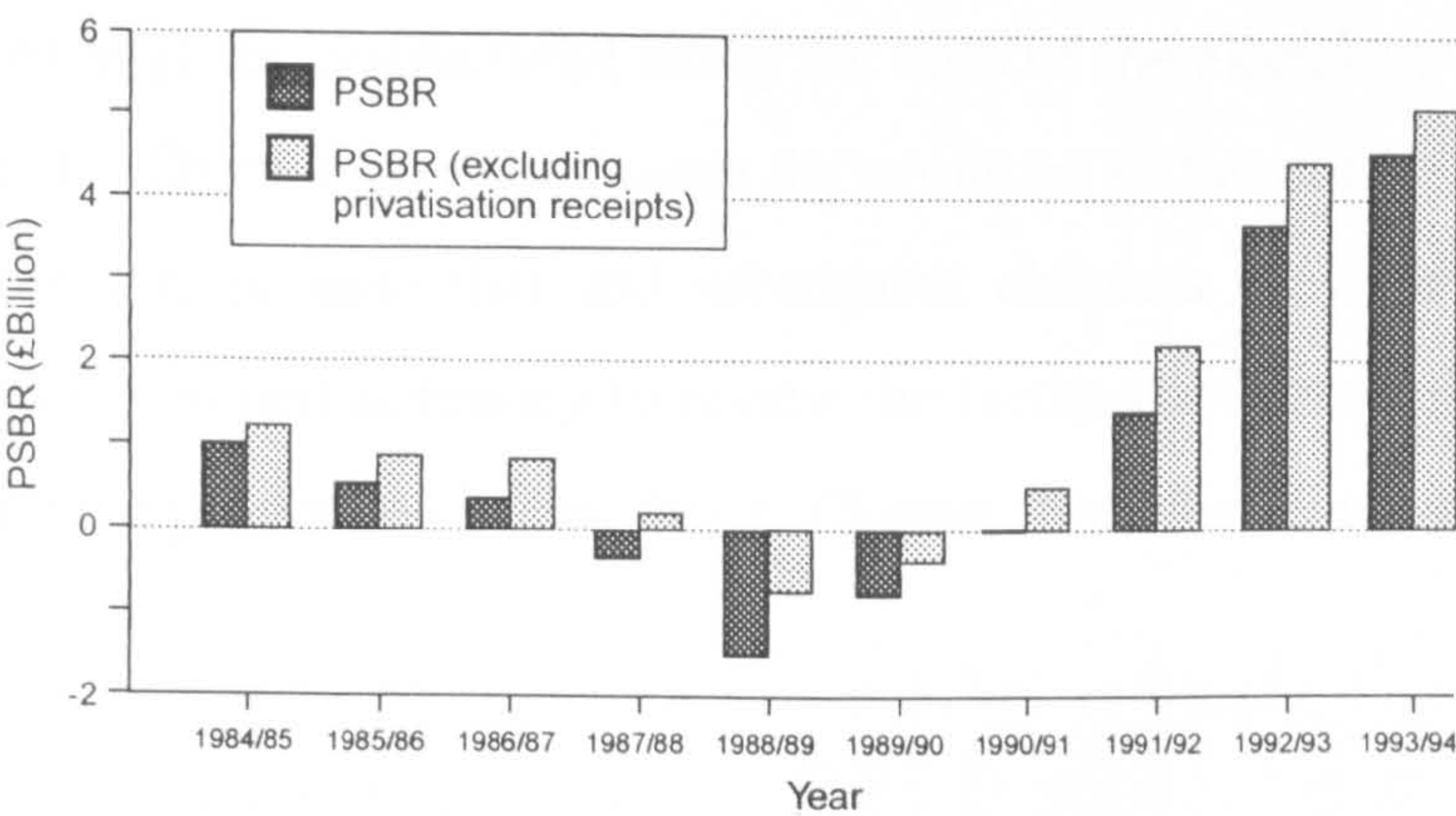


Figure 2.2. PSBR 1984/85 - 1993/94, showing the effect of privatisation revenue. Source: CSO Financial Statistics, 1992, 1995.

A third explanation relates to finance. Section 2.4 argued that the need to address a burgeoning PSBR resulted in BT being privatised as a monopoly in order to maximise sales proceeds. However by 1988, following several years of strong economic growth, the PSBR as a percentage of GDP had fallen considerably and the importance of privatisation revenue as a means of ‘balancing the books’ had subsided (see figure 2.2). As Pliatzky (quoted in Mitchell, 1990: 24) observes, it was increasingly felt in the Treasury that “the objective of reducing public expenditure... [could] be achieved without bringing privatisation receipts into the reckoning.” Thus the Conservatives were accorded an opportunity to experiment with restructuring the CEGB notwithstanding the lower income the Treasury would receive

from the sale of a liberalised industry. There is a strong possibility that the financial climate, just as it did in previous utility divestitures, proved decisive in determining the method used to privatise the CEGB. In the light of previous experience, it seems unlikely that backbench pressure or the appointment of Cecil Parkinson would have resulted in a genuine move towards market liberalisation had the government still needed to maximise its revenue from the sale.

Whatever the cause, this renewed commitment to neoliberal values continued in earnest throughout the mid 1990s. After the liberalisation of the telecommunications, gas and electricity supply industries, the next large network industry privatisation was that of British Rail. This was announced in 1992, at a time when the economy had relapsed into recession and the state of government finances had worsened considerably (see figure 2.2). Nevertheless, ministers announced their determination that BR should not be privatised as a monopoly like BT, BG and the water industry had been. Instead, they insisted that competition should be introduced into almost every aspect of railway operation, and that BR should accordingly be restructured along the lines of the electricity generating industry (Gibb *et al.*, 1998). Chapter four documents the evolution of the policy which was designed to do this. However, because that and subsequent chapters draw heavily upon original empirical research, it is first necessary to review the methods of data collection and analysis employed during the production of this thesis. Chapter three therefore undertakes this task.

Chapter Three

Researching rail privatisation

3.1 Introduction

As a preliminary to the empirical dimension of the study, this chapter reviews the methods employed to collect data in the 'field'. It provides an account of how the programme of research presented in this thesis was designed, implemented and interpreted. Although it is usual, and largely unavoidable, to report on study designs retrospectively, such a practice is not without its problems and can be misleading if due care is not exercised by the researcher. As Cloke *et al.* (1995: 356) contend, retrospective accounts can:

“...both result in a *post hoc* legitimization of the particular ensemble of concepts and practices which pertain at the time of writing, and present a view of the research process which suggests a logical, rational and well-ordered progression from original ideas to final 'results'. In our experience, such descriptions are inaccurate and can be dishonest.”

Partly in response to Cloke *et al.*'s concerns, and partly to assist in the general development of the research process, it was decided to keep a series of research notes throughout the course of the thesis to record comments and observations regarding methods used. In terms of this chapter, these notes proved extremely beneficial for recording the structure and detail of the research because they gave contemporaneous - as opposed to retrospective - accounts justifying decisions to pursue or abandon various initiatives. In a sense, therefore, this chapter represents a formally structured overview of the research notes. It attempts to present an honest and accurate account of the research process, highlighting where relevant the inevitability of flexibility and reflexivity (see May, 1997) within an overall framework designed to maintain logic, rationale and order. The chapter begins by identifying and justifying the principal methods chosen to collect the data, before reviewing issues arising in the preparation and execution of data collection, and describing the analysis process.

3.2 Research aims and interviews

As outlined in chapter one, the central aim of the study is to evaluate the extent to which the promotion of competition was an appropriate policy goal in the privatisation of British Rail. It was noted that, in pursuit of this aim, the study draws heavily on interviews with key personnel involved in framing, executing and operating within the new railway policy. It was immediately recognised that undertaking research of this kind could give rise to methodological difficulties. Most obviously, the study would involve conducting interviews

with 'elites'. Elites are regarded as the influential, the prominent and the well-informed people within organisations selected for interview because their expertise is relevant to the aims of the research (Marshall and Rossman, 1995). However, using elites as respondents can be problematic because they are usually busy people operating under considerable time constraints; they might have suspicions about the relevance of academic work; and they can be hard to reach - often researchers have to rely on sponsorship, recommendations and introductions to secure an interview appointment (Bird *et al.*, 1983; Marshall and Rossman, 1995; Shaw and Matthews, 1998). Despite such potential difficulties, it was felt that every effort should be made to pursue the study because, if successful, it would obtain high-quality data capable of making a valuable contribution to the understanding of a hitherto under-researched aspect of rail privatisation policy. In the event of insurmountable problems arising, the potential for a related study examining customers', rather than elites', perceptions of competition in the passenger rail industry was identified (see Bradshaw, 1997a). Fortunately, however, progress with the intended research was sufficient to ensure that this 'fall-back' option was not required.

An early task in the research design process was to decide which of the principal interview strategies should be employed to obtain the required information. The most common is the questionnaire interview (Hughes, 1990). Questionnaire interviews, or surveys, have their origins in the epistemic assumptions of positivism (see Williams and May, 1996) and employ a methodology logically similar to that used by physical scientists to uncover social 'truths' (May, 1997). Surveys are usually designed to test deductively the generalisability of hypotheses advanced by the researcher.¹ They do this by asking a pre-determined set of questions to a representative sample of a given population. The researcher's social theory is then 'proved' or 'disproved' following a statistical analysis of results.

Sarantakos (1993) identifies a number of advantages with surveys: they are cheap to administer (as Selltiz, quoted in Sarantakos (1993: 159), has pointed out, "questionnaires can be sent through the mail, interviewers cannot"); they provide quick results as many can be done at once; they are convenient for respondents to fill out at their leisure; they avoid the potential for bias caused by the presence/attitudes of the interviewer; and they provide for straightforward, quantitative, analysis by using closed-ended questions and answer categories. However, despite the many advantages of the survey technique, it was decided that questionnaires would not be a suitable research tool for this investigation. Because

surveys use closed-ended questions and answer categories, they are best suited to gathering 'broad' information from a large number of respondents, perhaps several thousand (Lowndes, 1997; Mostyn, 1985). But this study needed precisely the opposite. It required 'deep' information, comprising rich insights into the opinions and perceptions of respondents, and previous studies of this kind have suggested that a total of between 15-100 interviewees is appropriate to investigate relevant issues thoroughly (Bartram and Shobbrook, 1998; Bird, 1982, 1988; Grantham, 1998; Hoyle, 1993; Mostyn, 1985; Sidaway, 1997).

Schoenberger (1991) convincingly argues that an effective tool for obtaining 'deep' information from elite respondents is the semi-structured interview. Described by Kahn and Connell (1957: 149) as "a conversation with a purpose," a semi-structured interview allows the researcher to probe the respondents' opinions with open-ended questions. Such interviews are time consuming and can be difficult to analyse because they produce qualitative, rather than quantitative, data (Cook and Crang, 1995). Nevertheless, if executed competently in the correct research context, semi-structured interviews can produce valuable and revealing information. The use of semi-structured interviews allows the respondent's expertise to assert itself and, as a result, data regarding a particular phenomenon can unfold precisely as the respondent, and not the researcher, sees them (May, 1997). Moreover, it is possible to incorporate emerging issues into the study design as data collection progresses. Points raised by one respondent can be woven into subsequent interviews as additional questions to provide a potentially rich source of data which might have been overlooked in the original interview schedule. In contrast, the use of closed-ended questions and response categories in survey methods can wrongly presume that the researcher is able to anticipate all the possible answers before the research has been conducted. Data not falling into premeditated categories are therefore lost as provisions for their incorporation in the study cannot easily be made once the questionnaires have been despatched.²

The approach adopted by semi-structured interviews is inductive by nature and cannot, unlike the survey method, lend itself to formal hypothesis testing. As Strauss and Corbin (1990: 23) point out, "one does not begin with a theory, then prove it. Rather, one begins

¹ See Harvey (1969) or Haines-Young and Petch (1986) for discussions of inductive and deductive methods.

² Even though 'any other information' sections are often included in questionnaires, respondents use them infrequently and, where opinions are expressed, they can be difficult to interpret. Moreover, the low

with an area of study and what is relevant to that area is allowed to emerge.” Schoenberger (1991: 181) concurs, noting that the use of semi-structured interviews provides fertile ground for the *generation* of hypotheses about respondents’ behaviour. Although semi-structured interviews are widely accepted as a research tool in many areas of human geography (particularly those associated with ‘critical’ methodologies - see, for example, Bartram and Shobbrook, 1998; Herod, 1993; McDowell, 1992; Sidaway, 1997), they have, with a few notable exceptions (in particular Bird, 1982, 1988; Hoyle, 1993, 1995), been largely overlooked in transport-related aspects of the discipline. In part, this may be due to the fact that such techniques can still arouse suspicion in the minds of some social scientists, particularly those whose research is influenced by positivist assumptions. The inductive nature of semi-structured interviews, combined with the fact that they produce qualitative data, has led to charges that the method is in some way unscientific, and frequently questioned is the *objectivity* of qualitative techniques (Marshall and Rossman, 1995).

Objectivity as a concept in scientific research can be divided into two components, reliability and validity (Kirk and Miller, 1986).³ Reliability is the extent to which repetition of the same research procedures will yield the same results, whereas validity is the accuracy of that procedure - how closely the results conform to the ‘true’ reality.⁴ This distinction is clarified with a simple analogy: a thermometer which reads 82 degrees each time it is plunged into water boiling at sea-level gives a reliable, yet invalid, measurement. Crudely speaking, the more reliable and valid a piece of research, the greater its objectivity. However, as Kirk and Miller (1986) point out, the concept of validity is difficult to confirm. Even in the natural sciences, no experiment can be perfectly controlled and no measuring instrument can be perfectly calibrated. This “problem of validity” (Kirk and Miller, 1986: 21) is exacerbated in the social sciences because researchers are forced to contend with the vagaries of human nature. Schoenberger (1991) partially addresses the problem of validity by suggesting that semi-structured interviews are automatically valid by virtue of the fact that they allow a

response rates render most findings statistically insignificant, a major shortcoming in terms of a quantitative-based research technique (see, for example, Bailey, 1997).

³ Some qualitative researchers now argue that reliability and validity are not appropriate concepts by which to measure the objectivity of qualitative research because they are too moulded in the quantitative tradition (see, for example, Lincoln and Guba, 1985; Baxter and Eyles, 1997). Such developments serve to assert the value of semi-structured interviews as a technique in their own right rather than as an adjunct to more traditionally accepted quantitative methods.

⁴ The definition of reality will depend upon the epistemological convictions of the researcher. For example, the positivist ‘the truth is out there’ view is absolutely at variance with the relativist approaches advanced by postmodernists. A full discussion of these issues is not the purpose of this chapter, but see May, 1997; McDowell, 1992; Schoenberger 1991, 1992; Williams and May, 1996.

detailed exploration of respondents' circumstances.⁵ Nevertheless, standard practice in social research has been to rely almost entirely upon techniques for assuring reliability as a means to the 'truth'. Survey methods are ideal for ensuring consistent reliability because they completely standardise the design, administration and analysis of a study (McMiller and Wilson, 1984). Thus, as May (1997) points out, if all respondents are asked the same questions in the same manner, opinions expressed are believed to be 'true' rather than a result of subjective factors such as how the questions were asked. Provided the wider circumstances under which the initial survey was carried out do not change, the results of a survey can in theory be replicated by repeating the questionnaire with a different representative sample of the same population.

Demonstrating reliability in qualitative studies can be problematic. Although it is not an undisciplined technique, a semi-structured interview will not necessarily develop in the same way every time it is administered. To illustrate, questions may be asked in a different order according to the course of the conversation, the researcher will inevitably be involved in the dialogue, and the content of the interview could change in the light of data which have emerged from earlier discussions. As such, even if wider circumstances were to remain static, it may not be possible to replicate results if the interviews were carried out again. In response to such problems, some qualitative researchers have suggested a number of steps which those working within the tradition should take in order to assure others of the reliability of their techniques. Of these, the most notable is that the method employed must be explained in detail to allow the reader to judge whether it was adequate and appropriate (Marshall, 1990; Baxter and Eyles, 1997).⁶ Marshall and Rossman (1995) additionally suggest that collected data must be kept in an organised and retrievable form so that they can be made available if the research findings are challenged. Interview data collected during the course of this thesis have been retained in both tape and transcript formats, and the remaining sections of this chapter detail the research methods employed for the study.

3.3 Preparing interview schedules and identifying potential respondents

Schoenberger (1991) makes the obvious, yet important, point that it is essential to be well prepared before fieldwork can commence. Diligent preparation serves to maximise the effectiveness of the fieldwork programme: interview questions are more likely to be relevant

⁵ Indeed, Plummer (1983: 102) suggests that, as a matter of course, "validity should come before reliability... There is no point in being precise about nothing."

⁶ Marshall (1990) in fact provides a full checklist of 20 points for qualitative researchers to consider when explicating their methods.

to the aims of the study; respondents are usually more forthcoming when the investigator understands the issues - and the specialist language peculiar to their industry - under discussion; and well-informed investigators are likely to make a better assessment of the data they collect. Preparations for the construction of interview schedules therefore began with a thorough review of industry-related data sources. Material was obtained from: academic journals; the Conservative Archive at the Bodleian Library, Oxford; *Hansard* debates, questions and answers; *House of Commons Papers*; publications from the Department of Transport, the Office of Passenger Rail Franchising (OPRAF), the Office of the Rail Regulator (ORR), the Stationery Office (formerly HMSO), the National Audit Office (NAO) and the various rail companies; broadsheet newspapers and dedicated trade journals such as *Rail Privatisation News*, *Modern Railways*, *Rail* and *The Railway Magazine*. A formal content analysis (see, for example, Bird *et al.*, 1983) of these sources was unnecessary, although summaries were made of each document to be categorised for future reference. Specific works are cited throughout the text as and when they are referred to.

Themes relevant to the aim and objectives of the research were identified from the industry-related literature (see appendices one and two), and it then became necessary to construct draft interview schedules capable of obtaining relevant information. From various studies employing semi-structured interviews to question elites (see, for example, Bird, 1982, 1988; Hoyle, 1993, 1994a, 1994b, 1995; Schoenberger, 1989; Sidaway, 1997), two contrasting approaches to schedule construction are evident. The first of these, advocated by Bird and Hoyle, is based upon proposition sets. This approach invites interviewees to respond to a pre-determined number of sets, each containing a general introductory statement, a proposition and supplementary questions (see table 3.1). The sets are shown to respondents in a given order, and the researcher remains passive throughout the interview, speaking only to introduce each new set. Hoyle (1993) reports great success with this method, noting that although respondents were encouraged to be brief, extended, yet coherent, answers were frequently given.

In contrast, Schoenberger and Sidaway adopt a far less structured approach. Both authors prefer to base their interviews around a loose set of pre-determined questions. Unlike proposition sets, the questions are designed to facilitate as 'normal' a conversation as possible, and actively encourage the interviewer to engage in proceedings. In this way, the potential exists for investigating emerging issues and for exploring particular themes in

detail according to the direction of the interview (Sidaway, 1997). Schoenberger (1991) in particular comments on the success of this method, noting that it is especially helpful in allowing the interviewer to address ambiguities or inconsistencies which may arise in respondents' accounts.

Proposition set one
<i>Introductory statement</i>
The public and private sectors involved in waterfront redevelopment engage in competition, conflict and co-operation.
<i>Proposition</i>
The essential <i>broad</i> problem of waterfront redevelopment is how to link private sector dynamism with public sector non-monetary objectives.
<i>Supplementary questions</i>
Do you agree with this proposition, or do you see the essential problem in some other dimension? Please give your reasons.

Table 3.1. An example of a proposition set addressing approaches to waterfront redevelopment in Canada. Source: Hoyle, 1995.

Although both approaches seem successful in terms of engaging respondents, it was decided to reject proposition sets, principally because of their apparently inflexible nature. Not only does the proposition set approach preclude the possibility of a 'normal' conversation, but it also cannot be adapted to include emerging information or address inconsistencies. In this sense, proposition sets have much in common with the standardised survey format, and the association is by no means coincidental. Writing at a time when qualitative methods were unfashionable in human geography, Bird *et al.* (1983) seemed concerned to alert readers as to the deductive properties of their method. They argued that the passive interviewing style, reliant upon pre-determined questions in a given order, was a means of ensuring reliability and permitted the testing of pre-formulated hypotheses. Indeed, Hoyle (1993) acknowledges that his proposition sets were designed with anticipated answers in mind. Although proposition sets were an undoubted methodological innovation, it was felt that their inflexibility could have detrimentally affected the quality of data obtained in this study. Thus the approach used by Schoenberger (1991) and Sidaway (1997) was adopted, and it was noted that care would be needed when explaining the methods used in order to assure the reader of the study's reliability.

It was decided that there would be three sections to the study. The first would focus on the evolution of rail privatisation policy, to establish how and why the promotion of competition became an important policy goal, whereas the second and third sections would focus on the outcomes of the policy in terms of competition for the market and competition in the market respectively. Separate interview schedules were constructed for each of the three sections. It was recognised that there would be some overlap in the information obtained by each interview schedule - for example, the existence or otherwise of on-rail competition would affect not only TOCs, but also franchise bidders because of the potential for market liberalisation to impact upon their revenue streams - but sufficient differences existed between each section of the study to warrant separate schedules.

The schedules used for investigating competition for and in the market were each divided into four sections (see appendices one and two). The first section of each began with a statement outlining the aims and objectives of the research, to be read by the interviewer. The remaining sections of the schedule investigating competition for the market sought detailed responses regarding the preparation of franchise bids, the awarding of franchises and respondents' overall perceptions of the franchising process. The schedule relating to competition in the market asked for general opinions about on-rail competition, before turning to TOC-specific competition issues and potential future scenarios.

The schedules used to investigate the evolution of rail privatisation policy were constructed slightly differently. Whereas the above schedules were designed to collect data relating to shared experiences – all franchise bidders were asked about competition for the market and all TOCs about competition within it - the aim here was to assemble a chronology of 'facts' regarding events stretching over at least 18 years. Because of the protracted nature of rail privatisation policy evolution (see chapter four), it was felt unlikely that a sufficient number of key actors would have 'shared' the entire policy evolution process (although two who did were located), and so the construction of one universal schedule was deemed unsuitable.⁷ Thus, the approach ultimately adopted was to assemble a large 'pool' of questions based upon relevant themes identified from the earlier literature searches, and then to select a different combination for each interview as appropriate (see appendix three).

⁷ To illustrate, there would have been limited value in questioning a civil servant who worked at the Treasury from 1980 to 1985 about the internal workings of that Department in 1992.

Before finalising and piloting the interview schedules, potential respondents were selected and contacted. It seemed appropriate that the managing director/chief executive (MD/CE), or the member of senior management responsible for competition matters, of each of the 25 Train Operating Companies (TOCs) would be needed to answer questions regarding on-rail competition. A similar executive, but with experience in the franchising process, would be needed from each of the franchise bidders. The studies cited involving elites do not indicate an ideal proportion of the study population which should be interviewed in order to ensure the representativeness of a qualitative data set. However, because the populations of both TOCs and franchise bidders were relatively small, it was felt that a near-census would probably be attainable.

The names and addresses of each of the 25 TOC MD/CEs were obtained from the winter 1996/97 edition of the *Great Britain Passenger Railway Timetable* (Railtrack, 1997). Letters were sent to the MDs explaining the nature, aims and objectives of the research project, and their co-operation (in the form of granting an interview with the most appropriate manager) was requested. Based upon experience of previous semi-structured interview work (Hoyle, 1995; Sidaway, 1997), it was suggested that the interviews would last between 30 minutes and one hour (most actually lasted around 45-50 minutes). The letters also stressed that any information obtained from the interview would remain strictly confidential. Initial response rates were disappointing (only 12 responded) but follow-up letters were sent after three weeks and, where no responses had been obtained after six weeks, telephone calls were made to enquire as to whether the letters had been received. Ultimately a highly satisfactory 23 TOCs agreed to participate, and meetings were arranged at the respondents' places of work. Seven of the 23 interviews with TOCs were with MDs, and the remainder were with commercial/business directors or corporate affairs managers.

Although potential interviewees from TOCs were easy to identify, the same was not the case for those from franchise bidders because their identities had been declared commercially confidential by OPRAF. However, a list of 29 companies who were 'shortlisted' in the franchising process was located (Cormack and Pigott, 1997).⁸ The list was comprised of both management-employee buy-out (MEBO) and corporate bids. MEBO teams were contacted via the relevant TOCs (in some cases the contact person was the

⁸ The franchise bidding process consisted of numerous stages (see chapter five). OPRAF first invited potential bidders to pre-qualify. If successful, they would receive an Invitation to Tender (ITT) which entitled them to bid for the right to run the franchise under offer. Shortlisting occurred after bids had

same as it had been for the interviews dealing with competition in the market and, where this was the case, a request for two interviews was included in one letter), whilst the addresses for other bidders were obtained from various sources. 15 shortlisted bidders ultimately participated in the study, four being MEBOs and 11 corporate.⁹

The proportion of shortlisted franchise bidders taking part in the study is clearly not as high as that noted above for the TOCs. Predominantly this was due to a relatively high number of refusals from potential respondents, although researcher error was also a factor; where questions regarding competition both in and for the market were being answered by the same individual(s), an overrun in the first part of the interview twice restricted the length of the second. As a result, few meaningful data were obtained regarding the bidding process on these occasions, but this error was corrected in subsequent interviews (see also section 3.4). As already noted, the works cited above are silent regarding what proportion of a population should be interviewed in order to guarantee the representativeness of a qualitative data set, and some consideration had to be given to whether or not the amount of participants in this section of the study was sufficient. The issue was difficult to resolve. Because the purpose of semi-structured interviews is to generate, rather than test, hypotheses, the 'correct' amount to be undertaken cannot be determined by a straightforward mechanism like sampling theory. On the one hand, Bird *et al.* (1983: 145) judiciously observe that "the limitation of refusals is essential when the population in question is not large and where there may be no opportunity for substitutes." On the other hand, they point out that, if refusals do occur, it is important they do not remove all potential respondents of any given type from the investigation. For example, if all MEBOs had refused to co-operate in this study, an obvious gap would have been left in a study purporting to examine the franchising process from the perspective of all bidders. Ultimately it was decided to pursue the research because all types of shortlisted bidder - MEBOs and corporate bidders of varying sizes - were represented evenly and in sufficient numbers to generate a wide range of views regarding the issues under investigation. It is recognised, however, that many of the points raised in chapter five could to some extent have been explored more comprehensively had more franchise bidders, particularly MEBOs, participated in the study.

been received; those excluded from the shortlist could take no further part in that particular franchise bid, whereas those included entered further negotiations with OPRAF before a franchise award was made.

⁹ In two cases, respondents were able to answer on behalf of both their current employer and a Mebo in which they had previously been involved.

Problems were also encountered during attempts to identify and contact companies whose bids had failed to reach any of the shortlists. After various unsuccessful enquiries, it was decided to omit these companies from the study altogether. In essence, this was because it was realised that including non-shortlisted bidders in the study would probably effect only a minimal improvement in data quality. Many of the companies successful in being shortlisted for some bids had not progressed beyond the ITT stage with others, and thus the study was already canvassing views of some companies who failed to make the shortlists. Nevertheless, it is important to note that the study cannot claim to represent the views of those bidders who failed to make any of the shortlists during the franchising process.

Potential policy maker interviewees were initially identified as the public sector 'equivalents' to corporate MD/CEs - the Secretaries of State for Transport - over the period during which the Conservatives had been in power. These were identified in various editions of *Whittaker's Almanac*. Former ministers who were still alive were contacted either via the Houses of Parliament if they had remained in public service, or via Conservative Central Office if they had not. Six of these 11 potential respondents agreed to interviews, along with one former Minister of State for Public Transport who played a particularly crucial role in the development and implementation of rail privatisation policy.

It was quickly decided that interviewing only politicians would not produce sufficient information for three reasons. First, data would not be forthcoming for periods when the Secretaries of State who declined to be interviewed were in office. Second, it was suspected (and later confirmed by respondents during interviews) that the Secretaries and Ministers of State would have only been involved in decisions at the very highest level, and would thus have been unaware of much of the detail involved in the policy making process. Third, the data produced could have been somewhat biased as, based upon their interview tactics on television, it was felt that the politicians might engage in *post hoc* rationalisation in order to reflect favourably upon their achievements in office. Because the aim of the exercise was to establish a 'factual' chronology of rail privatisation policy development, it was important to ensure that, as far as possible, the data obtained were valid and not fabrications to suit respondents' own purposes. As such, it was decided to interview others who had been involved in rail privatisation policy formulation in different capacities to seek corroborative data. These fell into two categories, civil servants and individuals who were consulted by, or acted as advisors to, the government (the British Railways Board was included in this category).

Seven senior and mid-level civil servants from the Department of Transport were identified as potential respondents from the *Civil Service Yearbook* because of their particular involvement with rail privatisation policy development over a number of years. Permission to conduct the interviews was sought from the Department's Permanent Secretary, but the response obtained was rather negative. The Permanent Secretary noted that the policy of the Department under the new Labour administration was to press ahead with new policies rather than to revisit old ones, and that he therefore "did not see the scope" for interviews with the amount of individuals identified. An interview with only one civil servant was officially sanctioned by the Department of Transport. Although this respondent provided much valuable information, it was still felt that more corroborative data from civil servants were needed.

At this point an ethical dilemma arose. How could further information be obtained from civil servants without undermining the view of the Permanent Secretary of the Department of Transport? This problem was partially resolved by the fact that some key officials responsible for formulating rail privatisation policy, albeit not always those originally identified from the *Civil Service Yearbook*, had left the Department of Transport and could be approached for interview. Moreover, it transpired that others had been involved exclusively with other Departments, particularly the Treasury. A total of nine new respondents was identified using a 'snowballing' technique (May, 1997) which involved asking existing interviewees to name the pivotal figures with whom they dealt as policy was developed. All of these individuals were approached independently after obtaining their addresses from various sources, and seven agreed to be interviewed.

Finally, four government advisors and consultants, identified both through industry-related literature and the above 'snowballing' exercise, were interviewed. Despite the small number of respondents in this category, the information they provided was invaluable because two of them had been involved in the rail privatisation process as policy developed throughout the 1980s and early 1990s and were able to provide corroborative 'overviews' of developments during this time. It is recognised that the potential population for this category of respondent - indeed for most categories in the policy evolution section - was significantly larger than the 27 individuals actually approached, and it is accepted that a greater level of detail might have been obtained if more interviews were conducted. Nevertheless, the amount of interviews undertaken was probably sufficient for two reasons.

First, there were practical considerations to take into account. The total number of interviews, and the analysis associated with them, had already begun to exceed a realistic workload for a doctoral researcher constrained by limited financial and manpower resources. Second, and more importantly, the aims of this section of the study required only an investigation into how the decision to privatise BR in a vertically integrated manner came about. It was necessary to be selective when identifying potential respondents, and to concentrate on those involved in framing policy rather than those engaged in a less senior capacity. The amount of respondents interviewed was enough to ensure corroboration of each issue identified.

3.4 Pilots and interviews

Before formal data collection could commence, it was necessary to finalise and pilot the interview schedules, and this process consisted of three stages. First, a self-critique was undertaken. This involved thoroughly reviewing the interview schedules from ‘fresh’ - i.e. after a vacation - in an effort to locate mistakes in the initial drafts. As Sarantakos (1993) points out, undertaking a self-critique can be important to test questions for, among other things, relevance, clarity and simplicity before any external scrutiny is sought. This exercise was extremely valuable for two reasons. First, it allowed the interview schedules to be brought up to date in the light of recent developments. To illustrate, Wales and West Passenger Trains’ application to introduce through trains from Penzance to Manchester would rival Virgin’s existing service between the origin/destination pair. For this reason the proposed service had industry-wide ramifications because it was widely viewed as the “first test of competition on [the] railways” (Batchelor, 1997: 10). A question soliciting views on this issue was framed and inserted into the TOCs’ interview schedule accordingly. Second, several omissions were noted. Two of these were potentially serious: it was realised that although questions were framed to establish *whether* phenomena took place, there were few prompts asking *why*; and a question relating to the impact of on-rail competition was not included in the schedule for franchise bidders (see section 3.3).

Second, a formal exercise of external scrutiny was undertaken. Academic colleagues within the University were approached for practical advice regarding interviewing techniques, and suggestions made complemented those already absorbed from the literature (see section 3.3). In addition two transport professionals, both experienced in railway matters, were invited to critically review the interview schedules. The purpose of this was to establish the clarity and relevance of the questions from an industry point of view. Did the questions

make sense to those working within and around the railway industry? Moreover, given the potential sensitivity of the questions, how likely was it that they would even be answered by respondents? The reviewers suggested that the questions were sufficiently well framed to be understood by respondents, although both advised that franchise bidders and train operators would be unlikely to discuss openly their competitive strategies (such information is often viewed as commercially sensitive) unless they were absolutely assured of confidentiality. The interview schedules were amended to include an unambiguous confidentiality guarantee before the questions began (see also below).

The final piloting stage was problematic owing to the small populations to be interviewed. Piloting in the sense of pre-testing - that is, trialling the interview schedules on a sample of respondents before the bulk of data collection took place - was not possible because it would have significantly reduced the amount of data obtainable during the fieldwork exercise. As such, it was decided that a system of 'continuous' piloting should be adopted. This involved critically reflecting upon each interview conducted in order to identify, and therefore eliminate as far as possible, technical flaws as the fieldwork progressed. Cook and Crang (1995) suggest that early forays into the field are never as productive as later ones because interviewing technique improves with experience, and this research was no exception. It has already been noted that two interviews were mistimed and thus did not cover the franchise bidding process in sufficient detail. Additionally, however, when tapes of initial interviews were played back, it was apparent that, as a result of some early nerves, the format of the interview schedule was being observed too rigidly. Not only were important issues and inconsistencies being insufficiently probed when a deviation from the schedule would have been valuable, but all questions were being asked as written on the schedule even if the respondent had already (unwittingly) answered some of them. Had respondents perceived this to mean that their comments were being ignored, they might well have lost interest in proceedings and the validity of the interview could have been eroded. Fortunately, this and other problems were overcome with practice, and later transcripts demonstrate that a much more 'natural' style of conversation between interviewer and respondent was being achieved. Nevertheless, tapes were monitored continuously in order to check consistency, and to extract emerging information which could be appended to subsequent interview schedules.

Ensuring the relevance of questions and refining interview technique are clearly important considerations in a research project. However, throughout the fieldwork programme it was

necessary to be aware of, and be able to react to, various nuances of the interview situation which can also affect the validity of data gathered. Three of these are particularly significant: control, respondents' perceptions of the interviewer and ethical considerations. Issues surrounding the control of interviews have received considerable attention in the literature (see, for example, Kress and Fowler, 1979; Briggs, 1986). In fields such as anthropology, concern has centred around the potential for interviewers to exert excessive control over the respondent, in effect 'leading the witness' and distorting the information obtained (Schoenberger, 1991). By contrast, the greater risk in research involving elites lies in the potential for the investigator to *lose* control. McDowell (1992: 213) argues that, from the outset, the researcher can be reduced to "the position of a supplicant, [because he or she is] requesting time and expertise from the powerful with little to offer in return." Schoenberger (1991: 183) adds that this situation can be exacerbated during the interview itself because elites:

"... are people accustomed to being in control and exerting authority over others. There is a risk that the respondent will impose his or her agenda on the interview, taking it in directions not directly relevant to the research or not worth lengthy elaboration."

Schoenberger (1991) continues to note that the aim should be to encourage a collaborative dialogue, where respondents can contribute to the shape of the discussion without controlling it.

In general it was felt that Schoenberger's notion of a collaborative dialogue was achieved during most interviews, particularly the later ones. Some respondents appeared nervous, while others were forceful, but the style of interviewing could be adapted to the requirements of the situation. A combination of thorough preparation and alertness in the interview itself helped to minimise tangential discussions, and potential inconsistencies, with either the respondent's own account or those of others, were usually addressed. However, in one interview it quickly became apparent that the respondent was extremely keen to impose his own agenda on proceedings. It is unlikely that this was motivated by the 'management ego' referred to by McDowell and Schoenberger; the interview was conducted shortly after a rail crash at Southall in 1997 in which seven people were killed, and the respondent was, understandably, preoccupied with the events which had occurred. The unfortunate timing of this interview meant that a sensitive approach was required to refocus the respondent's mind onto the topics which were supposed to be under discussion. The approach to this was very much improvised, but involved listening to the respondent's

comments - and sometimes, depending on the degree of conviction with which he spoke, exploring his concerns further - before reintroducing the issues at hand. The interview was certainly less successful than it could have been, although some of the main issues were covered in satisfactory detail.

Respondents' perceptions of the interviewer can significantly affect the outcome of a fieldwork programme (Turner and Martin, 1984). Obvious differences in appearance or a clash of personalities between the respondent and the researcher could awaken prejudices in either party and result in poor data being produced if, for example, the respondent were to become deliberately unco-operative. It is clearly the responsibility of researchers to ensure that their own perceptions and prejudices do not compromise the integrity of an interview. Moreover, there are straightforward ways in which researchers can and should attempt to minimise the risk of being perceived inappropriately by respondents - being polite and dressing suitably are two obvious examples (Schoenberger, 1992). A suit and tie was worn to all interviews and every effort was made to identify, and adhere to, the social 'rules' appropriate to each situation. It was felt that these attempts were largely successful, although some respondents were visibly surprised at being confronted with a young researcher. Two respondents in particular were noticeably unco-operative until they appeared satisfied that the interviewer was able to undertake his duties competently.

In addition to age, certain other differences between respondent and researcher are impossible to conceal, particularly race and gender. Although all but one of the respondents in this study were white men (the other was a white woman), it would be over-simplistic to assume that issues of race and gender simply vanished because both parties to the interview were always the same colour and almost always the same sex (Herod, 1993). The issue of gender provides a useful illustration of this point. Based on an analysis of single and mixed sex group behaviour, Aries (1976) contended that men tend to be more aggressive and engage in more dramatisation and 'tall' story telling in the company of other males than when women are present. Aries' (1976: 11) conclusion that "the interpersonal styles of men and women are different in... single sex and mixed group settings" has led Herod (1993: 308) to argue that:

"...whereas a male interviewee might adopt one type of behavior towards a female researcher, such as paternalism... he may also adopt different cultural norms of masculine behavior - perhaps one-upmanship in recounting events - in his encounter with a male interviewer."

On the one hand, experiences in the field during this study might be interpreted as providing some evidence to support Herod's theory. On several occasions respondents seemed to adopt a spirit of male *bonhomie* - a 'laddish' tone - and accentuated their arguments with profane language and/or referred to colleagues in a derogatory fashion. On the other hand, however, the majority of respondents expressed their thoughts in measured and considered language. Nevertheless, the different conversational styles of respondents were noted after interviews in order that they could be taken into account during analysis (see section 3.5).

Finally, there are ethical considerations which can impact upon the information obtained from an interview situation. As Kimmel (1988) points out, it is important that all practical steps are taken to minimise potential harm to respondents which could arise from their participating in a research project. By far the most likely source of harm in an interview-based study of this kind is a failure to maintain the confidentiality promised to respondents.¹⁰ Although it was noted in the introductory letters sent to potential interviewees that data obtained would be anonymised, most respondents sought to confirm their rights in this regard. Respondents did not generally want to impart commercially sensitive information, especially that which their colleagues/superiors may well have wanted to contain, if there was a chance that it could be attributed to them. Respondents were reassured that the research was guided by the ethical procedures adopted by the University of Plymouth, and were supplied with a written undertaking that every effort would be made to anonymise all direct quotations (see section 3.5). Moreover, respondents were assured that chapters in which they appeared would be sent to them for inspection and validation (see MacPherson and Williamson, 1992) before being included in the final draft of this thesis. Respondents were content to proceed on this basis, and all but one were happy for the interview to be tape recorded (detailed notes were taken in this instance). Although it was initially feared that the presence of a tape recorder might inhibit respondents, most were used to meetings being recorded and seemed to ignore the machine. Indeed, the presence of the tape recorder even seemed to stimulate a mischievous streak within some of the respondents. As one noted whilst the machine was being set up, "I have absolutely no problem with being indiscreet, but I cannot possibly be found out doing it." Having reviewed the methods used to collect the data contained in this thesis, attention is now turned to the techniques employed to analyse them.

3.5 Data analysis

Making sense of qualitative data has, by definition, to involve some kind of content analysis technique (Bird *et al.*, 1983). Content analysis is the 'diagnostic tool' of qualitative researchers, and its purpose is to:

"...identify specific characteristics of communications systematically and objectively in order to convert the raw material [obtained during the study] into scientific data" (Mostyn, 1985: 117).

Content analysis is a time consuming process (in this case lasting longer than the fieldwork itself), and executing it correctly is essential if the data are to be exploited effectively (Cook and Crang, 1995). Mostyn (1985) identifies two main types of content analysis relevant to this study, one quantitative, the other qualitative.¹¹ The quantitative approach involves placing data into categories and noting the frequency of responses assigned to each. In this way, it is possible to identify 'major' or 'minor' points, depending on the amount of times they were raised by different respondents, and the result is a quantifiable measurement of feeling regarding any given issue (Bird *et al.*, 1983). In contrast, qualitative content analysis does not seek to generate numbers, but instead relies more upon the interpretations of the researcher to identify trends within the data. Emphasis is placed upon revealing the depth and context of the information collected (Cook and Crang, 1995; Miller and Crabtree, 1992).

At first sight, the former seems to offer notable advantages over the latter. Unlike qualitative content analysis, the quantitative approach can produce 'at-a-glance' descriptive statistics. Moreover, it is systemised to guard against subjective interpretations. However, despite these advantages, it was decided that the quantitative technique was not suited to this study for three main reasons. First, the method of sampling employed was not consistent with frequency counting. Many of the data, particularly those concerned with policy evolution, had been collected to piece together a chronology rather than to identify collective trends (see section 3.3). Where, say, only three people had been interviewed about a particular topic, counting codes to determine relative importance would be rendered somewhat meaningless as the result would have no statistical significance. Second, the method of data collection was not compatible with quantitative analysis. The inductive nature of the approach adopted - not all respondents are asked the same questions in the

¹⁰ Although others are not inconceivable. For example, as Shaw and Matthews (1998) argue, the failure of academics to publish research findings in appropriate outlets can result in any potential benefits arising from the study being lost to respondents.

same order - meant that frequency counts would have produced distorted results; some respondents may not have raised a particular point if they were not asked about it. Finally, and more generally, it was felt that the quantitative technique was not entirely consistent with the aims of qualitative research. It will be remembered that the purpose of qualitative investigation is to obtain deep data, comprising rich insights into respondents' opinions and perceptions. Reporting qualitative data solely by way of frequency counts would have stripped them of the depth which the semi-structured interviews had been designed to capture and, in this sense, would have defied the object of employing qualitative techniques in the first place (Mostyn, 1985).

For these reasons, it was decided to adopt a more qualitative method of data analysis. It should be noted that such techniques also possess shortcomings, and it was important that these were understood before analysis began. Quantitative researchers often argue that the reliability of qualitative analysis is not guaranteed, that the method is too heavily based on interpretation and not adequately systemised. As Goode and Hatt (quoted in Mostyn, 1985: 122) point out, "intuition is not enough to demonstrate the truth of ideas." Certainly studies have shown that there can be a low level of comparability for qualitative research (May, 1978) and May, himself a qualitative researcher, has acknowledged that qualitative analysts may on occasion be overly influenced by a 'neat turn of phrase' or a few dramatic but untypical cases and could face difficulties defending themselves against charges of bias or inaccuracy. Thus it was necessary to ensure that the potential for researcher error was minimised, and this was done by initially by adopting techniques already discussed - retaining evidence (see section 3.2) and being self-critical (see section 3.4). However, Krippendorff (1980) has suggested that the ultimate test of good content analysis is a simple question: "Does [sic] the data obtained in the research provide a trustworthy basis for drawing inferences, making recommendations and supporting decisions?" In order to establish the answer to this question, respondents *and industry actors who had not been involved in the study* were contacted and asked for their opinions regarding the validity or otherwise of the completed chapters (see below).

The analysis technique adopted closely resembles the 'editing' method widely used in social scientific enquiry (Miller and Crabtree, 1992). This approach involves the researcher coding the data and organising them into themes before interpretation commences. The codes

¹¹ There are numerous different types of content analysis techniques depending on the particular aims of a research project. Bird *et al.* (1983) outline some examples.

employed arise purely as a result of the data and not, as in some analysis techniques (such as the 'template' approach), from a pre-determined list; in other words, the views of the respondents, rather than the pre-conceptions of the researcher, prevail. The analysis undertaken in this thesis was informed by Cook and Crang (1995), May (1997), Miller and Crabtree (1992) and Strauss (1987), and the procedure consisted of three stages, transcript construction, coding and hypothesis formulation. Each is now discussed in turn.

Transcripts were typed verbatim, and spaced to leave enough room for future annotations. At the same time, notes taken regarding the context of the interviews (see section 3.4) were appended to the transcripts. The notes contained a wide range of information, including contemporaneous thoughts and details concerning the dynamics of the interview situation and the interviewees themselves. The importance of these notes cannot be underestimated, and on several occasions they influenced the subsequent analysis. In one instance, where a respondent had used particularly colourful language throughout his interview, the analysis was able to take account of the fact that his actual views were likely to be less extreme than those he expressed. Individual answers within other interviews were also altered after reference was made to the research notes. For example, one respondent, when asked whether a company was serious about its pledge to study the feasibility of an electrification project, answered "of course." What the tape did not reveal, however, was that the respondent had simultaneously mimicked his answer through his facial expression, and it was possible to record that the respondent actually meant "no." Although it is undoubtedly possible to misread such occurrences in interview situations, and often difficult to deal with them objectively during data analysis (to illustrate - by how much do you 'scale down' someone's opinion if they speak colourfully?), the research notes at least captured some of the more subtle characteristics of the responses obtained in interviews and allowed an albeit subjective interpretation of them.

Once the transcripts were complete, they were read in full to ensure a general level of familiarity with the data. Passages pertinent to the questions asked were highlighted, although care was taken not to automatically exclude the other data as they might have become relevant at a later stage in the analysis. Potential inconsistencies which remained were also identified and addressed as far as possible by referring to existing literature or other transcripts. In some cases, it was necessary to contact respondents again by telephone to clarify certain issues (this was particularly true in relation to the complexities of ORCATS-based competition - see chapter six).

The next step was to ‘code’ the data. This process involved thoroughly re-reading the transcripts and annotating the highlighted passages according to their meaning and intent. Strauss (1987) argues it is important that these annotations should be kept general during the early stages of analysis, and that specific relations between the data should not yet be sought; the researcher should avoid reaching premature conclusions and manipulating subsequent data to support them. Thus, each relevant passage of text was given a code, often between one and three words, pertaining to what was being said (see table 3.2). In many cases, particularly where one aspect of a wider topic was being explored by the respondent, it was also necessary to assign sub-codes to the data. A list of all codes assigned, along with a record of where each one appeared, was taken on a separate sheet of paper in order that passages could be located in the future. Once coding was complete, transcript passages were categorised according to general themes relating to potential chapter headings (‘Competition Between TOCs’, ‘Future’ and so on). Copies of the transcripts were ‘cut and pasted’ electronically according to the themes into which they fell to produce ‘themed documents’ ready for analysis.

<div> <div>Level</div> <div>pf</div> </div> <div> <div>LT</div> <div>buses</div> </div>	<div> R: They tried, but I still think the MEBOs were playing a game with them. The raw privatisations in the 1980s were very much open to this abuse. The analogy is that someone’s council house is for sale but they actually want to buy it themselves. So you go and see it and they tell you all the faults. That’s how it was in the 1980s. What happened in the 1990s - and London Transport I think started this with their privatisation - they put internal people in to stop them manipulating the cashflow to help the financing of the MEBO. They tried to filter the data so it was coming out sensitised for everybody. While that has some advantages which improves the quality of the data of the third parties, at the same time it is still giving the management a very strong hand to play because of the time... </div>
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Table 3.2. An example of ‘coding’ on a transcript.

Although this stage of the analysis process is theoretically value-free, it would be dishonest to claim that this can entirely be the case given the extent to which qualitative researchers invariably become immersed in their data (Cook and Crang, 1995). It is almost impossible not to consider tentative conclusions and hypotheses as the coding process is being undertaken; potential relationships between the data present themselves continuously. In an attempt to guard against being unduly influenced by ideas which materialised at the coding

stage, tentative conclusions were recorded separately from the codes in the full knowledge that they were likely to change as the analysis progressed. A whole host of ideas generated during the coding process were discarded following formal hypothesis formulation.¹²

The hypothesis formulation stage first involved creating a series of 'theoretical notes' (Strauss, 1987). These notes aimed simply to suggest trends which emerged after the data had been consistently revisited. For example, when analysing the extent to which the passenger rail market had been liberalised (see chapter six), the first stage was to identify each of the different methods of competition identified by respondents. The next task was to establish whether or not each took place, how and why. Each reading of the relevant themed document provided additional clues and/or refined ideas regarding answers to such questions, and reference was made to existing literature where this was relevant. Hypotheses, in the form of over-arching arguments to chapters, were formulated when the theoretical notes had been finalised, and these were compared with the tentative hypotheses recorded during the coding process (see above). Perhaps unsurprisingly, it was found at this stage that many of the ideas generated during coding could not be supported by the evidence, and these were discarded accordingly. The importance of keeping tentative hypotheses separate from the coding process was thus vindicated as they could well have proved an inappropriate influence on the analysis process. The final set of theoretical notes, including hypotheses, was then appended to each of the themed documents in order to produce a set of 'templates', around which the chapter drafts could be constructed (see table 3.3).

When the analysis process was complete, the empirical chapters were drafted and checked for a final time against the templates to ensure that they accurately reflected the information contained in the transcripts. The chapter drafts were then sent to interviewees and industry actors who had not been involved in the study for validation.¹³ The principal benefit of respondent validation exercises is that they can provide an invaluable means of ensuring the analysis in the study reflects accurately the 'reality' which was researched (MacPherson and Williamson, 1992). Although few respondents returned the drafts of chapters five and six,

¹² For example, it was thought at one stage that OPRAF was held in contempt by franchise bidders because of its inability to expedite the franchising process. The reality turned out to be more subtle - OPRAF were disliked in the sense that it was seen as the 'gatekeeper', although all bidders admired its practical franchising achievements (see chapter five).

¹³ These actors were identified by respondents as being industry experts in fields relevant to this research.

OPRAF learnt valuable lessons from the sales of the first three franchises. To begin, they filled in all the information ‘holes’. Second, they standardised the documentation and that made it easier from both sides. Bidders were able to know what was required of them and OPRAF could streamline their activities and get things done quicker. The speed of the process was an important factor. OPRAF had been given instructions to finish the process by March (although they deny that was necessarily influenced by the general election: “if the election had been six months before when it was, we’d never have finished the process”) and all parties were aware that the process had speeded up considerably. From taking almost a year to let the first three, the remaining 22 were let in around 18 months. When OPRAF first presented its timetable in late 1995, the DoT was still riddled with sceptics:

“After we’d produced the programme, and presented it to the Department as what we were going to do, there were smiles all round, everyone nudging each other as if to say ‘what’s this bloke smoking?’ And when we started delivering it, they just went ‘oh!’

Most companies did not have a problem with the bidding timetable speeding up because they felt they had ample experience of the process and what was required of them by then:

“I haven’t really any argument that we were left short of time to do what we wanted to do, or our bids were compromised because we ran out of time... You either had to get your act together or forget it!”

Only one bidder did not share this point of view, noting that the risks of making an error were increased:

“I guess the problem towards the end was the very short time period, because you had less and less time to prepare your indicative bids and final bids... I think it increases the risk that you make the wrong decision and specify the wrong service improvement or the wrong rolling stock that you’re going to buy, or put the wrong price in”.

Table 3.3. Example of a ‘template’. The theoretical notes surround the raw data (presented in quotation marks) which had formed the themed document. Some of the section shown has now been edited out of the final version of chapter five.

an encouraging level of approval was obtained from those who did.¹⁴ Only limited alterations were made to the chapters’ contents after a few mistakes and omissions were identified. These related to changes in regulatory policy which had occurred after the drafts had been completed, or minor misinterpretations of respondents’ comments in some circumstances.

Respondents' reactions to chapter four were more varied, however. Although it was commented that the draft had "come out very well," one interviewee was particularly critical, arguing that one part of section 4.5 - that which suggests the track authority model was not adopted as a result of considered analysis (see chapter four) - was "seriously misleading." Data relating to this section were re-examined thoroughly in response to this assertion, and particular care was taken in doing this; although it was of course possible that the analysis was incorrect, it was also borne in mind that some respondents are wont to view validation exercises as opportunities to influence a research project's outcome, especially if it reflects badly upon them (MacPherson and Williamson, 1992). After a detailed re-evaluation of the data, which involved some supplementary interviewing, it was accepted that one aspect of section 4.5 was inaccurate and the text was changed accordingly.¹⁵ Other aspects of the respondent's argument were rejected, however, as no corroborative evidence could be found to support them. This episode served to illustrate the difficulties involved in establishing a 'factual' chronology from a variety of respondents whose viewpoints often conflict, and the remainder of the chapter was thoroughly reviewed in case of further errors (one was found with regard to the timing of Cecil Parkinson's tenure as Secretary of State for Transport).

Finally, the style of data presentation adopted conforms to the standard currently adopted by qualitative authors (see, for example, Bartram and Shobbrook, 1998; Schoenberger, 1989; Sidaway, 1997). Points raised are supported with verbatim quotes, although on occasion it was necessary to paraphrase the views of numerous respondents to protect anonymity and/or assist style. The sources of verbatim quotes are not revealed, and in some instances, where it was felt that respondents were easily identifiable, minor alterations to the wording of quotes have been made. Usually, this only involved changing the first person to the third person or *vice versa*, but all affected respondents were informed of this approach.

3.6 Conclusion

This chapter has described and evaluated the methods adopted in this thesis to collect primary data. In order to fulfil the aims of the study, it was recognised that interviews would have to be conducted with elites. Several potential difficulties exist with undertaking

¹⁴ Four responses were obtained for chapter five and five for chapter six. Chapter seven was not forwarded to respondents as relatively little interview data was used in the chapter. Its contents were scrutinised by a leading railway journalist, however.

¹⁵ The original draft overlooked the role of one key actor in selecting the track authority model of rail privatisation (see chapter four) and underestimated the amount of analysis which preceded the publication of the White Paper *New Opportunities for the Railways*.

research of this kind, but these were negotiated and it is felt that this enabled the collection of a high quality data set capable of making a valuable contribution to the understanding of rail privatisation policy. The key research tool employed was the semi-structured interview, recommended by Schoenberger (1991) as an effective means of obtaining 'deep' information from respondents. This kind of interview is a standard research tool in many areas of human geography (see, for example, Bartram and Shobbrook, 1998; Herod, 1993; McDowell, 1992; Sidaway, 1997) but, with a few notable exceptions (in particular Bird, 1982, 1988; Hoyle, 1993, 1994, 1995) has been largely overlooked in transport-related aspects of the discipline. It is recognised, therefore, that this technique may be unfamiliar to some transport geographers, but this chapter has been designed to explain the method in detail in an attempt to pre-empt any misgivings or confusion which may have arisen. The potential disadvantages associated with qualitative techniques have been noted, but it is felt that these have been adequately addressed. As a result, the key advantage of semi-structured interviewing, namely that it allows the thorough investigation of an issue from the perspective of the respondent rather than the researcher (Strauss and Corbin, 1990) has been exploited.

Following detailed preparations, interviews were undertaken with policy makers and senior management representatives from both TOCs and franchise bidders. Policy makers and TOCs were well represented by the amount and nature of respondents interviewed, but there was concern that not enough franchise bidders were participating in the study to warrant continuing enquiries into the competitive tendering process. However, it was decided after consideration that a sufficient number and range of views could be obtained from *shortlisted* bidders, but it should be noted that the opinions of those who failed to reach final tendering stage on any occasion are not represented. Finally, data analysis was undertaken using a qualitative 'editing' technique. Although the respondent validation exercise revealed some analytical errors, it is felt that the decision to adopt the editing technique was justified because it allowed the presentation of 'deep,' contextualised data, which would have been problematic to express in numbers. The results of the data collection and analysis techniques reviewed in this chapter are now presented throughout the remainder of the thesis.

Chapter Four

Adopting the track authority model of rail privatisation

4.1 Introduction

Chapter two examined the network industry sell-offs in the context of neoliberalism, the theoretical framework upon which the privatisation programme was based. It was suggested that throughout the 1980s, rather than promoting competition and reducing public sector involvement in the privatised sectors, the Conservatives marginalised the goal of market liberalisation and retained an influential role in the affairs of the utilities through the creation of regulatory mechanisms and institutions. The restructuring of the electricity generating industry in 1990 saw the first real attempt to secure a genuine move towards market liberalisation when divesting a utility. The CEGB was split into four companies - a common carrier (National Grid) and three, competing generating companies - and restrictions controlling market entry were abolished (Electricity Association, 1998). Actual competition within the industry is now considerable (Littlechild, 1993), and Offer does not impose 'surrogate' competition measures.

The government's proposals for rail privatisation were formally unveiled in the 1992 White Paper *New Opportunities for the Railways* (Department of Transport, 1992a). As noted in chapter one, selling BR had been regarded by some as potentially troublesome because it differed from the other network industries in several important respects (Shaw, 2000). Most importantly BR, unlike the utilities, was heavily dependent upon public subsidy (some operational differences are discussed later). The Serpell Report (Serpell, 1983) concluded in 1983 that in order to make BR profitable, 84 per cent of its route miles would have to be closed. Hostile public reaction to such a prospect confirmed to ministers that moves to cut back BR's network before (or after) privatisation would be politically unacceptable, and that at least some continuing financial support would be necessary to "sustain the... national network of services" at 1992 levels (Conservative party, 1992: 35). As such, ministers were forced to acknowledge that it would be impossible - and, indeed, undesirable - for the government to reduce significantly its influence over certain parts of the industry despite a transfer of ownership (Department of Transport, 1992a). Not only would the state's role continue through its financial contributions, but also by virtue of the fact that it could reasonably demand guaranteed levels of service in relation to subsidy where it was being

paid. In this sense, therefore, some compromise of the neoliberal policy goals outlined in chapter two would be inevitable in the rail sell-off.

This situation notwithstanding, the promotion of industry-wide actual, rather than surrogate, competition was a fundamental objective of the government's rail privatisation plans. The Conservatives' 1992 election manifesto noted:

"We believe the best way to produce profound and lasting improvements on the railways is to end BR's state monopoly... Companies have already said that they want to introduce new railway services as soon as the monopoly is ended. We will give them that chance" (Conservative Party, 1992: 35).

New Opportunities for the Railways emphasised ministers' wish to reduce the role of the state in the railway industry in order to harness the "management skills, flair and entrepreneurial spirit" of the private sector (Department of Transport, 1992a: i; Welsby and Nicholls, 1999). A complete reorganisation of the railway industry was advocated, and the plans put forward in the White Paper - the so-called track authority model - essentially represented further experimentation with the method used to divest the electricity industry (Charlton *et al.*, 1997; Helm, 1996; Mountford, 1996). A common carrier equivalent to the National Grid, Railtrack, was created, and as well as introducing competition to the maintenance and 'support' aspects of BR's business, ministers also sought to liberalise passenger and freight train services.¹ The following four chapters analyse the BR sell-off in the context of competition and regulation established in chapter two. Chapters five through seven assess the policy's outcome in terms of liberalising the passenger rail market, but the remainder of this chapter is devoted to describing its development and establishing how the track authority model of rail privatisation came to be selected by the government. This chapter therefore provides a background for subsequent analyses.

Debates within and around the Conservative Party concerning the privatisation and liberalisation of the railway industry were protracted, some even pre-dating the election of the first Thatcher administration in 1979. Evidence suggests that the Department of Transport was attempting to sell parts of BR as early as 1980. However, despite rail privatisation having been considered by government for more than a decade, there is a strong case to be made that the privatisation and liberalisation strategy outlined in *New Opportunities for the Railways* was not, as some respondents suggested (see also *House of Commons Papers*, 1992a), the result of a coherent exercise in policy analysis. Indeed, the chapter shows that policymakers had not considered the intricacies of the track authority

model before the White Paper was published, and that ministers were unclear as to whether their plans were actually capable of achieving what was expected of them. It was not understood if adopting a neoliberal policy agenda - seeking to maximise competition and minimise the role of the state - would be as appropriate for the railways as it had apparently been for the CEGB. The purpose of this chapter is to investigate how and why this situation arose.

The study of rail privatisation policy development is not new, and a number of academic accounts have examined the subject from various perspectives.² Gibb *et al.* (1996: 35) first advanced the argument that the process leading to BR's divestiture was extremely protracted. Zahariadis (1995, 1996) explained the timing of the BR sale through a conceptual model which drew upon the interaction of three policy 'streams', problems, solutions and politics. Both studies have made a useful contribution to the understanding of rail privatisation policy development, but the context of this thesis demands a new perspective in order to emphasise policy makers' evolving attitudes towards competition as plans to sell BR developed. Moreover, the arguments advanced in Gibb *et al.* and Zahariadis' work rely heavily upon secondary data sources. Although this is not to contest the validity of the studies, their exclusion of primary data might have compromised the 'depth' of the empirical investigation undertaken in each. This chapter's original contribution to the understanding of rail privatisation policy development therefore relates both to content, with a focus upon policy makers' attitudes towards market liberalisation, and to method, with the incorporation of primary interview/parliamentary data to support its arguments.

4.2 Government rail privatisation policy, 1979 - 1986

Debate within the Conservative Party regarding the privatisation and liberalisation of BR can be traced back to the late 1960s. The CRD's Committee on Nationalised Industries, which identified the need to begin a sustained programme of privatisation (see chapter two), considered divesting BR's core activities but concluded that denationalisation would be inappropriate because "there would be no takers at the price which would be acceptable to us" (CRD, 1968: 15). Instead, the Committee suggested that emphasis should be placed on securing better public sector management. Following the election of Thatcher as Party

¹ This thesis is of course primarily concerned with passenger train services.

² The two most comprehensive examples are mentioned here. Others are: European Research Centre, 1993; Harris and Godward, 1997; Jenkins, 1995; Shaw *et al.*, 1998; Truelove, 1991; Turton, 1992; Williams, 1992; Wolmar, 1996.

leader in 1975, support for the liberalisation of BR's market began to materialise among the Conservative Right. The Young Conservatives' (1976) *Key Policy Statement* called for the rail industry to be liberalised by allowing private operators onto the network to compete with BR, and the shadow transport spokesman, Norman Fowler, emphasised his support for market, rather than state, determination of transport provision (Fowler, 1977).

Considering Thatcher's cautious outlook to privatisation in the early 1980s, plans to attract private sector capital into the railway industry materialised remarkably quickly. A likely reason why is because both the new Minister of State for Transport, Norman Fowler, and the British Railways Board (BRB) favoured private investment in BR's subsidiary industries (BRB, 1981; *Modern Railways*, 1980a, 1980b).³ Proposals to achieve this were developed during 1980 and the result was the creation of a new holding company, British Rail Investments Ltd (BRIL), as a wholly owned subsidiary of the BRB. The assets of Sealink UK Ltd, British Transport Hotels, British Rail Hovercraft Ltd (Seaspeed) and British Rail Property Holdings were transferred to BRIL in order that private sector involvement could be administered separately from BR's core activities (*Modern Railways*, 1980c; 1981a). The BRB saw its new subsidiary as a means of expanding the total level of investment in the existing businesses on top of government grants:

"...for BR, the benefit of privatisation is seen as being two-fold: in addition to receiving the proceeds of sales, BR will also face reduced calls on the finance available within its investment ceiling as the investment requirements of the subsidiaries in the holding company will be met in part from the private sector" (*Modern Railways*, 1980c: 386).

The government's primary motivation for establishing BRIL was soon revealed to be different from BR's. When ministers realised that revenue from asset sales could be used in order to 'massage' the PSBR (Brittan, 1984; Howe, 1981), they prioritised the divestiture of BR's subsidiaries in order to reduce the overall level of its subsidy and raise money for the Exchequer (Jenkins, 1995). As noted by a respondent:

"...the [government] got to work on all public assets and simply stripped them. A 1970s merchant banker couldn't have done better. 'Get rid of your hotels, get rid of your hovercraft, get rid of your ships, we don't want all these engineering works, we don't want any of this catering, get rid of it. But most of all get rid of your property. And give us the money.'"

³ Because there were too many cabinet ministers for the government legally to pay their salaries, Norman Fowler initially served as Minister (not Minister of State) for Transport outside the cabinet but in attendance at its meetings. In January 1981, following the removal of Norman St John-Stevass and Angus Maude, Fowler was accommodated as Secretary of State for Transport.

The 1981 Transport Act (House of Commons, 1981) provided for BR to dispose of its subsidiary businesses and these were sold throughout the 1980s (see table 4.1).

The sale of BR's subsidiaries in the early 1980s was consistent with the development of privatisation policy in other industrial sectors at the time, as all the divested companies were relatively small and already operated in competitive markets. But having established the concept of privatisation in the rail industry, it seems that the Department of Transport was keen to set a precedent and be the first to sell the core activities of a network industry. As a result, attention was turned to the possibility of privatising parts of BR's rail operations. A Monopolies and Mergers Commission (MMC) report on BR's Southern Region (SR) in 1980 had concluded, among other things, that more investment was needed in order to improve rail services in the area (MMC, 1980). Increased government expenditure was ruled out because this would clash with the policy of reducing BR's overall subsidy (and the PSBR), but Fowler did ask BR to investigate operational and managerial independence for the SR in order to seek clearer accountability for the operation of services (*Modern Railways*, 1981b). The Department's semantic subtlety in fact concealed its objective of finding a way to divest the SR, perhaps opening up an alternative investment source: "...Norman Fowler... did a study of the Southern Region. He got his officials to study privatising the SR as an experiment. 'Sell off the SR,' [he said]."

Business Sold	Date of Sale
BR Hovercraft	October 1981
BR Hotels	1982 - 1984
Superbreak Mini Holidays	February 1983
Slateford Laundry	September 1983
Sealink UK	July 1984
British Transport Advertising	August 1987
Doncaster Wagon Works	October 1987
Horwich Foundry	August 1988
Travellers' Fare	December 1988
British Rail Engineering Ltd	April 1989
Golden Rail	May 1989

Table 4.1. BR's subsidiary and peripheral business sales, 1981-1989 (excluding various property disposals). Source: *Hansard* (1995).

In addition to the SR, the Department examined proposals for the privatisation of rail operations in Scotland and Wales (Hope, 1983). The favoured approach at this stage was to

auction franchises for vertically integrated, geographically discrete rail businesses broken from the rump of BR. In this sense, some provision had been made for competition *for* the rail market (as opposed to *in* it), although this was almost certainly by accident rather than by design. Early privatisation plans were crude and there is nothing to suggest that officials had submitted a blueprint capable of liberalising BR's core market; rather, the approach seems to have been to let the private sector formulate proposals of its own and present them to the Department (Abbott, 1984).

Despite Fowler's enthusiasm for a rail sell-off, his plans were ultimately over-ridden by his Cabinet colleagues. Although numerous state-owned enterprises had been sold off by 1982, privatisation had not yet been extended to tackle the network industries and a BR sale was viewed as complicated and unworkable by many ministers. As already noted, the privatisation of BR would involve continuing subsidy payments:

"...It got absolutely nowhere because no-one believed in it. They didn't think it was going to happen, it was crazy, and so on... Norman pushed it quite hard, but... at the end of the day he just didn't have any clout."

The most influential objector to rail privatisation was Margaret Thatcher, who sustained opposition to the idea throughout the early 1980s (Jenkins, 1995). In addition to the fact that "she was not convinced that privatising a loss-making industry was feasible," Thatcher felt sure that 'middle-England' held an inexplicable affection for its railways (a sentiment also expressed by Gibb *et al.*, 1996) and that to tinker overtly with BR's core activities would precipitate a political disaster. The then Prime Minister's cautious approach to privatisation (see chapter two), although quickly evaporating with regard to other industries, remained acute in relation to the railways. When Nicholas Ridley, Secretary of State for Transport from 1983 to 1986, arranged a meeting with Thatcher specifically to obtain her support for rail privatisation,

"...she told him never to mention the words again, and that was it. She said 'railway privatisation will be the Waterloo of this government, I don't want to hear about it. Please never mention the railways to me again... Nick had a very shrewd political sense and I remember him saying 'it's not worth a candle. As long as she's PM, there's no point in discussing railway privatisation.'"

The divergence of opinion between the Department of Transport and Downing Street resulted in the abandonment of attempts to divest train services. Although the rhetoric of privatisation was kept alive by the Department of Transport - it recorded that it still

supported the idea - the responsibility for encouraging private sector train operation was passed to BR (*Hansard*, 1983a, 1983b, 1984). In reality, with the majority of the BRB opposed to core activity privatisation, it is scarcely credible to suppose that the Board would pursue this option enthusiastically. It therefore seems likely that the Department of Transport pursued this strategy because it allowed a policy compromise whereby Fowler and his successors could maintain a position in favour of privatisation safe in the knowledge that it was unlikely to occur. By the mid 1980s, however, the Department of Transport also appeared to lose interest in selling BR. Notwithstanding claims from Conservative backbenchers that parts of BR were “positively crying out for privatisation” (*Hansard*, 1985: Cols 5-6), the Department stated that the government had no plans to privatise any part of the rail network (*Hansard*, 1986). That official position did not change publicly until 1988.

4.3 External proposals

Despite the absence of a definitive government position on rail privatisation, the Department of Transport’s initial enthusiasm aroused debate among interested observers regarding how BR might be sold. As in the case of BT, where divestiture plans had resulted in numerous analyses of potential methods of sale to promote competition (for example, Beesley, 1981; Kay and Silbertson, 1984; Veljanovski, 1989), suggestions regarding BR’s future were advanced by academics (Beesley and Littlechild, 1983; Gylie, 1984; Starkie, 1984), think tanks (Adam Smith Institute (ASI), 1983; Gritten, 1988; Irvine, 1987, 1988) and Conservative backbenchers (*Hansard*, 1988a, 1988b). Before this chapter moves on to discuss developments in government policy in the late 1980s and early 1990s, it is necessary to review the key ‘external’ contributions to the rail privatisation debate because they proposed concepts and methods which influenced policy makers’ thoughts when they eventually came to privatise and liberalise the railway industry.

Two suggestions were put forward in 1983, one by the ASI and the other by Beesley and Littlechild. Both elaborated upon the Department of Transport’s original concept of regional separation as they advocated selling vertically integrated, geographically discrete cost centres. The ASI’s (1983) *Omega Report* asserted that the government should aim for a free market in public transport run by private enterprise, and espoused charging road users in order to level the playing field between transport modes. Within this context, the future of the railways would have to “be [subject to] a commercial, rather than an emotional, assessment” (ASI, 1983: 27). The report called for the restructuring of BR’s management

into cost centres to help identify financial and traffic records for each line. Once sufficient information had been collated regarding the commercial viability of individual cost centres, each could be auctioned, leasehold, to private bidders. Hopelessly uneconomic and underused lines would be closed and disposed of, although where “politicians [were] insistent on keeping lines open” (ASI, 1983: 31) the report suggested a degree of competition for the market could be created by offering franchises. Competition in the market was largely overlooked, although some restrictions to prevent one company buying up leases for adjacent lines were proposed in order to encourage competition between operators in ‘border’ areas.

Beesley and Littlechild (1983) emphasised the social, as well as the commercial, advantages rail privatisation could bring for consumers. Unlike the ASI, Beesley and Littlechild took seriously the social and political problems which would have accompanied the withdrawal of services. They suggested that once BR had been restructured (perhaps into the pre-1948 regions), it would be sold on the condition that successor companies committed themselves to a minimum programme of rail output. Given that privatisation would, according to Beesley and Littlechild, make the successor companies much more efficient than BR, they could make better use of their equipment and a quite considerable passenger output could be insisted upon. The model included the potential for new operators to introduce services in competition with the successor companies although, like the ASI, Beesley and Littlechild effectively discounted any need for on-rail competition to develop.

Debate in 1984 shifted towards the possibility of vertically separating BR before privatisation in a manner similar to that suggested by Nigel Lawson for BT in 1982 (see section 2.4). Vertical separation would have involved splitting BR into two successor companies, one assuming responsibility for infrastructure and the other operations. A key characteristic of this method is that it would expose BR’s operations business as an *artificial* monopoly. Whereas the infrastructure would retain its natural monopoly characteristics, there would be, in theory at least, no reason why any number of operators should be prevented from operating different services on the same stretch of track (‘on-rail’ competition).⁴ Gylie (1984) advocated vertical separation but argued that although the operations business should be privatised, the infrastructure should not. By retaining the

⁴ In practice there can be numerous difficulties with introducing such an arrangement, and they are discussed in section 4.5 and chapter six.

‘track authority’ in the public sector, he suggested, the government would be able to make strategic decisions regarding investment in surface transport infrastructure:

“...if road and rail [were] viewed simply as rights of way, the track, track bed, signalling and policing of the railway could be considered for investment in the same way as highways and the respective costs for both networks could be compared... The rail network would generally be considered as the equivalent of the trunk road network” (Gylie, 1984: 16).

Moreover, the common funding and control of ‘highway track’ and ‘railway track,’ combined with the sale of BR’s maintenance operations would, according to Gylie, result in considerable efficiencies and cost savings. On the operations side, Gylie favoured disaggregating BR’s services and selling them off bit by bit. Rather than seeking to promote competition, Gylie’s plan was to create either an intricate, regional division of services, or a mainline network with supporting feeder services. The latter would be run commercially as far as possible, but with the potential for local authorities to contribute subsidy to uneconomic, yet necessary, routes.

The first to advocate a significant liberalisation of BR’s market was Starkie (1984). Following Kay and Silberston (1984) he argued that, although privatisation in and of itself would secure some consumer advantages, a divestiture which introduced on-rail competition would be more beneficial. Indeed, Starkie (1984: 16) dismissed the effect of competitive pressures from other modes of transport because BR was “still not as efficient as it might be” despite their existence. Thus, “...the issue... [was] what form of privatisation [would] increase competitive forces within the railway industry [?]” (Starkie, 1984: 16). Starkie went on to suggest that although the government should retain control of the infrastructure, train sets should be vested in private sector companies who could compete over commercially attractive routes. In the case of socially necessary services, train operators could compete for a ring-fenced Public Service Obligation (PSO) grant to be awarded through a regime of competitive tendering. Starkie’s model thus identified the potential for competition both in and for the market.

By the late 1980s, considerable emphasis was being placed by Conservative parliamentarians and think tanks upon the importance of Starkie’s notion of competition between operators on the same tracks. Two backbenchers, Keith Mans and Nicholas Bennett, suggested models through which on-rail competition could be achieved (*Hansard*, 1988a, 1988b). Both espoused a track authority with slight modifications to Starkie’s suggestion. The ASI contributed further proposals with Kenneth Irvine’s *The Right Lines*

(1987) and *Track to the Future* (1988). Irvine's papers represented a shift of opinion for the ASI. Whereas *The Omega Report* had favoured a vertically integrated solution with minimal subsidy and limited competition, the ASI now championed a track authority supported by a grant to maximise competitive opportunities. Unlike Starkie, who advocated a nationalised infrastructure company, Irvine contended that trains should be able to compete with each other on privately-owned track. With this exception, Irvine generally concurred with Starkie's ideas and developed them further in certain cases. For example, with reference to competitive tendering for loss-making services, Irvine borrowed from Beesley and Littlechild (1983) and suggested that, in return for compensating revenue losses, a franchise must include quality of service stipulations in order to guarantee an acceptable level of service for consumers.

Gritten (1988) returned the debate to vertical integration, although he placed a much greater emphasis on the desirability of, and the prospects for, market liberalisation than either the ASI (1983) or Beesley and Littlechild (1983). Gritten argued that BR should be broken into a perhaps a dozen discrete operating areas, and that such an approach would make commercial sense, provide efficiency and financial clarity. Competition would then occur not only in 'border' areas, but also within the regions themselves as companies would be made to open their tracks to on-rail competitors. Ring-fenced grants for loss-making services were again proposed, although Gritten made no mention of competitive tendering for these operations.

The suggested methods of privatisation reviewed here fall into two categories. First, building upon the Department of Transport's initial work, is the *regional* model. Beesley and Littlechild (1983), the ASI (1983) and Gritten (1988) espoused breaking BR up into vertically integrated, geographically discrete operations with or without opportunities for competition. Second is the *track authority* model. Advanced initially by Gylie, and developed by Starkie (1984), Irvine (1987, 1988) and backbench MPs (*Hansard*, 1988a, 1988b), this option involved the vertical separation of BR in order to allow either economies of scale from a state-owned combined track/highway company, or competition between different operators on the same tracks. Some competition for the market was also proposed.

In common with other academic thought regarding utility privatisation (for example, Kay and Silbertson, 1984; Veljanovski, 1989), none of the authors recommended that BR should

be sold as one company, although it is important to recognise that the ASI (1983), Beesley and Littlechild (1983) and Gylie (1984) appear to have suggested disaggregating BR for reasons unconnected with promoting competition. It seems likely that this was the case because their authors regarded BR as one of many transport modes already in competition with one another; in other words, they disagreed with Starkie's (1984) view that BR constituted a monopoly.⁵ In each case a break-up was suggested principally on administrative grounds. Only after Starkie (1984) had suggested that competition with other transport modes had little effect on BR's performance did authors begin to assume that the company in essence behaved as a monopoly. Referring perhaps to ideological objections to monopolies (Friedman, 1962), and almost certainly to empirical experience of the disappointing performance after privatisation of BT and British Gas (see chapter two), the proposals began to advocate splitting BR up with a view to promoting competition.

Of course, the existence of numerous academic arguments regarding the need to liberalise the markets of network industries had not prevented the government from selling BT, British Gas and the water industry as regulated monopolies. So long as it was politically convenient to forego market liberalisation, there is no reason to suggest that the above models would have influenced ministers to any practical extent. However, as the next sections point out, an announcement that BR would once again be considered for privatisation coincided with the publication of the electricity White Paper in 1988 (see chapter two). With the government becoming more interested in promoting competition, there was perhaps a more realistic expectation that restructuring BR to liberalise its market would become a policy commitment (see, for example, *The Economist*, 1991). It has already been noted that this option was ultimately pursued; the following section of this chapter reviews developments in advance of the publication of the White Paper, *New Opportunities for the Railways*.

4.4 Rail privatisation and liberalisation: an idea whose time had come

It is argued by Gibb *et al.* (1996: 40) that rail privatisation was firmly established on the political agenda by the late 1980s: "[i]t was no longer a case of whether the government would decide to privatise, but of when and how the railways could be privatised." Paul Channon, Secretary of State for Transport from 1987 to 1989, was the first to "fly a kite"

⁵ Beesley and Littlechild (1983) and Gylie's (1984) opinion was shared by many in the railway industry and pressure groups such as Transport 2000 (1989) who argued that making rail operators compete with each other would distract their attention from the real issue which is competing with the private car. This point is discussed in more detail in chapters six and seven (see also Charlton *et al.*, 1997).

regarding the sale of BR at the 1988 Conservative Party Conference (Webster, 1988). Channon was publicly circumspect in that he committed himself only to investigating whether privatisation might be a viable option in the future, but personally he was committed to the idea. Driven by developments occurring elsewhere in the transport field - such as the sale of British Airways and the deregulation and privatisation of the bus industry (see chapter one) - and at least partially by backbench pressure and his own commuting experience, Channon did not share Thatcher's view that the railways could not be sold:

"... he became convinced that the government ought to grasp the nettle and do something about British Rail privatisation... It was something a Tory minister was bound to want to do, bound to want to look at, but he found it astonishing that it hadn't been looked at earlier in a big way... he was the first person to take a big step on it."

Why Thatcher changed her mind and allowed Channon to refer so overtly to rail privatisation remains unclear, even to Channon himself:

"... He casually let it be known that he wanted to announce at the [1988] Party conference the fact that the government was going to privatise BR... He went to some meetings in September 1988 and asked permission to make this announcement at the Party conference. There were all sorts of wise people saying 'oh, you can't do that, it's much too dangerous, the ground hasn't been prepared' and all that, and Mrs Thatcher was fairly luke warm. She said he could say something if he would submit the exact form of words to her before the Party conference. So about a week before the Party conference, he wrote to her with the paragraphs that he wanted to use in his speech about rail privatisation. To his astonishment, within 48 hours he had them back with no comment."

Whatever Thatcher's reasoning, Channon announced shortly after the 1988 Conservative Party Conference that the Department of Transport was considering potential models for rail privatisation (Webster, 1988). In a speech at a Centre for Policy Studies (CPS) conference he listed them and outlined in general the pros and cons of each (see table 4.2) (Channon, 1988). Two of the sale options were lifted directly from the proposals outlined in section 4.3 above - the regional and track authority models - and three, 'BR plc,' sectorisation and a 'hybrid' approach, were new. The BR plc option involved a direct transfer of BR from the public to the private sector in the same way that BT and British Gas had been sold some years before. The sectorisation model was an extension of BR's contemporaneous management structure. Until 1982, BR had been organised largely on a regional basis, with each region managing its own planning, marketing and operation of services, as well as maintaining its own infrastructure. For accounting purposes BR was reorganised in 1982 into five business sectors, each defined to be relatively homogenous in the type of traffic it operated. InterCity provided high speed services between major

conurbations; Network SouthEast served the London and south coast commuter market; Regional Railways operated the remaining, provincial passenger services; and freight and parcels handled the non-passenger trains that their names suggest. Although further reorganisation would have been necessary before privatisation, it was these businesses which the sectorisation model would have sold to the private sector.⁶ Finally, the form of the hybrid model had not been determined by 1988 - instead, it was noted only that this “option would allow some of the better features of the other [proposals] to be incorporated, while avoiding some of the drawbacks” (Channon, 1988: 37).

Model	Advantages	Disadvantages
Regional	Some competition, but largely indirect; Improved moral through local loyalty; Improved flexibility and efficiency	Potential difficulties with network benefits; Problems with through trains between regions; Possible loss of economies of scale; Business ‘mix’ within each region requires division of management attention
Track authority	Promotes competition	On-rail competition limited by railway practicalities, eg economics, capacity; Track authority still a monopoly and difficult to regulate; Track authority remote from rail users; Investment decisions difficult
BR plc	Continuity of style and structure; Minimal cost of privatisation	Not even limited competition; Size of BR has engendered ‘diseconomies of complexity’; Lack of operational transparency
Sectorisation	Avoids problems of operational transparency	Difficulties with track ownership
Hybrid	Better features of other models can be incorporated while their drawbacks can be avoided	

Table 4.2. Advantages and disadvantages of possible rail privatisation models identified by the Department of Transport in 1988. The limited number and nature of points raised indicates that the proposals were still being considered at a general level. Source: Channon (1988).

Despite the emphasis placed on the potential for market liberalisation in some of the 1988 proposals (Redwood, 1988), speculation in the press and elsewhere implied that Channon did not share the enthusiasm of his right-wing colleagues for promoting competition. Channon’s primary concern seems to have been to effect a relatively straightforward sale. Moreover, Channon was not convinced of the logic of promoting competition in a loss-

⁶ The sector names listed here are the most recent to have been used by BR. The sectors were later reorganised under the Organising for Quality (OforQ) initiative (see chapter five) into fully vertically-

making industry, and it was initially reported that he was impressed by the sectorisation and 'BR plc' models of divestiture (Leadbeater *et al.*, 1989; Brown, 1989). Not only would these methods obviate the need for a complex restructuring exercise, but they were also approved by BR's management. A majority of the BRB was known to be "fanatical for a unitary solution," but was prepared to accept sectorisation as a possible alternative (this position was also advanced by Transport 2000 (1989)). In fact, Channon was not particularly swayed by the feelings of the BRB and instead favoured Gritten's (1988) regional approach, at least in part because he had an emotional attachment to it:

"...it would be in different regions again... That's the solution that he would have done - at least, when he left, that was the front runner. He was very keen to do that... he thought it would be nice, people would like to go back on the Great Western or whatever, and that was certainly the chief runner at that stage."

Gritten's original proposal had envisaged considerable scope for market liberalisation (see section 4.3), but Channon was less enthusiastic. He suggested that any competition arising from this model should be largely indirect, rather than 'open access', and that greater passenger benefit would be derived from the improved loyalty, flexibility and efficiency which would result from the removal of a nationalised management structure (Channon, 1988).

Before significant progress on the regional model could be made, Channon was replaced as Secretary of State for Transport by Cecil Parkinson. Parkinson's success at introducing competition into the electricity industry led him to sympathise with David Starkie's view that a degree of rail competition was needed (although he did not favour Starkie's suggestion of how it should be secured). As it stood, Channon's regional model did not really encourage the development of competition (it could only have taken place along the territorial borders of different companies), but circumstances were to militate against Parkinson selecting an alternative. Upon arrival at the Department of Transport, Parkinson discovered that rail privatisation had been somewhat marginalised after the CPS conference in 1988. Officials had become lethargic, "looking at options, looking at more options and [saying] 'let's have a look at some options,'" and the whole exercise was being examined "in a rather half-baked fashion." A respondent recalls Parkinson reminding some civil servants that BR was an important industry, and that "the more important [industries] are, the more essential it is to get the government out."

integrated businesses and the sectorisation model would most likely have involved a similar restructuring exercise to remove some idiosyncracies from the mid-1980s structure.

More significantly, however, Parkinson became aware that Thatcher had again lost interest in selling BR after becoming alarmed at adverse public reaction to Channon's plans (Irvine, 1987). He sent Thatcher a copy of his speech for the 1989 Conservative Party Conference but "got a message back saying she'd be grateful if he'd leave the subject alone and not say anything." Press speculation began to suggest that the government was planning to shelve indefinitely its plans to sell BR (Stephens, 1989), and Parkinson felt it was necessary to emphasise that this was not the case:

"...he got a message back saying she'd be grateful if he would leave the subject alone and not say anything. He actually went to see her in Blackpool and said 'look, if I don't say anything that will be seen as a retreat and... I don't think we should be seen to be backing off.' So they agreed a form of words like 'studies continue.'"

Parkinson was forced to state after the conference that plans for selling BR "are not at the top of my list of priorities at the moment" (quoted in Stephens and Brown, 1989: 10), but he continued to pressure Thatcher into giving a firm commitment to privatise. He acknowledged that the government did not have a mandate to sell BR (a potential sale had not been mentioned in the 1987 election manifesto) but, drawing on his experience with electricity privatisation where "he had arrived at the beginning of a parliament with no plans" at all,

"...he said that he would like to get it in the open so that we could start the discussions and we could develop our ideas. Then, by the time they came back after the next election, which was 1992... we could have [already] developed plans so we could crash straight into the business of getting on with it and reorganising [BR]."

Thatcher relented in autumn 1990 (although it is again uncertain as to why she changed her mind), and Parkinson was able to announce to Parliament that the government was now "determined to privatise British Rail" (*Hansard*, 1990, Col. 606).

In 1990, a decade after Norman Fowler had first suggested privatising BR's core activities, the government had finally announced a firm intention to sell the railways. However, the various disagreements and delays throughout the 1980s had resulted in the Department of Transport undertaking little detailed work on the subject and, as Thatcher (1993: 676) herself notes, privatising BR at that point would still involve "large questions which needed careful thought and economic analysis." One such question was that of competition. Notwithstanding the recent change in the Cabinet's attitude towards liberalising the markets of network industries, Parkinson had been unable to shift the Department of Transport's

policy beyond Channon's vision of a regional solution with no direct competition. Although improving government finances and backbench pressure had enabled Parkinson to press ahead with liberalising the CEGB, they had done little to alter the nature of rail privatisation policy. The bulk of Parkinson's efforts regarding rail privatisation had been devoted to persuading Thatcher of the need to sell BR, rather than exploring ways in which to liberalise its market. Not until Thatcher had agreed to a sale could Parkinson refocus his attention upon how to promote competition.

A working group comprising ministers and officials from the Department of Transport, the Treasury and the Department of Trade and Industry was established in the autumn of 1990 to advance a final solution regarding the privatisation and liberalisation of BR. Parkinson left the Department of Transport before he could contribute in any meaningful way to the group's deliberations, and Thatcher was replaced as Prime Minister in December 1990 (the group was able to proceed without significant objections from Downing Street because her successor, John Major, was an enthusiastic advocate of rail privatisation). Parkinson's replacement, Malcolm Rifkind, shared an enthusiasm for market liberalisation, but concluded that Starkie's model of vertical separation was not necessary and that the simplest means of liberalising BR's market was to modify Channon's regional solution in two ways. First, he saw advantages in keeping the InterCity business intact. Not only would this allow a degree of continuity, but it would also provide scope for some competition between origin/destination pairs served by both InterCity and a regional company. Second, 'open access' operators would in certain circumstances be allowed to operate services in competition with incumbents, as Gritten (1988) had originally proposed.

In contrast, the Treasury and the Department of Trade and Industry supported the track authority option. The Treasury in particular was convinced by Starkie's argument that BR behaved like a monopoly, especially in major commuter areas such as London, and was fully persuaded by the case for vertical separation. The outcome of the track authority option would be similar to the model of privatisation adopted for the bus industry in the sense that it would promote competition for the market, through the competitive tendering of train paths, and competition in the market on the tracks themselves (see chapter one). It is interesting to note, however, that Treasury officials' enthusiasm for vertical separation did not result from experience from the transport sector, but rather following their involvement with the break up of the CEGB. The sale of the CEGB had been a model neoliberal privatisation. Since restructuring, the electricity generating industry had seen genuine

competition emerge and efficiency increase, and the state had been able to significantly reduce its role in the industry's affairs (see chapter two). Although various technological factors had prevented competition being extended beyond the generating section of the industry, rail privatisation was seen as an opportunity to experiment further with vertical separation. As such, an analogy was drawn between the new electricity industry structure and the track authority model of rail privatisation:

“...we were convinced that the model was to try and strip things down to the natural monopoly... accept that was a monopoly and regulate it, but everywhere else bring in competition. So when we approached BR, we said ‘where is the natural monopoly in BR? Let’s strip it down, let’s isolate that, let’s try and break the rest of it up into units which can be open for competition in a variety of ways’... And that’s the model we were convinced of, ourselves, as being right.”

Treasury officials were even able to use the onset of recession to their advantage. Whereas in the past the government had not broken up utilities on the grounds that monopolies fetched a higher sale price, evidence from the electricity privatisation enabled the Treasury to argue that competition created by vertical separation would increase rail operators’ efficiency and thus lower the future subsidy bill.

In light of this disagreement, the working group’s conclusions, outlined in a report in mid 1991, were a compromise. A hybrid solution was recommended, which suggested that there should be a separation of infrastructure and operations throughout most of the UK, but that the London commuter area should remain vertically integrated. Although the Treasury thought that competition would be difficult to introduce in the vertically integrated area, this compromise was accepted because it was estimated, on reflection, that the amount of rail congestion around London would preclude the majority of competitive opportunities in any case. Treasury officials were aware that a degree of social regulation, in addition to the imposition of minimum service levels (see section 4.1), would probably be needed to protect commuters, but had made a strategic concession in a “desperate attempt to get agreement with a pretty damn recalcitrant DoT... [The Treasury] bought that for a quiet life to try and get the rest of it.”

The conclusions of the working group were adopted in principle by Cabinet following the circulation of its report, and the Department of Transport and the Treasury were cleared to finalise policy detail in the run-up to the 1992 general election (the DTI had stepped back from proceedings by this stage). Although the need to secure a genuine move towards market liberalisation had now been agreed, the practicalities and implications peculiar to the

hybrid model had still to be analysed and legislation needed to be drafted. Key officials had hoped, like Parkinson in 1990, to undertake these tasks before the next general election, due no later than spring 1992, in order that the policy could be implemented quickly in the 1992 - 1997 Parliament. As the next section shows, however, a definitive policy decision was not taken as soon as many both within - and outside - government would have liked. It is argued that, as a result, the policy advanced in *New Opportunities for the Railways* was not the result of a coherent exercise in policy analysis and ministers were unclear as to whether their plans would actually be capable of achieving what was expected of them. It was not understood by the government if adopting a neoliberal policy agenda - seeking to maximise competition and minimise the role of the state - would be as appropriate for the railways as it had apparently been for the CEEB.

4.5 Adopting a model for rail privatisation

4.5.1 The advent of franchising

Although the conclusions of the working group were clear, it became apparent during 1991 that Rifkind was not satisfied with them. The Secretary of State attached increasing importance to the sectorisation model, and became keen to re-evaluate its potential benefits (Atkins, 1992). Because this option had not been seriously considered since the CPS conference in 1988, few details regarding its potential implications had been prepared by officials. Rifkind decided to devote manpower to re-examining sectorisation and, as a result, the development of a rail privatisation Bill was temporarily halted. This new delay intensely frustrated the Treasury because it had wanted to forge ahead with drafting legislation as quickly as possible. Nonetheless, officials were able to use the extra time to subject their conception of a track authority to some further analysis and, as it turned out, this was beneficial because by this stage the literature had identified several shortcomings with the idea.

Although there was an apparent analogy between the separation of generation and distribution activities in the electricity industry, and the creation of a track authority for the railways, it is in fact far from perfect (Adamson *et al.*, 1991). Perhaps the most obvious difference is that railway tracks, unlike electricity wires, cannot function as passive conduits. Whereas electricity generated by competing companies can be supplied simultaneously to different customers using the same cables, it is clearly impossible to run two or more trains simultaneously along the same stretch of track. As a result, services between origin/destination pairs have to be run according to a series of dedicated train paths

monitored by a track authority. The Treasury had intended to auction available paths to whoever offered the highest bid (or required the lowest subsidy):

“We had a view... that, if we had the time, one would have devised a rather more sophisticated structure of allocating railway slots, which was effectively a system of auctioning... [but] with some minimum requirements for grossly anti-competitive behaviour like running a train fractionally in front of another train and all that kind of stuff.”

In this way, there would be both competition for the market, through the auctioning of paths, and competition in the market, between winning bidders' train services. It was believed that this would lower the overall subsidy bill, whilst at the same time make those in receipt of subsidy directly accountable for it.

It quickly became apparent that such a scheme would be inoperable, at least in the short term. The heterogeneous nature of rail services - trains serve different markets by running at different speeds and frequencies - means that they are vastly interdependent. Any company bidding for rights to run, for example, a half-hourly stopping service between London Euston and Birmingham New Street would generate certain train-path requirements over a route shared with other operators. Running this service would thus affect the availability of paths for other operators wishing to offer a different type of service on the same, or different, routes. (Two stopping trains per hour could seriously constrain the opportunities to run fast services, for example.) Conflicts arising in this way were resolved by BR through co-ordination in the timetabling process, but in practical terms it would be extremely difficult to replicate this through market mechanisms (Nash, 1990; Nash and Preston, 1993). Bids from different companies for potential services over the whole network would inevitably clash, and a first auction would become impossible - unsuccessful tenderers would therefore need to reconsider their need for paths in the knowledge that some were already allocated to a competitor. Not only would assembling a timetable in this manner be tortuous, but it would also introduce considerable financial uncertainty for bidders (Adamson *et al.*, 1991).

Moreover, even if paths could be efficiently allocated, day to day operational problems were identified in the form of *externalities* and the loss of *network benefits*. Externalities can be divided into two categories, 'train to train' and 'track to train' (Jones *et al.*, 1993). The former occur as delays to one service, perhaps owing to locomotive breakdown, affect the running of others, whereas the latter arise as trains are delayed by a failure of the infrastructure. Both have a 'snowballing' effect because of the interdependency of rail

services, and their resolution presents a host of complex problems. As Foster (1992) notes, each late train requires a consequential decision: shall following trains be delayed? Whose train? Who should then compensate whom for lost traffic? It became evident that, even with a logical (yet elaborate) accounting scheme, such problems would probably not be soluble without considerable goodwill from the multitude of operators. Of course, the existence of such goodwill in a 'new' industry could not be guaranteed.

Network benefits are advantages which accrue to passengers from the existence of a unified railway network (*House of Commons Papers*, 1993a). Tickets can be purchased from any one station on the network to any other; and tickets can be 'inter-available' - that is to say, passengers can purchase one ticket and use it on any train between an origin/destination pair. As Jones *et al.* (1993) point out, the fragmentation of rail operations can result in problems with co-ordinating the sale of 'through' tickets which involve numerous changes of operator, and/or the cessation of ticket inter-availability (see chapter six) if it is deemed anti-competitive. In cases of the latter, rail would lose its 'turn up and go' facility because passengers would have to buy operator-specific (or 'dedicated') tickets. A passenger wishing to travel from, say, Plymouth to Exeter St David's might purchase a ticket to use an infrequent Regional Railways train because it were cheaper, but in so doing he would forfeit his right to travel by more frequent InterCity services.

Finally, arguments unconnected with trainpath auctioning were advanced in opposition to the track authority model. The Department of Transport had noted (Redwood, 1988) that effecting a track-train split could result in the track authority abusing its monopoly; that the track authority would be remote from rail users and responsibility for service shortcomings would be difficult to pin down; and that investment would be difficult to attract and co-ordinate (see also Helm and Thompson, 1991).⁷ The combination of all the above factors led Adamson *et al.* (1991) to question whether the passenger train industry could be reorganised into a potentially competitive industry if it was vertically separated. Bradshaw (1991: 25) went further, suggesting that the track authority offended "every professional

⁷ Further objections to the track authority concept were advanced by transport academics after the Treasury's deliberations had concluded. Among these - some of which are expanded upon later where relevant - were: the loss of cross-subsidisation opportunities for operators (Glaister and Travers, 1993); the incompatibility of franchising and open access operations (Charlton *et al.*, 1997); an increase in transaction costs between operators and the track authority (Else, 1996); the difficulties of co-ordinating maintenance work and investment between train operators and the track authority (Dodgson, 1994); the (in)appropriateness of establishing a heavily contractual industry structure (Foster, 1994); and problems with creating train operators with no day to day control over a chief aspect of their operations, i.e. their infrastructure (Shires *et al.*, 1994).

principle of railway operation” and was “likely to result in an outcome which will be expensive, unsuitable and unsafe.”

The Treasury conceded that its plans for a system of train path auctioning would be unworkable given the limited time available to address the above issues. As an alternative, passenger rail franchising was suggested. Franchising had been employed by the government in selling other industries, especially local authority services (see chapter two), and was perceived by the Conservatives to be a generally successful method of privatisation (see also chapter seven). Rail franchising would combine groups of train paths, perhaps over a given area, to be offered to the private sector as one package. In this way, the retention of some competition for the market would be allowed through a tender for subsidy relating to the whole package of routes, and competition in the market would occur in border areas where operating territories overlapped. In addition, open access operations would be permitted, where a market for them existed, subject to operating constraints arising from franchise commitments.

Franchising was seen by the Treasury as a “much cruder model” than the “sophisticated auctioning of... slots,” but it was a means of addressing the problems which would have arisen under a regime of train-path auctioning. By combining the path requirements of numerous services, the potential for reducing the number of operators on the network - and thus the complexity of inter-operator dealings - would be considerable: trains could be co-ordinated in a central timetable before franchises were let (with a degree of flexibility retained for private operators to re-arrange service patterns in the future); the majority of train to train externalities could be ‘internalised’ because delays to any given service would principally affect other services run by the same operator; the resolution of track to train externalities would be simplified for the same reason; and attempts to secure network benefits would be somewhat more straightforward with a smaller number of operators working to a co-ordinated timetable. Once a framework to resolve these issues in the context of franchise operation had been established, it was suggested that open access services could be slotted in around existing services with relative ease.

Franchising did not provide a complete solution to the train-path auctioning problems identified above - it only moderated them - and there was still no guarantee that they would be straightforward to resolve. Nevertheless, the Treasury had at least been working within the framework of the hybrid model suggested by the 1991 working group. In contrast, the

Department of Transport's position on rail privatisation, following Rifkind's decision to re-evaluate sectorisation, had fallen into disarray. Rifkind continued "agonising over whether InterCity should be vertically integrated or not," and the remainder of 1991 was a "saga of... grief within the DoT." So long as the Department of Transport failed to commit itself to a formal policy option, the government was unable to draft legislation. With hindsight, it is obvious that decisive action was required by Downing Street at some point during this period in order to restore a sense of direction to rail privatisation policy. What actually happened, however, was precisely the opposite. Rather than instructing the Department of Transport to accept the hybrid model, Major's policy unit began advancing solutions of its own based around the regional concept. Downing Street's action served only to confuse matters further, and there was "tremendous faffing around... between the Department [of Transport], the Treasury and the cabinet secretariat who were trying to pull [rail privatisation policy] together - and not succeeding." At least three models were now being considered - hybrid, sectorisation and regional - with none, other than the track authority element of the hybrid model, having received anything more than a cursory analysis.

4.5.2 Framing the policy

The government was obliged to call a general election by spring 1992, but at the beginning of that year there was still no consensus between Departments about rail privatisation. A White Paper on the subject had been promised for before the election but it was being delayed as ministers and officials continued to argue over the most appropriate industry structure (*Financial Times*, 1992a). As polling day neared, policy necessarily became considered in the context of an election campaign. One respondent pointed out that, "by the end of [1991] we'd lost a whole bloody year faffing around, most of it Rifkind's fault, and number 10 suddenly said 'we've got to write an election manifesto.'" Thus:

"...the deal was brokered not in the context of considered papers or great meetings; [it] was brokered by a guy... in the policy unit at Number 10 essentially - almost literally - walking around Whitehall with the bit for the manifesto. That was the way the final deal was done."

It is perhaps an overstatement to refer to the manifesto commitment as a 'deal'. The only firm policy decision which appears to have been taken in terms of industry structure by April 1992 was that of ruling out Rifkind's sectorisation model (Tomkins, 1992a). The manifesto (Conservative Party, 1992: 35-36) promised a track authority ("one part of BR will continue to be responsible for all track and infrastructure") and at the same time kept alive the possibility of regions ("our aim will be... to reflect regional and local identity... we

want to... recapture the spirit of the old regional companies”). The wording could have referred to the hybrid solution, where BR would maintain control of operations in the Network SouthEast territory; the universal track authority solution; or a vertically integrated regional solution, where the infrastructure would be divided among several track authorities coinciding with the territories of train operators. As a respondent, who had been observing developments from outside government circles, correctly guessed:

“...minister X wanted something in about competition, minister Y wanted something in about regions and so on. So they just cobbled something together which appeared, in manifesto terms, to satisfy all this lot. And they went with that.”

When John MacGregor was appointed as Secretary of State for Transport following the Conservatives’ election victory in 1992, there was “not quite a blank sheet of paper as our election commitment, but very close to it. Just a few outlines about how [rail privatisation] might work.” Another respondent added that because of “Rifkind blowing [1991] out of the water and things being resolved in the context of drafting the manifesto, when they won the election we had nothing drafted at all. There was no base.” MacGregor’s job was to resolve the debate over industry structure and present a Bill before Parliament as soon as possible. Although ministers were quoted as saying privatisation would be gradual and might take up to 10 years (*Financial Times*, 1992b), the real intention was always to complete the sale before the next general election. As a former minister pointed out, “you either did it or you didn’t - and if you did it, you had to complete it.”

Along with officials and ministerial colleagues, MacGregor undertook a “huge amount of work” in May and June 1992 to frame final proposals outlining how BR would be privatised. MacGregor was also convinced of the need to promote competition between train operators, and:

“He spent the first two months [after the election] making up his own mind as to whether the framework - almost the blank sheet of paper in the manifesto - was the right framework or whether we should go differently. Horizontal and vertical integration was one crucial aspect of that.”

MacGregor was further assisted by Sir Christopher Foster who had been appointed as a special advisor on rail privatisation. Foster was, like the Treasury, a proponent of the track authority model (despite having severely criticised it at the CPS conference some years before), and he outlined his views in his subsequent publication, *The Economics of Rail Privatisation* (Foster, 1994). Foster’s arrival at the Department of Transport suited

Treasury ministers and officials because it increased the likelihood of them realising the option they had originally advocated. And so it was to be: although Foster recalls Departmental misgivings regarding the track authority model, a blueprint was “hammered out” and it was accepted as the government’s official policy shortly thereafter.

Former BR chairman Bob Reid identifies Foster’s view as being the primary influence behind MacGregor’s decision to adopt the track authority model. In 1995, he contended that the debate over how to privatise BR “was a dogmatic argument of three or four years ago. We lost [BR had, of course, supported a vertically integrated solution]. It means we now have a structure that is more complicated than necessary. Our view was subordinated to the view of one consultant who had never run anything” (*The Guardian*, 1995). But Reid’s contention overlooks the influence of the Treasury, whose desire to maximise competition had seen it campaigning for vertical separation since 1990, and it is worth considering how far the Department of Transport could realistically have adopted anything other than the Treasury line. With Rifkind’s sectorisation plans rejected in the manifesto and the vertically integrated half of the hybrid model still incomplete, the track authority proposal had at least been subjected to a relatively comprehensive policy analysis. Moreover, a new European Community directive, 91/440, which required member states to introduce split accounting into their railway industries, now further supported the case of those in favour of vertical separation (see Knill and Lehmkuhl, 1998).⁸ MacGregor reviewed arguments for and against the various models of rail privatisation, but it seems that his hands were tied. Alternative models were insufficiently developed and, if the railways were to be in the private sector within the 1992-1997 Parliament, there was not enough time to analyse them further. The track authority model was effectively MacGregor’s only choice. The Treasury remains adamant that, notwithstanding Foster’s preferences, the final decision to adopt the track authority model was taken principally as a result of its sustained campaigning in the face of continuing disarray within the Department of Transport. Although the recollections of various people differ, this view is corroborated by a former Transport minister:

“Put it this way. MacGregor stood back and reviewed the options to familiarise himself with his brief at Transport. He just wanted to make sure that vertical separation would work. He may have said in

⁸ EC 91/440 requires that member states’ railways account for their infrastructure and operations businesses independently of one another. The idea is that trans-Europe freight and passenger movements will increase as one member state’s rail operator could gain access to another’s tracks following the simple calculation of a track access fee. Because the whole process is transparent, discriminating in favour of the incumbent operator becomes more difficult. However, it is important to emphasise that the directive only requires separate *accounting* - it does not require separate ownership of track and trains.

public, ‘we’re doing another consultation’, but in reality we all knew what the outcome would be... The Treasury won.”⁹

Thus it is apparent that, despite the protracted evolution of rail privatisation policy, the decision to adopt the track authority model was not the result of a coherent policy analysis. Despite the existence of numerous models advanced by academics, think tanks, civil servants and politicians, the Department of Transport was unable to decide upon a suitable method of selling BR and agreement regarding how the railways would be privatised was for a long time not found within government. Vertical separation was favoured by the Treasury because it was seen as the most likely means of maximising competition and minimising the role of the state on the basis that it had been successfully applied to the CEGB when the electricity industry was privatised in 1991. The Treasury’s assumption was that the model used to sell the CEGB could, with only a few minor changes, simply be transferred to the privatisation of BR. John MacGregor had little choice but to accept the Treasury’s argument.

In reality, of course, relatively little consideration had been given to whether or not the track authority model was an entirely suitable approach to privatising and liberalising the railway industry. Although a respondent argued that there had been “substantial analysis of many points,” this had necessarily been conducted at a general level. Despite the more obvious shortcomings in the Treasury’s analogy between a track authority for BR and the National Grid for the electricity industry having been identified, and ministers satisfying themselves regarding essential considerations such as safety, the government still had little more than a framework; there was very minimal *detail* beyond it. To highlight a few key issues, little had been worked out regarding: the calculation and allocation of track access charges; the formation and vesting of successor rail companies; the specifications and administration of franchises; the precise functions and responsibilities of the regulators; the likelihood of privatising the structure within one Parliament or the probable cost of the exercise. Most importantly in terms of this thesis, the opportunities for, and appropriateness of, service competition and the potential impact of market liberalisation upon the relationship between the railways and the state had not been adequately examined. Ministers could not be sure that the track authority model would actually be capable of providing what was expected of it; although it was known that neoliberal values would be

⁹ This passage is a joining together of quotes obtained in two separate interviews with the same respondent. The intent of each has been retained.

compromised by the state's continuing payment of subsidy (see section 4.1), policy makers could not be sure that the plans contained in *New Opportunities for the Railways* would be capable of promoting actual, rather than surrogate, competition.

4.6 The new railway structure

Having finally decided upon vertical separation, ministers were now faced with the task of formulating policy detail and producing a workable industry structure. This was essentially undertaken over a three year period between 1992 and 1995, beginning with the publication of *New Opportunities for the Railways*. The document noted that ministers wished to see “a reliable, efficient operation offering high quality services to users,” and confirmed the view that “the introduction of competition... and the ending of BR's monopoly in the operation of services will be instrumental in achieving this” (Department of Transport, 1992a: 1). The government's wish to liberate private sector management from state control in order to harness its “skills, flair and entrepreneurial spirit” was also emphasised (Department of Transport, 1992a: i; Welsby and Nicholls, 1999). The White Paper set out the government's commitment to establishing a track authority, Railtrack, and to splitting BR's passenger services up into franchises which would be awarded by competitive tendering. In addition, the document noted the intention to provide for private sector operators of passenger services to engage in on-rail competition with franchisees. This would mean that:

“...companies wishing to provide new railway services... will have a right of access to the railway network... [At present], there is no choice of operator for the rail passenger... liberalising access to the network will [provide] the opportunity for new operators to run services. This will give... rail operators the stimulus of competition to provide better service quality and value for money” (Department of Transport, 1992a: 13).

Responsibility for negotiating, awarding and monitoring franchises would be transferred to a new Franchising Authority, whilst the rights of access for both franchised and non-franchised operators would be overseen by a new Rail Regulator.

New Opportunities for the Railways attracted numerous hostile commentaries, not least because the plans appeared ill-considered and lacking in detail. Of course, a White Paper is not necessarily the place in which a thorough exposition of a new government policy is found. Nonetheless, *New Opportunities for the Railways* was seen by many as being exceptionally vague. The then Chairman of the Transport Select Committee, Robert Adley MP, argued that a Green Paper should have preceded the White in order to allow a fuller debate of its detail and likely implications before legislation was published (*Hansard*,

1993a). MacGregor did not deny that “in working through some of the proposals, it is clear that much work remains to be done” (*Hansard*, 1992a: Col. 974). Crucial aspects of the work to which MacGregor referred were not, in fact, completed when the Railways Bill was presented to the House of Commons in early 1993 (Nash, 1993). As later chapters will show, certain issues had proved complicated to resolve and, because of the need to proceed with rail privatisation as soon as possible, it was decided not to wait until the plans were fully formulated before drafting legislation. The solution was to produce a Bill which contained numerous enabling powers and to continue policymaking during, and after, its passage through Parliament. As one respondent who was involved in drafting the legislation admitted, “the Bill was a mess, and it had lots of enabling powers rather than specific proposals... [because] the thing wasn’t properly prepared.”

During the Bill’s second reading, Liberal Democrat MP Nick Harvey mocked its vague content when he pointed out that:

“the Bill comprises 132 clauses and 11 schedules and gives massive powers to the Secretary of State... It might have been preferable to have had a Bill of one clause which simply said ‘the Secretary of State can do what he likes, how he likes when he likes and where he likes.’ It would have had more or less the same effect” (*Hansard*, 1993b: 190).

MacGregor, in contrast, argued that “the principles and the main structure of the Bill are entirely consistent with [those in] the White Paper” (*Hansard*, 1993b: 160). It is true that the offices of the Rail Regulator and Franchising Director were established, along with the concept of franchising and several technical details such as closure procedures. Beyond this, however, MacGregor’s assertion is somewhat spurious. Although a deviation from the White Paper was *unlikely* because of the circumstances in which the policy had been decided, the Bill was not necessarily consistent with *New Opportunities for the Railways* in several crucial areas precisely because it was vague. To illustrate, no details were provided as to: the structure of the industry (the Bill noted merely that the Secretary of State could instruct the BRB to form a number of companies); the framework within which on-rail competition could develop (it was stated only that a facility owner might be instructed to allow more than one company access to its assets); or how it would be regulated (although some duties were assigned to the Regulator and the Franchising Director, the majority of their functions were to be prescribed by the Secretary of State at a future, unspecified, date) (House of Commons, 1993).

The majority of these details were finally forthcoming in 1994, and are summarised in *Britain's Railways: A new Era* (Department of Transport, 1994). Although the 'new' railway appears complex in comparison with its predecessor, BR, the structure is in fact quite logical when viewed in the context of the electricity industry privatisation (or, indeed, any industry which is characterised by a substantial vertical division of labour). A brief overview of the new structure is presented here, although further details regarding the provision of passenger services are given as appropriate in chapters five and six. As indicated in the White Paper, BR was divided into two basic elements: infrastructure and operations. Control of the rail infrastructure passed to Railtrack, which became responsible for the safety, maintenance and renewal of the railway network, and now operates in seven zonal divisions¹⁰. Railtrack also co-ordinates train movements and, subject to the Regulator's approval, grants train operators access to the track.

BR's operations business was divided into 91 separate companies which can be placed in six groups that reflect the nature of their activities (Department of Transport, 1994; 1996). These are:

- *Train Operating Companies (TOCs)* - 25 franchises to provide passenger rail services. The franchises were awarded to the private sector by competitive tender and, at the time of divestiture, the TOCs accounted for passenger services formerly operated by BR. In addition to the 25 TOCs, the Railways Act provided for the operation of non-franchised passenger services on an 'open access' basis. These trains would run in addition to those operated by TOCs to stimulate further on-rail competition (see chapter six).
- *Freight* - seven companies to operate freight trains. Five (Rail Express Systems, Loadhaul, Mainline, Transrail and Railfreight Distribution) were sold to a business consortium led by Wisconsin Central Transportation, now trading as English, Welsh and Scottish Railways (EWS). Red Star Parcels and Freightliner were sold to management buy-out teams (MBOs). Open access competition in the freight sector is also provided for by the Railways Act.
- *Rolling Stock Companies (Roscos)* - three businesses, Porterbrook Leasing, Eversholt Leasing (now Forward Trust Leasing) and Angel Trains Contracts, established to lease

¹⁰ Railtrack does, however, lease most of its stations and light maintenance depots out to train operators. The company has retained direct management of only 14 stations throughout the network: London Charing Cross, London Euston, London King's Cross, London Liverpool Street, London Bridge, London Paddington, London Victoria, London Waterloo (excluding Waterloo International), Birmingham New Street, Edinburgh Waverly, Gatwick Airport, Glasgow Central, Leeds and Manchester Piccadilly. Railtrack was privatised by share issue in 1996.

rolling stock and locomotives to the TOCs. BR's railway vehicles were divided such that each Rosco owned a balanced portfolio at the time of divestiture.

- *British Rail Infrastructure Services (BRIS)* - 20 companies concerned with the maintenance of track and signalling established initially on a regional basis.
- *British Rail Maintenance Limited (BRML)* - seven businesses to undertake the heavy overhaul of rolling stock and locomotives.
- *Central* - 27 companies to provide general support services to the industry such as telecommunications, consultancy and research.

With the exception of TOCs, all businesses were sold outright to the private sector. A full list of all the rail businesses established, along with their sale details, is provided in appendix four.¹¹

Companies within the new structure interact on a commercial, contractual basis, and the whole system is essentially financed through the TOCs. TOCs' payment of track access charges, rolling stock leases and other bills in turn enables Railtrack and the Roscos to let contracts for maintenance, renewal, support services and so on (see figure 4.1). Subsidy is paid to the TOCs to cover any shortfalls between their costs and revenue receipts, and the amounts payable were determined by competitive tender during the franchising process. All TOCs receive a declining level of subsidy - thus increasing their risk of financial loss - because their bids were predicated on a substantial growth in business over the coming years. If a franchisee goes bankrupt, the state reassumes control of the affected TOC(s) and initiates a new round of tendering. Subsidy cannot be paid to open access operators, as their services must be run on a commercial basis.

Despite predictions that the government would save money through vertical integration (see section 4.4), the overall level of subsidy payable to the railway industry has increased dramatically as a result of the track authority model (Knowles, 1998). By splitting BR into 92 companies, the government vastly increased the transaction costs within the industry because each new business needed to trade at a profit (see table 4.3 and Else, 1993). When the railway was still in public ownership, the net subsidy payable by the government was similar to that prior to reorganisation because the Treasury would administer and receive the profits made by all 92 companies (these have been estimated by White (1988) as

¹¹ The assets of European Passenger Services (which operated Eurostar) and Union Railways passed to central government prior to their divestiture. The two companies were combined as part of the Channel Tunnel Rail Link (CTRL) deal.

amounting to around £880m).¹² When these companies were privatised, however, their profits passed to the private sector while the level of subsidy remained static. White (1998) has calculated that, even when sales revenues from Railtrack, the Roscos and other rail businesses are accounted for, privatising BR could incur a net *cost* to the state of as much as £2.2 billion (Harris and Godward (1997) suggest this cost might be as high as £5 billion). The potential for net gains depends heavily on declining subsidy payments to TOCs which were secured during the franchising process. The issue of subsidy in terms of this thesis is discussed further in chapters five and seven.

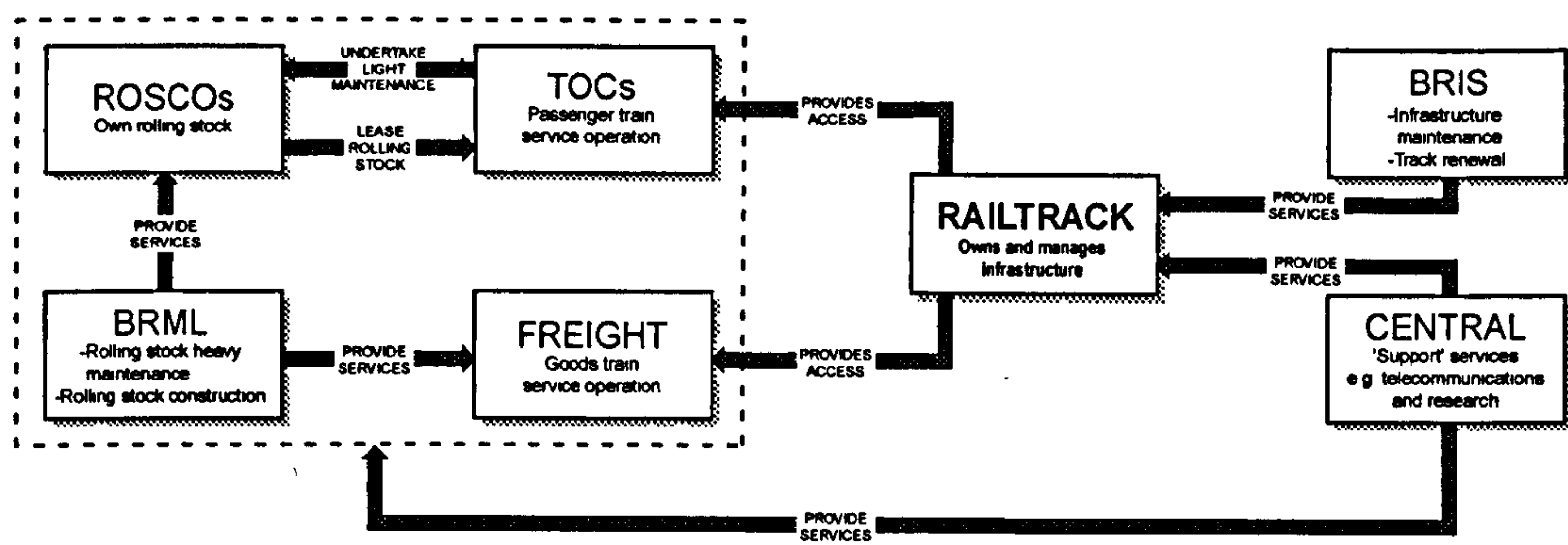


Figure 4.1. Company-group interactions in the new railway structure. Source: Charlton *et al.*, 1997.

Year	Grants to passenger services (£m)
1990/91	752
1991/92	1022
1992/93	1301
1993/94	1092
1994/95	2161 (1281)
1995/96	2074 (1194)
1996/97	2103

Table 4.3. State support to the passenger rail industry in Great Britain, 1990/91 - 1996/97. An estimation of net state support paid whilst the restructured BR was still in public ownership is shown in brackets. Source: White, 1998.

The creation of a number of companies within each group provided the potential for competition not only among train operators but, excepting the infrastructure, throughout

¹² The increase in BR's 1992/93 support can be explained in part by additional costs incurred by works associated with the channel tunnel. Two factors account for the difference between BR's 1993/94 support and that paid in following years: industry restructuring costs and the cessation of loans previously being made to BR (White, 1998).

the whole industry. In theory, a TOC can choose between competing Roscos; Railtrack can choose between competing track maintenance companies, and so on. Leaving passenger train operators aside (they are considered in chapters five and six), competition has often been slow to emerge throughout the industry. Partly this is because the government misjudged market conditions (for example, the relatively small rail freight business could not support seven discrete companies) and partly it is owing to the nature of contracts drawn up to formalise working arrangements between each of the individual businesses (Charlton *et al.*, 1997). Most firms were sold with fixed term contracts which guaranteed them a market for a finite period (thereby raising their sale value above a nominal level). For example, whereas in theory TOCs could choose between three competing Roscos to negotiate rolling stock deals, in practice most leasing contracts were designed to match the length of the first franchise period (OPRAF, 1996a); TOCs are therefore bound by *de facto* monopolists. The same was initially true of Railtrack's relationship with the BRIS units, although some competition is now taking place for infrastructure maintenance contracts (SBC Warburg, 1996; *Modern Railways*, 1998a). Of course, many would argue that the imposition of fixed term contracts was a necessary stabilising measure in a newly restructured industry, and that competition will emerge when current deals expire and are re-negotiated. This will to some extent be the case, although a marked trend of horizontal and vertical integration currently occurring within the industry could limit considerably the potential for market liberalisation in the future (see, for example, Charlton *et al.*, 1997; Curwen, 1997; Simonian, 1996).

The regulatory framework within which the industry operates was established in large part by the Regulator and the Franchising Director, following directions from the Secretary of State. At the simplest level, the Regulator is responsible for granting and monitoring licences to TOCs, approving access agreements between Railtrack and train operators, protecting consumers and promoting competition (Office of the Rail Regulator (ORR), 1996). Constitutionally, the regulator is independent from government, although he was required to take account of guidance from the Secretary of State until January 1st, 1996. The Franchising Director was given the roles of transferring the TOCs from the public to the private sector as quickly as reasonably practicable, paying subsidies to (and, in some cases, collecting premiums from) TOCs, and undertaking consumer protection measures which complement those of the Regulator (OPRAF, 1994; 1996a). Unlike the Regulator, the Franchising Director does not enjoy constitutional independence from government, primarily because he administers subsidy on its behalf. As a result, he is obliged to follow Objectives, Instructions and Guidance given to him from time to time by the Secretary of

State. Whereas the roles of the Regulator and Franchising Director in relation to this thesis are discussed in more detail later, fuller analyses of the interaction between all the various actors in the new railway can be found elsewhere in the literature (see, for example, Bradshaw, 1997b; Curwen, 1997; Charlton *et al.*, 1997; Department of Transport, 1994; Harris and Godward, 1997; OPRAF, 1996a).

4.7 Conclusion

This chapter has reviewed the development of rail policy in the context of privatisation and market liberalisation established in chapter two. The track authority model of rail privatisation was employed to break what was perceived by the government as BR's monopoly of train service provision (see Starkie, 1984). It essentially represented further experimentation with the method used to privatise the electricity industry (Charlton *et al.*, 1997; Helm, 1996; Mountford, 1996) - which had promoted actual, rather than surrogate, competition - and was supported by the Treasury on that basis. A common carrier, Railtrack, was created and the remainder of BR's operations were split into 91 separate companies in order to maximise competitive opportunities (Gibb *et al.*, 1998). However, this chapter has shown that, despite rail privatisation having been considered by government for more than a decade, the privatisation and liberalisation plans outlined in *New Opportunities for the Railways* (Department of Transport, 1992a) were not the result of a coherent exercise in policy analysis. Despite a significant conceptual and empirical base for evaluating rail privatisation policy options - models advanced by think tanks, academics, politicians and civil servants were complemented by the practical experience of other network industry divestitures - the Department of Transport was unable to decide upon a suitable model for rail privatisation, and agreement regarding a method of selling BR could not be found within government. The track authority model was ultimately chosen by MacGregor not because it was best suited to the future needs of the railway industry, but because it was the only viable policy option - in the sense that others had not been sufficiently developed - given the time constraints in which he was forced to work.

The wrangles among policy makers prevented sufficient *ex ante* analysis of the track authority model before it was announced in *New Opportunities for the Railways* and, as a result, the plans were ill-prepared and lacking in practical detail. John MacGregor defended the logic of the government's proposals to Parliament and the Transport Select Committee, but the chairman of Committee, Robert Adley, remained sceptical, noting that:

“...the Secretary of State, the Minister of State and Department [of Transport] officials have appeared before this committee and... it seems to me that none of them, quite frankly, have a clue about how all this is going to be worked out” (*House of Commons Papers*, 1992b: 52).

Although it had been realised that the analogy between the separation of generation and distribution activities in the electricity industry and the creation of a track authority for the railways was far from perfect, policy makers had been unable to fully appraise the likelihood of vertical separation accomplishing what was expected of it in the case of BR. Key questions regarding all aspects of the track authority model had still to be resolved when the White Paper was published; of fundamental importance to this thesis is the fact that the opportunities for, and even appropriateness of, service competition and its potential impact upon the relationship between the railways and the state had not been investigated. Although it was known that neoliberal values would be compromised by the state's continuing payment of subsidy, policy makers could not be sure that the plans contained in *New Opportunities for the Railways* would be capable of promoting actual, rather than surrogate, competition. Against this background, the following chapters now examine the detailed development and the outcome of this aspect of rail privatisation policy. The discussion investigates competition *in* the market in chapter six, but begins in chapter five by assessing competition *for* the market through the franchising process.

Chapter Five

Competition for the passenger railway market

5.1 Introduction

Chapter four argued that the industry structure advanced in the White Paper *New Opportunities for the Railways* was not adopted as the result of a coherent policy analysis, and that ministers and officials had been unable, by July 1992, to consider many of the intricacies associated with the model they had proposed. Importantly in terms of this thesis, the prospects for, and even appropriateness of, liberalising the passenger railway industry were unknown in 1992. This chapter focuses on the development and outcomes of the franchising policy adopted to promote competition for the passenger rail market.

Since 1996, numerous authors have reviewed the franchising process in relation to both the level of competition it generated and the benefits (or otherwise) it bequeathed to rail users and taxpayers (Glover, 1997; Harris and Godward, 1997; Knowles, 1998; NAO, 1996; Powell, 1997; White, 1998). Whilst there is no consensus regarding the effects of franchising on the overall quality of privatised rail services, it is generally agreed that the process was successful in terms of generating competition for the passenger rail market. All 25 TOCs were transferred to the private sector by April 1997, and the number of shortlisted bidders in each franchise round ensured the generation of “relatively intense” competition (Preston, 1997: 15; White, 1998). The NAO (1996: 25) confirmed that OPRAF had attracted and maintained a “good level of competition” in the early bidding rounds, and Knowles (1998) found that the franchising process became more competitive over time. Subsidy levels will be significantly lower than those claimed by BR at the time of letting, and a number of market-driven quality of service enhancements were also secured as a result of the tendering process (Knowles, 1998).

It is not the purpose of this chapter simply to restate the conclusions of the above studies, but rather to develop an understanding, in the context of arguments already advanced in this thesis, of how franchising policy developed, why it became successful at generating competition and what impact it has had on the relationship between the rail industry and the state. Despite the intensity of competition ultimately generated for the passenger rail market, it was for a long time unclear as to whether the private sector would actually bid for the right to run TOCs. For a variety of reasons, some unquestionably the result of events

discussed in chapter four, many potential bidders viewed rail privatisation as something of an uncertain proposition. Although some (notably Stagecoach and Virgin) had expressed an interest, others suggested that they were not persuaded of the government's case and would be unlikely to bid in competitive tendering rounds (*House of Commons Papers*, 1993a). Tomkins (1993) found that private sector interest in rail franchising was extremely low, with most TOCs attracting little or no corporate interest. Moreover, although the government argued that healthy competition would be assured by the presence of Management Employee buy-outs (MEBOs), a large majority - 91 per cent - of BR managers were opposed to the track authority method of privatisation, and almost three-quarters indicated that they did not see MEBOs as a primary means of privatising TOCs (Smithers, 1993a). Financiers were also sceptical to the point that one, NatWest, refused to become involved with rail privatisation (Grantham, 1998), and Preston (1996) raised concerns about the risk of the entire franchising process being characterised by minimal competition and collusion among bidders.

Against this background, sections 5.2 and 5.3 of this chapter examine the development of passenger rail franchising policy. It is argued that the nature of the franchising policy finally adopted was heavily influenced by the government's need to convince the private sector of the viability of passenger rail franchising. Focus shifted from the ideological to the practical because senior policy makers harboured doubts as to whether they would be able to create a market for passenger rail franchises (*House of Commons Papers*, 1996). Certainly, the degree of competition which ultimately developed among franchise bidders was considerably in excess of that which officials had expected. Sections 5.4 and 5.5 review the extent to which the franchising market was ultimately contested and seek to ascertain, from a bidder's perspective, the principal reasons why this was so. Finally, the chapter concludes by considering the franchising process in terms of the extent to which it impacted upon the role of the state in the passenger railway industry.

5.2 Passenger rail franchising: an uncertain proposition

Several factors can be argued to have made passenger rail franchising appear unattractive to potential bidders. First, as noted in chapter two, the British economy had slumped into recession by 1992, and the viability of the whole rail privatisation exercise was being undermined by the prevailing economic conditions. While the fortunes of many industries are tied up with the overall performance of the economy, this is especially true of the railways (Nash and Preston, 1993). In previous recessions, fewer jobs in the major

conurbations had led to a decrease in the number of rail commuters, and the demand for leisure travel had fallen as people re-evaluated their expenditure priorities. Potential bidders were aware that the economic downturn of the early 1990s was having the same effect as the government was again being forced to increase BR's subsidy (Welsby and Nicholls, 1999). In 1989/90, the final 'boom' year of the late 1980s, the total government grant to BR had been £705 million, but by 1991/92 it had risen by over 40 per cent to £1035 million (Nash and Preston, 1993). Prospective franchisees were very much aware that subsidy following privatisation was unlikely to be so flexible, especially if it were determined by contract, and that they could be left in severe financial difficulties in a future recession.¹ Moreover, concern about the viability of rail privatisation was heightened following the collapse of two private-sector initiatives in the early 1990s. Charterail, a private sector freight company, fell into receivership, and Stagecoach withdrew its Aberdeen-Edinburgh-London and Glasgow-London overnight services because of lack of demand (Dynes, 1992; White and Smithers, 1993).

Second, the rail privatisation plans were facing hostility from interested parties both within, and outside of, the railway industry, and this had the effect of "talking the risks up and the value down." As already noted, most BR managers disliked the track authority model and rejected the idea of MEBOs as a principal vehicle of rail privatisation (Smithers, 1993a). Although many of these managers were subsequently to modify their opinions (as section 5.5 will show, MEBOs were submitted for most TOCs), their misgivings in 1993 did not serve to endorse the franchising proposition. The rail privatisation plans were also being criticised by journalists (NAO, 1998a), transport academics (Bradshaw, 1991; Dnes, 1993; Harman, 1993) and politicians of all major parties - including senior Conservative backbenchers (*Hansard*, 1993a) - but perhaps the most effective opposition campaign was being led by the Labour Party, which had committed itself to a "publicly owned, publicly accountable" railway (Labour Party, 1996).² Labour exploited the government's small

¹ Conversely, of course, if the economy were to pick up after the franchises had been let, the government would have been burdened with a disproportionately high subsidy bill.

² This phrase is somewhat misleading. Labour did not expect rail privatisation to be completed by the time of the 1997 general election (Grantham, 1998) and, as such, resolved to keep what had not been sold in public ownership. It was not the case that an incoming Labour government would have repurchased companies where this involved significant capital expenditure: "Some people have argued that Labour could have halted the privatisation by simply seeking to repurchase parts of the rail network that have been sold off so cheaply. This is untrue. In the case of Railtrack, a promise to repurchase at anything less than the market price would be illegal under European law. A promise to repurchase at market price would... require considerable public resources, meaning that the taxpayer would be hit twice. It would also ensure that there would be insufficient resources left for investment. The challenge for an incoming Labour government is to deliver the improved railway network that we need whilst guaranteeing value and accountability for taxpayers' money" (Labour Party, 1996: 20).

majority and, although it was not absolutely certain that the Conservatives would lose the forthcoming general election, based the authority of their attacks on the probability of this happening. Opposition spokesmen made clear their contempt for rail privatisation (*Hansard*, 1992b), and promised that the operational environment for franchise holders would be considerably more demanding under a Labour administration than a Conservative one (Labour Party, 1996). As Michael Meacher, then Shadow Transport Secretary, told the Labour Party Conference:

“If there are any investors thinking of buying into our rail system, I have a message for you. The railways depended on public subsidy last year to the tune of £1.8 billion. There can be no guarantee from any government that such a subsidy will continue indefinitely at that level... If you want to buy a pig in a poke in all those circumstances, it’s up to you. But don’t come crying to me when it all ends in tears” (quoted in Landale, 1995: 12).

Third, there was no international precedent for the proposed model of rail privatisation from which prospective bidders could judge the likely implications of acquiring a franchise. Although other examples of rail privatisation existed around the world, Britain’s plans were unique in their complexity (Shires *et al.*, 1994b). Schemes in Japan, New Zealand and Argentina had all been undertaken on a vertically integrated basis, and whilst the Swedish approach had created a track authority, the post-privatisation industry structure remained relatively simple in comparison with that proposed in *New Opportunities for the Railways*. Although franchising was a major component of the Swedish proposals, little emphasis had been placed on the need for open access competition and, under interrogation by the Transport Select Committee, Department of Transport official Phillip Wood confirmed the the British proposals were “uniquely different from anybody else’s” (*House of Commons Papers*, 1992c: 28).

Finally, and not insignificantly, the effect of these factors was compounded by uncertainty surrounding the nature of the franchising proposition itself (Welsby, 1997). Because *New Opportunities for the Railways* had advanced little more than an industry framework, it was unclear at the outset as to precisely what the government was going to sell. MacGregor reported that the private sector had expressed some interest in taking on rail franchises, and that they wanted “to go into a great deal of detail... about what a franchise will comprise and so on” (*House of Commons Papers*, 1992d: 5). Accordingly, a consultation document, *The Franchising of Passenger Rail Services*, was published in October 1992 to describe how the franchising process would work (Department of Transport, 1992b), and

prospective bidders were asked to respond to questions regarding the proposals set by the Secretary of State. The document provided basic information about franchise administration, noting that successful bidders would be expected to provide a level of service at least comparable with that of BR (see chapter four), and that this would be subject to certain quality benchmarks (see chapter six). However, details of franchise specification were couched in very broad terms. No firm decisions had been taken on the size, length and depth of franchises and, in this sense, there was very little for prospective bidders to respond *to*. As Andrew Mackinley of the Transport Select Committee pointed out,

“If you look at the franchising document, if I can use that term, I strain to find anything new in that, anything additionally revealing in substance to that which was in the White Paper... I cannot see any substance in terms of beef being put on the issue” (*House of Commons Papers*, 1992d: 9).

The Committee’s chairman, Robert Adley, agreed, noting that there was not “enough information for people to come forward with answers to the questions the Secretary of State is asking and on which the future of our railway depends” (*House of Commons Papers*, 1992b: 49).

A possible reason for the vagueness of *The Franchising of Passenger Rail Services* was that the policy making process was badly managed at first.³ Although the formulation of rail privatisation policy had become “one of the biggest tasks of project management that’s ever been seen in government anywhere at all,” responsibility for organising the entire project was vested in policy analysts rather than project managers. The result was inefficiency, not just in relation to franchising, but in all aspects of policy development:

“...[to begin] they staffed it with very bright people who were used to doing policy analysis, but weren’t used to managing a project process... [For example] just very simple things like if you’ve got advisors on a project like this, your advisors have to be absolutely comprehensive in their understanding of what’s going on, who is meant to be doing what, when, all these kinds of things. [One policymaker’s] view was you may or may not have them all in for a meeting, you may or may not tell them all what had happened. It just didn’t work, it’s as simple as that.”

This situation was ultimately resolved by the appointment of an experienced privatisation project co-ordinator, but in the meantime MacGregor was forced to defend the contents of the consultation document before the Transport Select Committee. He did this by stressing the importance of retaining flexibility in the process in order to gear “the system to the

³ This argument is included with some reservation because only one respondent raised it (although he was directly involved with proceedings at the time). Nevertheless, it does offer a credible explanation for the fact

needs of the marketplace rather than sitting in Marsham Street and deciding how you think it will run” (*House of Commons Papers*, 1992d: 10). He continued:

“We will have a variety of different shapes and sizes of franchises. A variety of depth of franchises. Some operators will mainly want to do a marketing operation, perhaps not even employ the drivers. Others will want to employ depots, maintenance depots, for the period of the franchise and may well want to get involved with stations.”

MacGregor’s enthusiasm for flexibility appeared to exceed that which was originally intended in the consultation document, however. Despite its general paucity of detail, the document had implied that over-reliance on the wishes of the private sector might be impractical, especially if ‘cherry picking’ left the government with a disaggregated residue of unsaleable services. Accordingly, *The Franchising of Passenger Rail Services* had noted that franchisees would assume responsibility for managing all aspects of train operation, and would be grouped in a way which made commercial and operational sense, had regard to markets being served and promoted competition. Notwithstanding these points, the majority feeling of the Transport Select Committee after MacGregor’s appearance was that “the government do not really know what to do,” and ministers admitted that there were still huge areas of detail which needed filling in before the private sector could be convinced that rail franchising was an attractive opportunity (*House of Commons Papers*, 1992d: 22; Tomkins and Smith, 1992). The following sections review the process through which the basic franchise specifications of size, length and depth were established.

5.3 Determining franchise specifications

5.3.1 Franchise size

As noted above, the main aims of *The Franchising of Passenger Rail Services* were to group services in a way that made operational and commercial sense, that had regard to markets being served, and that promoted competition. These last two aims reflected the agendas of Downing Street and the Treasury respectively. Although Major’s preference for a regionally-based railway had lost out to the track authority model in summer 1992, “there were those, including the Prime Minister, who [remained] keen to develop regional identities in the railways,” and this idea could be realised through exerting an influence over the franchise boundaries. On the other hand, the Treasury, having been forced to abandon its idea of train-path auctioning (see chapter four), was keen to negotiate the next best thing by disaggregating BR into as many franchises as reasonably possible. A large number of

that the advances in policy detail from *New Opportunities for the Railways* to *The Franchising of Passenger Rail Services* were slight with regard to franchise specifications.

franchises would maximise competition *for* the market by increasing the amount of competitive tenders, and *in* the market by boosting the amount of shared track miles (see chapter six). According to Grantham (1998), for example, the Treasury advanced the idea of splitting BR's South Western Division into as many as eight different companies (it was eventually franchised as two).

Far more important to the Department of Transport, however, was to effect a split which made operational and commercial sense. Officials were aware that private sector confidence in rail privatisation was low, and realised that further delays in policy development would jeopardise the likelihood of their creating a market for TOCs. Protracted disputes might also have hampered the government's attempts to complete rail privatisation within one Parliament. Accordingly, the Department of Transport argued that, provided they were generally consistent with the policy outlined in *New Opportunities for the Railways*, solutions to arising complications should be determined by practicality:

"We were driven by the practical necessity of getting the franchising programme launched... It had never been done before anywhere else in the world, and we were anxious to try and reduce uncertainties and risks wherever that was possible, but consistent with the policy... It [needed to be] a practical, sensible decision to make sure that we didn't waste any time."

The problem with both Downing Street and the Treasury's proposals was that they were driven by romanticism or ideology rather than practicality and, although each might have been feasible in the longer term, the Department of Transport could not risk approaching its task from a Utopian standpoint. Officials in Marsham Street recognised the need to establish pilot franchises in order that potential bidders could gain some idea of how the TOCs would function and what the costs associated with running them would be (*Hansard*, 1993a; *House of Commons Papers*, 1993a). As such, accommodating the whims of others, particularly those of the Treasury, was: "not at all, absolutely not at all [a factor]. We had an awful lot to do very quickly. We had to provide as good a track record as BR's accounting system would allow us to do for potential buyers."

Academics and transport consultants offered their conclusions regarding the optimum size for franchises. Most argued for splitting BR into a few, large operating businesses. Nash and Preston (1993) and Dodgson (1994) referred to evidence from the United States to show that dividing BR into 20 or more companies could result in at least some of them using rolling stock inefficiently. The Economic Research Centre (1993) reviewed literature which suggested the optimum size for a rail firm was around one third that of BR, especially

where economies of density were being maximised.⁴ Jones *et al.* (1993) also advocated large franchises because they limit the transactions costs associated with train to train externalities. Chapter four pointed out that train to train externalities occur where delays to one operator's train disrupt the service patterns of others, and therefore occur primarily along stretches of track shared by one or more franchisee. Franchising would, of course, provide only a partial solution to this problem, as it was unlikely to remove all instances of shared track miles around the network. Although Jones *et al.* (1993) did not doubt that externalities could be regulated by contracts between operators and the track authority, they did speculate that monitoring and enforcing such contracts would be costly and problematic, especially in congested areas where the effects of delays might be highly diffused. Thus, while fewer franchises would not eliminate shared track miles, they would reduce them and simplify the administration of associated externalities.

Although these suggestions provided the Department of Transport with further policy options, there were practical difficulties associated with creating larger franchises. This would either have involved a significant - and therefore lengthy - restructuring of BR's passenger businesses, or reconstituted BR's business sectors, an option which had been ruled out by the election manifesto. Moreover, as Williams (1992) has pointed out, the significant turnovers which would have been associated with large franchises (up to £1 billion) might have discouraged many potential bidders. Increasingly it became obvious to observers (Nash and Preston, 1993, Tomkins, 1992b) that the shape of the franchises would be largely based on BR's existing profit centres. After sectorisation in the mid 1980s (see chapter four), BR underwent a further restructuring exercise in 1992, Organising for Quality (O for Q). The O for Q initiative separated each of BR's business sectors into a series of individual profit centres, each with its own management reporting to the relevant sectoral Director. A total of 19 were created, and these are listed in table 5.1. The profit centre approach to franchising offered four key advantages as far as the Department of Transport was concerned. First, and most obviously, BR had already designed its profit centres to make operational and commercial sense. Second, track records for the new franchises would be *relatively* straightforward to assemble. Third, the transition from sectorised to franchised management would be eased if a degree of continuity in senior personnel were maintained (Tomkins, 1992b, Grantham, 1998) and, finally, the profit centre

⁴ Economies of scale with respect to density increase as a rail operator makes more intensive use of its fixed assets. Economies of density are also related to size: for a given fixed cost (the infrastructure), a rail operator will have lower unit costs (the services) the greater its output (although there are limits to this - see, for example, Dodgson, 1989).

approach promised to generate interest among potential bidders as some (Stagecoach in particular) had indicated that they wanted to acquire rail operations in this form (*House of Commons Papers*, 1992e). As a respondent pointed out:

“We knew how BR organised itself [in 1993] and that seemed a sensible number of TOCs both in terms of the speed in which you could generate interest and complete the franchising programme within the Department. So we ruled out half a dozen, and we ruled out hundreds, and the existing structure seemed to present a practical and sensible way forward.”

InterCity	Network SouthEast	Regional Railways
Great Western	South West	Central
West Coast	South East	North West
East Coast	South Central	North East
Midlands/Cross Country	Thames and Chiltern	South Wales and West
Gatwick and Anglia	Great Eastern	ScotRail
	North	
	Thameslink	
	West Anglia Great Northern	
	London, Tilbury, Southend	

Table 5.1. BR’s profit centres. Source: Tomkins (1992b).

MacGregor announced the first batch of franchises in February 1993 and a draft structure of 25 TOCs three months later (*Hansard*, 1993c; 1993d). The franchises were indeed based around BR’s profit centres, although some changes had been made to further localise the management of certain route groups following suggestions from potential bidders: in InterCity, Midlands/Cross Country and Gatwick and Anglia were both separated; in Network SouthEast, Island Line was removed from the South Western Division, and Thames and Chiltern were separated; and in Regional Railways, Merseyrail Electrics was split from North West, and the Cardiff Valley Lines were separated from South Wales and West. Some of the 25 TOCs have now undergone name changes and these are listed in table 5.2. For the sake of clarity, TOCs’ new names will be used throughout the remainder of this thesis. Figures 5.1 to 5.3 show the final disaggregation of BR. Although it came about primarily for practical reasons, the final franchising map did offer Downing Street some regionally based franchises (Anglia, ScotRail) and the Treasury a considerable amount of competition. One respondent argued that “after all, 25 was not an inconsiderable number” of auctions to hold. The potential for competition in the market was also substantial as 56.4 per cent of all rail journeys under the O for Q structure were undertaken by more than one company (ORR, 1994a). However, as chapter six will show, this scope for on-rail competition was largely theoretical as it was subsequently restricted by a number of regulatory and operational factors.

InterCity	Network SouthEast	Regional Railways
Great Western Trains (First Great Western)	South West Trains	Central Trains
InterCity West Coast (Virgin Trains)	South Eastern (Connex South Eastern)	North West Regional Railways (First North Western)
InterCity East Coast (GNER)	Network South Central (Connex South Central)	Regional Railways North East (Northern Spirit)
Midland Mainline	Thames Trains	South Wales and West (Wales & West)
CrossCountry (Virgin Trains)	Chiltern Railways	ScotRail
Gatwick Express	Great Eastern (First Great Eastern)	Cardiff Railway Company
Anglia	North London Railways (Silverlink) Thameslink West Anglia Great Northern LTS Rail Island Line	Merseyrail Electrics

Table 5.2. The 25 TOCs. Names outside brackets are those which TOCs were franchised under. The remainder are current and will be used during the remainder of this thesis.

Source: OPRAF, 1998a.

5.3.2 Franchise length

The Franchising of Passenger Rail Services (Department of Transport, 1992b) noted that no decisions had been taken regarding franchise length by October 1992, and just as the Treasury and the Department of Transport had been at odds over the size of franchises, so they also fought over their length. The Treasury was again anxious to maximise competition, and therefore sought to minimise the interval between competitive tenders for each TOC. Treasury officials argued at first that franchises should be short, no longer than “three to five” years:

“We were saying ‘no, this is competition for the market. We want franchises which are long enough for people to make change and benefit from it, but we want the prospect of re-tendering.’”

The Department of Transport, on the other hand, disagreed:

“I always felt that we would have to go for longer franchises than the Treasury were initially trying to argue for, because I didn’t think it was practical otherwise, we wouldn’t get the bidders... There was a great debate about that.”

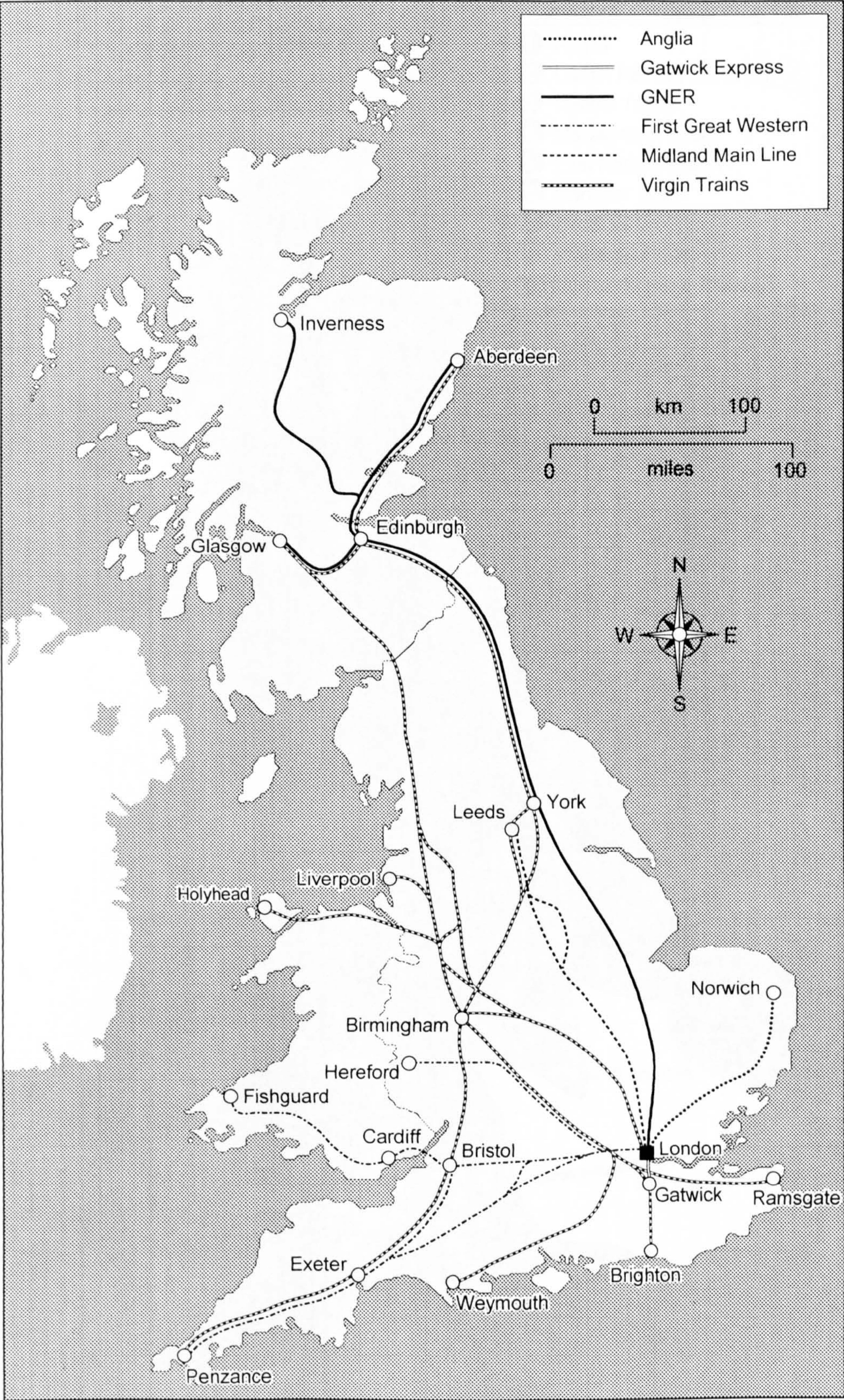


Figure 5.1. Route plans of the former InterCity TOCs. After Shaw *et al.*, 1998.

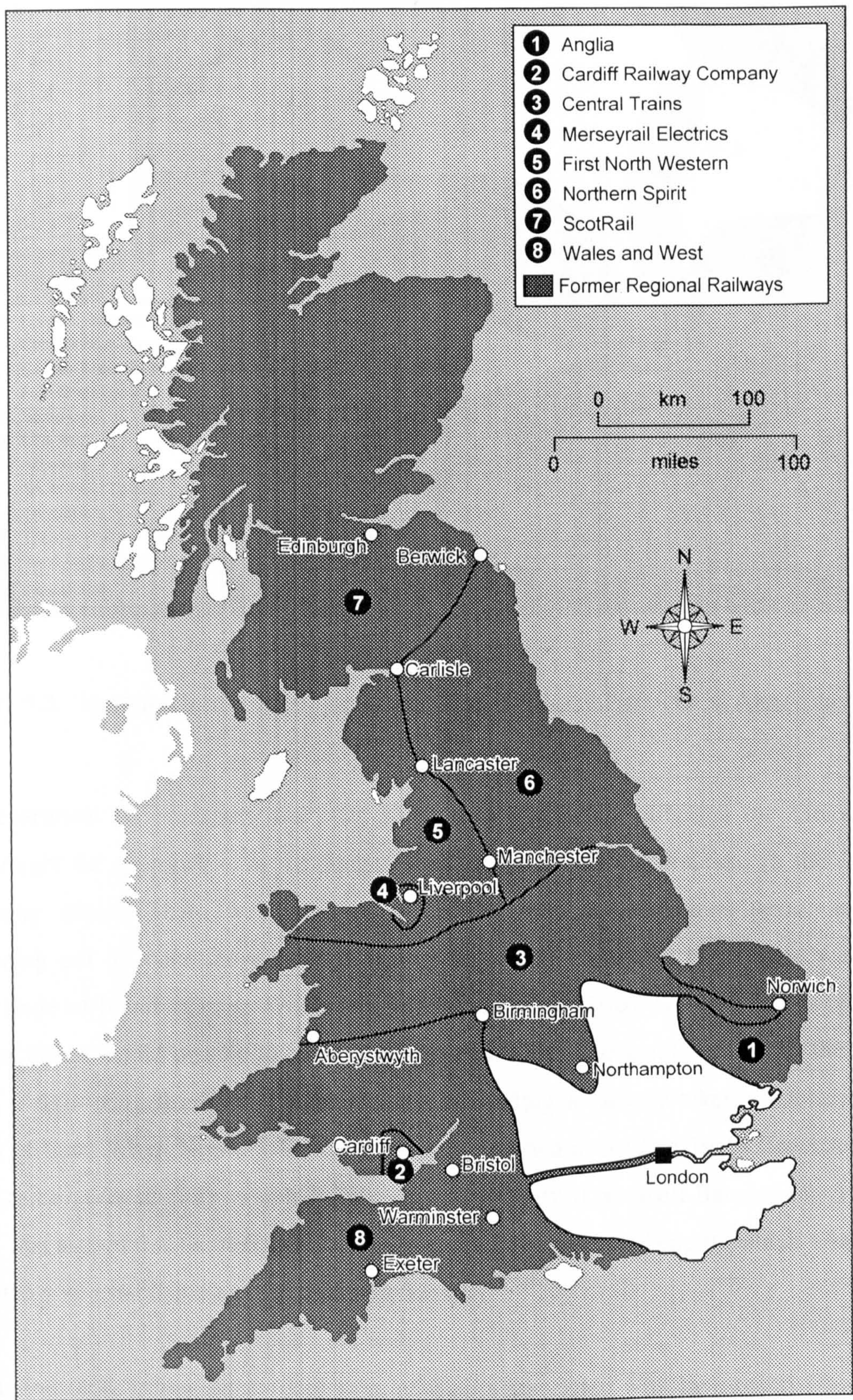


Figure 5.2. Operating territories of the former Regional Railways TOCs. After Shaw *et al.*, 1998.

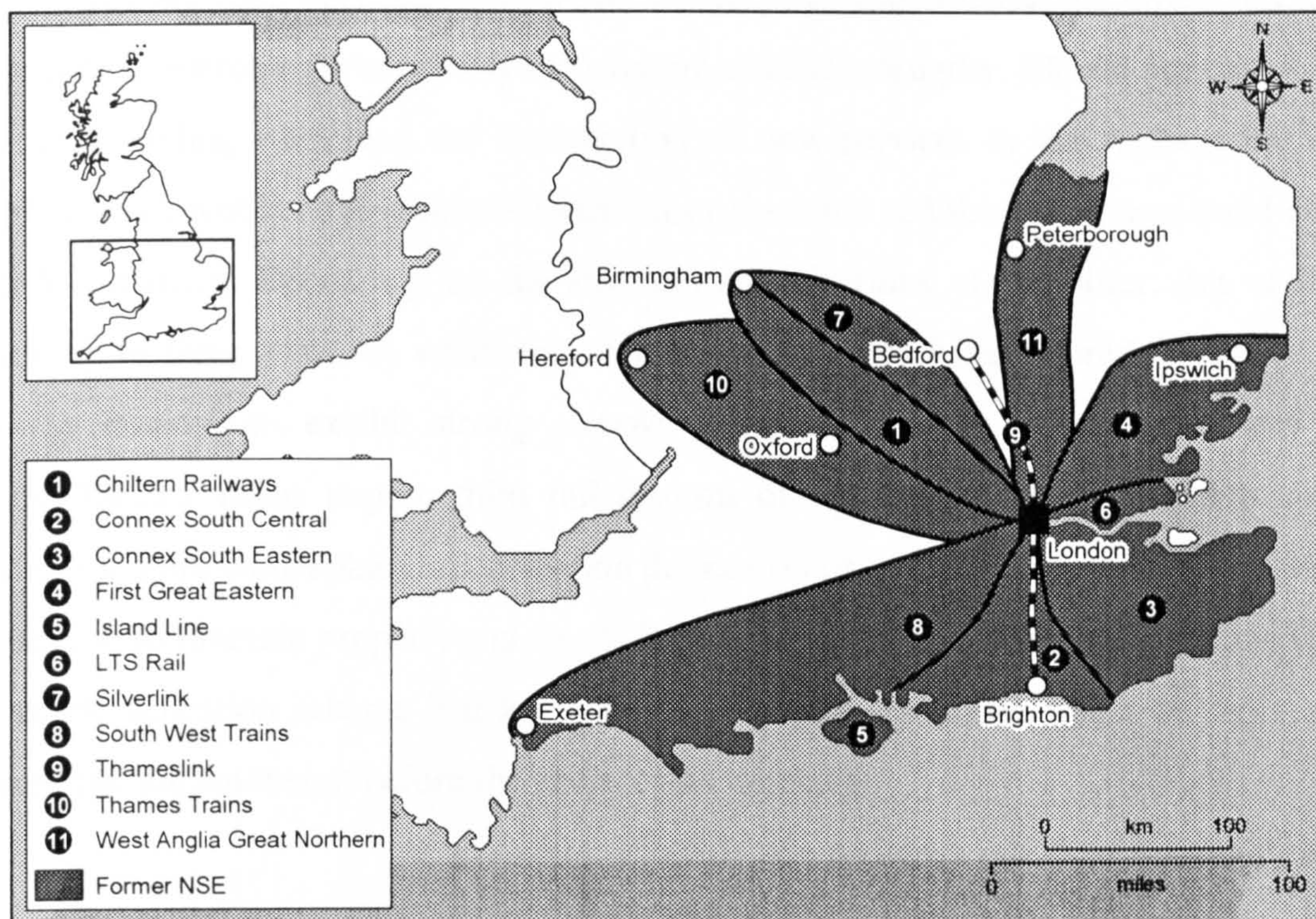


Figure 5.3. Operating territories of the former Network SouthEast TOCs. After Shaw *et al.*, 1998.

The Department of Transport had once more recognised that, although the Treasury's stance might be appropriate in the longer term, it would not be practical in the initial franchising round. There were two main reasons why the franchise terms needed lengthening out to make them more attractive to potential bidders. First, there was the simple issue of branding. *The Franchising of Passenger Railway Services* had suggested that franchisees would be able to trade under their own brand image. However, as the Bow Group, a right-wing think tank, pointed out, re-branding a railway takes a considerable amount of time. When Network SouthEast was relaunched in the late 1980s, for example, it took three years to fully establish its corporate identity (Campbell-Bannerman, 1993). Thus it was argued that short franchise contracts would negate any benefits which might be associated with establishing a new corporate identity.⁵

Second, and more importantly, there were problems associated with investment (Jones *et al.*, 1993). Attracting investment to the railway was central to the government's plans (BBC, 1996; *House of Commons Papers*, 1993a), but the Department of Transport argued

⁵ The Bow Group's case was based on a train operating sector significantly larger than any of the TOCs which appeared as a result of the 1993 Railways Act. However, experience after privatisation has shown that, while some operators (e.g. GNER) have rebranded quickly, others (e.g. Virgin, Wales and West, Northern Spirit) may take up to three years.

that short franchises were unsuited to this. In part, this was because the timescales required for major investment in the railway industry are relatively lengthy. BR did not carry a surfeit of excess rolling stock and the introduction of new services or the replacement of life-expired stock would have required franchisees to procure refurbished or new-build carriages and locomotives. Depending on the size and specifications of the order, this could have taken up to three years, by which time the franchise might have expired. Moreover, many railway investments exhibit strong complementarities between infrastructure and rolling stock. Electric trains require third rail systems or overhead catenary, modern signalling systems require compatible train detection devices on or near the tracks and on rolling stock if they are to function properly and so on. Railtrack would have had little incentive to invest in an electrification scheme if it knew that the current franchisee might be replaced by a diesel traction enthusiast before the project was complete.

The most significant investment-related problem from a franchisee's point of view was that of residual value risk. Railway assets are generally long-lived and highly specific. As such, investment in infrastructure under the franchisee's control (e.g. stations) is to all intents and purposes sunk and, although rolling stock can often be transferred to other areas of the network, the government could not guarantee that an active second hand market would have developed by the time the first generation of franchises ran out. Thus, with the residual value of assets highly uncertain, a franchisee would have sought to amortise them during the course of its contract, and Jones *et al.* (1993) argued that extremely high subsidies - or greatly inflated ticket prices - would have been required to encourage private sector bids in these circumstances. A solution to this problem in relation to infrastructure now exists through the Franchising Director's ability to designate 'franchise assets' which an incoming franchisee must take on. With rolling stock, however, the answer was to establish a leasing market in order to ensure that residual value risk was assumed by a third party. The government had recognised in 1992 that, although some franchisees may wish to buy physical assets outright, leasing was likely to be the favoured option for most, and the creation of rolling stock leasing companies (Roscos) was announced in mid-1993 to accommodate this (Department of Transport, 1992b, 1993a; *House of Commons Papers*, 1993c).

In theory, the advent of Roscos lent weight to the Treasury's case for short operating contracts because franchisees, relieved of residual value risk, could replace rolling stock without making the capital investment themselves. Nevertheless, the Department of

Transport continued to press for longer franchises because it felt that bidders would submit tenders only if they were offered a degree of temporal security:

“I certainly felt that franchises of 10 or more years would attract more interest... I had spent the summer of 1992 talking to potential bidders for the franchises. Of course, these conversations had nothing to draw upon in terms of experience anywhere else in the world or in the United Kingdom, and I do recall the initial reaction of the companies I spoke to... was that they would look for a longer period than three to five years in order to recover any investment that was made.”

This was a view shared by the first Franchising Director, Roger Salmon, whose “answer to just about everything was to lengthen out the franchise terms. If you had longer franchises, it looked a more enticing process, and so on.” The *Draft Objectives, Instructions and Guidance* to the Franchising Director (*House of Commons Papers*, 1993a) signalled a partial victory for the Department of Transport in that the basic franchise term had been lengthened out to seven years, but that the Secretary of State’s approval had to be sought if a longer contract was proposed. In private, however, the Department of Transport’s case had more or less prevailed in full, as “where there was a good case for reinvestment in rolling stock” the Treasury had conceded “OK, we can see the case for a longer contract” of up to 15 years.

5.3.3 Franchise depth

Despite the White Paper being “seen as a clear victory for the track authority option, the opposite of vertical integration,” some potential bidders - and, as already noted, the majority of BR managers (Smithers, 1993a) - disagreed with the concept of vertical separation and began to stress the importance of infrastructure ownership to any franchising prospect. Their concerns revolved around the degree to which a franchisee would be dependent on a monopoly - Railtrack - under the track authority model, particularly with regard to cost control and managerial responsibility (*House of Commons Papers*, 1993a). Sea Containers argued that Railtrack’s continued custody of the infrastructure would substantially reduce the prospects of being able to run a profitable business. Referring to his proposal to operate the southern region of BR, James Sherwood, president of Sea Containers, suggested that:

“If we maintain the track and signalling ourselves... we could save £50 million a year over what British Rail is paying today. So if the idea is that British Rail [as Railtrack] are [sic] going to continue to run the track and the signalling, then there is no scope for us to achieve that £50 million of saving” (*House of Commons Papers*, 1992e: 196).

Apprehension over the loss of managerial responsibility was heightened when Chris Green, director of InterCity, pointed out that vertical integration of his business under O for Q had

enabled it to make good progress towards delivering a high quality service. Brian Scott, Director of InterCity's Great Western Region, added that, as an operator, he could not contemplate forfeiting control over infrastructure because, if he did, he would no longer have charge of all the key components of his own business (see also Shires *et al.*, 1994b):

"As an experienced, professional railway business manager, I would not put my money into a train operating company... without having day to day command and control of operations, including signalling, track and signals maintenance [as it would be] an act of folly to buy into something with so little control of performance and, therefore, profit" (*House of Commons Papers*, 1993a: lii).

Given the struggle preceding the selection of the track authority model, it was unlikely that ministers would have been "prepared to junk it" even in the face of such criticism. Policy makers could afford to let debates over the size and length of franchises be guided by the views of potential bidders because they were not likely to compromise the fundamental aims of vertical separation. A significant number of competitive opportunities would still exist even if the Treasury's plans were rejected. But vertical integration was anathema to the concept of a track authority, and it might have been expected that any circumstances in which it would be permitted as an expedient would be minimal. Somewhat surprisingly, however, a passage in *The Franchising of Passenger Rail Services* suggested that a franchisee might "take on a 'vertically integrated' franchise covering the operation of track and signalling as well as trains" (Department of Transport, 1992a: 13). The *Railways Bill*, published in January 1993, also left the government's options open.⁵ As one witness told the Transport Select Committee:

"The Bill... bears no relation to the White Paper because technically it allows the government to dispose of BR in any way it sees fit. There is no mention of Railtrack within the Bill... As far as I can see... they can split it up into a hundred million parts, vertically integrated, laterally separated or whatever" (*House of Commons Papers*, 1993a: 708).

The decision to allow a degree of vertical integration was not originally adopted as a result of the arguments advanced by prospective franchisees - in fact, it pre-empted them - but was agreed on the basis that there were likely to be exceptional circumstances around the network where vertical separation was neither logical nor desirable. In particular, ministers were aware that Island Line, the Isle of Wight's single track, eight-mile Ryde to Shanklin route, was so isolated and subsidy-dependent that it was unlikely to attract open access

⁵ Chapter four noted that the Bill was essentially a piece of enabling legislation which gave Ministers the licence to create whatever they wished out of the BR monolith (see also Shaw *et al.*, 1998).

operators and raise issues of anti-competitive practice (see chapter four). As policy developed, however, there is evidence to suggest that, as a result of pressure from potential bidders, the Department of Transport began to argue that vertical integration should be considered more favourably in relation to other self-contained TOCs such as LTS Rail. Again, agreement from the Treasury was obtained:

“There was a theoretical possibility that in certain cases [a degree of vertical integration] might become necessary... That indication that vertical integration would be possible in certain circumstances was just to make sure that if there were any major problems in getting the franchises away, then some modest compromise within the idea of a single, unified track authority was possible.”

The ‘modest compromise’ to which the respondent referred would have resulted in Railtrack retaining ownership of the infrastructure, but then leasing it to the TOC for a period coterminous with the length of its franchise. In the event, only Island Line was franchised in this manner as had originally been envisaged; all TOCs on the British mainland were vertically separated, although they were to lease stations and light maintenance depots from Railtrack (see chapter four).⁶

5.3.4 Basic franchise specifications

By mid-1993, almost a year after the publication of the White Paper, the government had finally decided upon the basic franchise specifications to complement the administration requirements it had outlined in *The Franchising of Passenger Railways*. There would be 25 TOCs, each franchised for a period of between seven and 15 years, and all but Island Line would be vertically separated.⁷ Franchisees would also be expected to provide a level of service which, at a minimum, roughly reflected that of BR immediately prior to privatisation. In attempting to resolve policy matters quickly, and to address the uncertainty surrounding the franchising proposition, the Department of Transport - with the approval of Downing Street and, more importantly, the Treasury - pursued a pragmatic line to define the basic characteristics of the TOCs.

Yet a question remains as to how the Department of Transport was able to convince the Treasury of its plans. The period leading up to the publication of *New Opportunities for the Railways* had been dominated by the Treasury, and the ideologically-driven track authority model had prevailed in part because Marsham Street had been unable to produce a viable

⁶ As will become apparent later in this chapter, MacGregor’s adoption of almost complete vertical separation did not discourage those who had opposed the idea from bidding for franchises. Brian Scott, for example, won the Great Western franchise as part of a Mebo in 1996, and then sold it to FirstGroup - at a personal profit of almost £3.8 million - in 1998 (*Railway Gazette International*, 1998).

alternative. However, in securing pragmatic solutions to franchise-related problems, officials in the Department of Transport had effectively reversed the prevailing hierarchy in rail privatisation policy formulation. Whereas the Department of Transport had previously been forced to accept the track authority model on the basis that it maximised competitive opportunities, so the Treasury became obliged to concede the impracticability of many of these opportunities as policy details were developed in 1993 and 1994:

“You could sum up the whole process as follows: at the outset, [the Treasury] fought for - and won - the structure that was going to deliver the most competitive industry post-privatisation. [It] then spent the implementation years defining the exact *trade-off* between competition... and the practicalities of getting the businesses ready for sale... In lots of areas, [the Treasury] had to accept that greater competition would be introduced over time rather than immediately.”

It would appear that the Department of Transport's previously unseen dominance arose as a result of the continuing recession. Since 1991, the Treasury had been struggling to contain public expenditure and was becoming vulnerable to charges that its ideas on rail privatisation would further extend the PSBR. Proponents of the track authority model had been protected from such charges before it was adopted because little was understood about the policy's likely implications. Following their experience with electricity privatisation, Treasury officials had argued strongly that vertical separation would benefit the taxpayer because of the myriad opportunities for competition, and thus cost reduction, it presented. Moreover, the contractual nature of the track authority model would ensure that subsidy would remain stable during future recessions (see section 5.2). These were compelling arguments, especially in an economic slowdown. But the Treasury was suddenly confronted with a financial 'double whammy'. First, the higher transactional costs associated with the track authority model were by now starting to reveal themselves (see chapter four) and second, as the above sections have shown, the Department of Transport became aware from its discussions with prospective franchisees that implementing the Treasury's proposals would jeopardise its chances of creating a market for TOCs. Failure to let franchises would defeat the object of passenger rail privatisation, limit the potential for future subsidy reductions, and damage the flotation value of Railtrack and the Roscos upon which the government was heavily dependent, not least to curtail the net cost of rail privatisation to the state (see also Jenkins, 1995). As such, the Treasury was forced to concede that creating extremely short franchises and excessively disaggregating BR were no longer viable policy options:

⁷ Reflecting its unique circumstances, Island Line was franchised for only five years.

“The Treasury’s role in controlling public expenditure... became more dominant than competition and [rail] industry experts within the Treasury. Therefore, they were particularly susceptible to any arguments which protected the value of Railtrack for a public flotation and the ability to generate competition for franchises. So it was a question of the Department of Transport saying ‘this is what you’re going to have to do, this will maximise our chance of getting the whole thing away with reasonable returns and results’. Then the Treasury was more amenable [to the Department of Transport’s position].”

By accepting the Department of Transport’s re-orientation of the policy-making agenda away from ideology and towards practicality, the Treasury was forced to recognise the paradox that its own plans, which heavily emphasised market liberalisation, were likely to result in less competition than the Department of Transport’s, which did not.

Despite having won this battle, key officials in the Department of Transport and OPRAF remained sceptical as to whether they would be able to create a market for TOCs. Although the basic franchise specifications had now been decided upon, a vast amount of policy detail required filling in before the competitive tendering process could begin. TOCs’ assets had to be assigned and incorporated, the contractual matrix through which the train operators would interact with other rail businesses needed to be assembled (see Grantham, 1998) and regulations governing the new industry had to be formulated.⁸ The most significant regulation was the Public Service Requirement (PSR), the manifestation of the government’s 1992 commitment to maintain the “current national network of services” (Conservative Party, 1992: 35). PSRs detail the minimum amount of trains each TOC must run in return for its subsidy (quality of service regulations are discussed in chapter six). They do not function explicitly as timetables, but instead set parameters, based largely on BR’s service levels of 1992, within which TOCs must construct their timetables. The PSR for South West Trains, for example, stipulates that at least a two-hourly service must run between London Waterloo and Exeter St David’s on weekdays and Saturdays, and that the last train to Exeter must leave at or after 18.30.

The number of services stipulated in PSRs is generally less than that operated by BR, but operators are free to run more should they deem them commercially viable. Although the

⁸ In addition, some broader policy issues were still to be resolved. As noted in chapter four, it was not envisaged in *New Opportunities for the Railways* that franchisees would have an exclusive right to operate services over any given stretch of track, but that other operators would be able to run competing trains on an open access basis. On rail competition forms the basis for chapter six and is discussed more fully therein. Nevertheless, it is appropriate to note here that many potential bidders found the prospect of open access incompatible with franchising because it would pose a serious threat to the viability of their businesses. This issue was not finally resolved until December 1994 and, at the very least, reinforced the conviction of some potential franchisees that the government did not fully understand the implications of its own rail privatisation policy (*House of Commons Papers*, 1993a).

government expected that this would happen - and thus that 1992 service levels would at least remain constant or increase (*House of Commons Papers*, 1993a) - its optimism was not shared by opponents of rail privatisation. Opposition spokesmen led a campaign to suggest that the policy would lead to service cuts which the Conservatives had ruled out, and the pressure group Save Our Railways launched a court action in an attempt to increase the number of services included in PSRs (Grantham, 1998).⁹ Notwithstanding courtroom distractions, the production of PSRs was novel and complex, and some delay was perhaps inevitable because of the likelihood of errors. OPRAF admitted to producing an unworkable PSR for South West Trains where they experienced difficulties with train paths out of London Waterloo, and similar problems were encountered with LTS Rail (Grantham, 1998). As a result, the PSRs - and, indeed, other sales documentation - were not completed by the time bidders were invited to tender for TOCs, a fact which led Grantham (1998: 132) to suggest that the franchising process "was being conducted with a paucity of detail."

Policy makers were aware that the franchising proposition had been characterised by a high degree of uncertainty since it was first unveiled in the White Paper. Not only was there a lack of international precedent, but the proposals had faced continued hostility from both within and outside the railway industry which had talked "the risk up and the value down." Such was the perception of rail privatisation at the time that opposition frontbenchers genuinely believed the process would be significantly short of completion by the 1997 general election (Grantham, 1998). Compounding these factors was the conduct of the government itself. Because of the way in which the track authority model had originally been adopted (see chapter four), policy makers had not been able to begin defining the nature of TOCs until after ministers had publicly committed themselves to vertical separation. Even though the Department of Transport had prioritised the need to complete the process quickly and make it more attractive to potential bidders, various complications had delayed the development of policy details. As a result, even when the competitive tendering process was imminent, key information was either missing or had only recently been provided, and critics of rail privatisation were able to portray rail privatisation in a very negative light (NAO, 1998a).

⁹ Save Our Railways argued that some of the PSRs suggested by OPRAF - in particular those for Gatwick Express, LTS Rail and InterCity East Coast were unlawful because they would not, as stipulated in the Franchising Director's *Objectives, Instructions and Guidance*, protect an amount of services similar to that operated by BR immediately prior to franchising. In response, the Secretary of State for Transport simply rewrote his guidance to the Franchising Director, thus re-legalising the offending PSRs. As events have transpired, some TOCs are now beginning to cut back services, particularly in rural areas (see chapter seven).

The only factor which appeared to be working in the government's favour was the economy. The recession which had beset the early 1990s was over by 1995, and ministers were assured that business confidence was generally higher than it had been in the recent past. As one respondent (rather prosaically) pointed out, had the economy still been in a slump when competitive tendering began, the latter would have been "an absolute fucking disaster." The Department of Transport had ascertained that there were around 20 or 30 companies interested in bidding for TOCs - despite MacGregor having earlier put the figure as high as 50 - but was unsure whether any would participate in the franchising process. Indeed, Tomkins (1993) had suggested that MacGregor was being disingenuous in that many of the companies included in his figure were organisations such as banks and venture capitalists who were unlikely to bid themselves. A respondent admitted: "no-one really knew. I could not put my hand on my heart and say 'they will bid.'" Key personnel in the Department still feared that, despite their efforts to minimise the commercial uncertainties associated with passenger rail franchising, potential bidders would still consider the proposition too risky:

"We were saying to people, 'come buy these train companies. All you've got to do is, today - when there isn't a private sector train running on the network; when the company that we're asking you to buy has been run for the last 50 years as a sort of business sector part of BR, and a vertically integrated business sector at that; where difficult decisions are forced up the line [of companies within the new structure] and so on and so forth; all the problems of buying a subsidiary where there's no track record of the company operating - all you need to do is tell us how much money you're going to need over the next seven years to run that franchise. No break clauses saying 'if you think you've got it wrong in two years' time come back for more'. Tell us now how much money you need in 2002. So that's a really difficult proposition for franchisees to bid on... We weren't sure who the hell we were going to sell these franchises to."

Some within OPRAF were of a similar opinion:

"The reality with OPRAF, and in particular OPRAF under Salmon, was that they badly lacked confidence for a long time that they were going to actually sell these things. Salmon's great worry was that no-one was going to come forward and bid for these things."

Roger Salmon himself subsequently admitted that, as late as May 1995, there had still been "very considerable uncertainty that we should ever sell any franchises. There was a widespread view that they were unsaleable" (*House of Commons Papers*, 1996: 13).

With hindsight, it might be suggested that this situation might have been considerably different had the government been able to agree upon a suitable model for rail privatisation immediately following the circulation of the Redwood/Maude/Freeman working group report in January 1991. A significant amount of preparation could have been undertaken before the 1992 general election - legislation could have been drafted, analysis regarding the

break-up of BR could have been undertaken - and operational records for the new companies could have been built up from at least 1993 onwards. The government would have been able to present and defend its plans in the full knowledge of how they were intended to work, and with a reasonable expectation of what the policy's outcomes were likely to be. The success of passenger rail franchising would perhaps have been much more assured. As it was, despite the efforts of the Department of Transport to make franchising a more enticing prospect, policy makers could not be sure that the process would even create a market for TOCs, let alone generate real competition for it. As one respondent summed up, "it was a bold act [for us] to proceed without knowing precisely who would come to the table and negotiate." Policy makers were understandably relieved, therefore, when bidders quickly began *queueing* to get to the table.

5.4 Franchising the passenger railway

5.4.1 The franchising process

The Franchising Director explained the franchising proposition to the media in December 1994, and outlined the bidding process through which companies would apply to acquire TOCs. The process would consist of five key stages (NAO, 1996). Interested parties would first be asked to pre-qualify, in order that OPRAF could check whether they had the financial backing and management competency to operate a franchise. Second, Invitations to Tender (ITTs) would be issued to those who had pre-qualified, inviting indicative bids. Third, a shortlist would be produced on the strength of the indicative bids and, fourth, a Preferred Bidder would be announced after final bids from shortlisted companies had been received. Finally, provided that contractual negotiations were successfully completed, the franchise would be awarded to the preferred bidder and private sector operation would commence. Although the bidding process may seem cumbersome, it was so designed in order to discourage all except *bona fide* bidders from submitting tenders. OPRAF were satisfied that, in general, the system achieved its aim in this regard (Grantham, 1998).

Financial and trade interest in the Franchising Director's announcement was such that OPRAF considered it unnecessary to take out more than minimal paid advertising (NAO, 1996). 246 potential bidders received pre-qualification documents for the first three franchises to be let, South West Trains, Great Western Trains and LTS Rail.¹⁰ 36

¹⁰ The LTS Rail franchise was revoked after it had been awarded to the MBO team because of financial irregularities. OPRAF re-opened negotiations with the other shortlisted bidders, and the TOC was subsequently re-let in May 1996 on slightly more competitive terms than were contained in the original contract. See Grantham (1998) for a review of events.

organisations returned the documents to OPRAF by March 1995, and only six failed to progress to the ITT stage. 16 final bids were received from nine companies for the first three franchises (NAO, 1996). At first glance, it may seem that such a low 'interest to bid' ratio (246 originally interested parties resulted in 16 bids giving a ratio of around 15:1) demonstrated a lack of private sector interest in rail franchising, and that the bidding process was unlikely to attract more than minimal competition. This view is justified in part by previous experience as Kennedy (1995) had found that during the privatisation of the London bus companies, bidders behaved cautiously where uncertainty surrounding a sale was high. However, "such ratios are not uncommon in business for ITTs," and academic analysis undertaken prior to the tendering process showed that shortlists of only three to five bidders per TOC - which OPRAF managed to secure - would lead to "relatively intense" competition (Preston, 1997: 15). In the event, the levels of subsidy negotiated by OPRAF for the first three TOCs were less than those claimed by BR in 1995/96, and the NAO (1996: 25 and 30) subsequently concluded that OPRAF had generated and sustained "a good level of competition" to secure "value for money" for the taxpayer.¹¹

The exact meaning of the expression 'value for money' in rail privatisation terms had been a source of some contention since the announcement of franchising in *New Opportunities for the Railways* (Department of Transport, 1992a). As stated previously (see sections 5.2 and 5.4), all franchises were to be let subject to basic administrative requirements such as PSRs and some quality of service regulations. Assuming all bids met these stipulations, value for money could still be defined in a number of ways. Was it simply to mean the cheapest, 'no frills' tender? Did it refer to major quality enhancements over and above those required by the regulations carried out on an efficient basis? Or did it imply some kind of compromise between these two extremes? In cases where substantial investment was needed - for example, where rolling stock was life-expired - the government recognised that the likely outcome of attempts simply to minimise subsidy would be a deterioration in the provision of rail services.¹² Ministers argued that this would be undesirable and, under interrogation by the Transport Select Committee (*House of Commons Papers*, 1993a), insisted that it was not their intention to make rail privatisation primarily a means of securing financial

¹¹ The average annual claim for South West Trains was £49m (£54.7m in the first year declining to £40.9m in the last), compared to £63.5 million paid to BR in 1995/96 (OPRAF, 1996a). For Great Western the average claim was £40.1m (£53.2m in the first years and £38.2 in the last) compared to £47.3m paid to BR in 1995/96 (OPRAF, 1996b). After LTS had been re-tendered, its average claim was £18.1m (£27.6m in the first year and £12m in the last) compared to £31m paid to BR in 1995/96 (NAO, 1996; OPRAF, 1998a).

¹² Life-expired rolling stock is more likely to present maintenance problems (as is currently the case on, for example, the Gospel Oak to Barking Line (*Rail*, 1999a)) which impact upon a TOC's ability to maintain a prescribed minimum level of service.

advantages for the Treasury (although it will be recalled from section 5.3 that the government was depending upon revenue it would obtain from the flotation of Railtrack and the Roscos). On the other hand, the government did not wish for subsidy levels to impact excessively on the PSBR, and a compromise approach to defining value for money became inevitable. Some differences existed between policy makers, especially those in OPRAF and the Treasury, over how this compromise would be reached. OPRAF appears to have been unable to decide whether it should err on the side of subsidy minimisation or quality maximisation, but it was finally accepted that value for money would have to be determined individually for each franchise:

“Salmon was constantly hankering for the view that value for money either meant cheapest or meant lots of new kit. He kind of veered between the two at various times. The Treasury was saying ‘no, value for money is a more holistic concept than that, and it depends on what one’s asking for in the way of minimum service levels, it depends on whether there’s a good case for reinvestment or not’. Once they’d decided what the proposition enshrined in the particular franchise contract was, then at that point they wanted it let on the best financial terms they could. But in determining what the investment proposition was, as it were, it had many more dimensions to it than ‘my Christ, how can we flog this to minimise the subsidy bill?’”

Some TOCs, especially those which had received major investment from BR (examples are Thames Trains, Chiltern Railways and GNER), could be let ‘as seen’, whilst those at the opposite end of the scale (examples are LTS Rail and Virgin West Coast) might carry certain investment requirements or ‘recommendations’. OPRAF asked bidders to attach the highest priority to minimising subsidy according to each individual franchising proposition, and to include further quality of service enhancements only where they were self-financing or separately priced, in the form of ‘non-compliant’ bids (NAO, 1996).¹³ In an attempt to ensure that bidders included at least some original service innovations, it was also made clear that in cases where two or more bids had identified similar subsidy requirements, detailed attention would be paid to their qualitative aspects.

5.4.2 Competition for the passenger rail market

As noted in section 5.1, competition for the passenger rail market and its impacts upon subsidy and investment levels have already been documented by numerous authors (see, for example, Glover, 1997; Harris and Godward, 1997; Knowles, 1998; NAO, 1996; Powell, 1997; White, 1998) and, as such, will only be reviewed here in brief. Table 5.3 shows the award and commencement dates, length and winner of each franchise. Shortlisted bidders

¹³ A bid was compliant if it conformed to the requirements or recommendations stipulated by OPRAF. Non-compliant bids might suggest longer franchise terms or offer higher levels of investment, usually at a higher level of subsidy. As section 5.6 will show, OPRAF received many non-compliant bids at the beginning of the process, particularly from bidders who misunderstood its definition of value for money.

for all franchises are shown in table 5.4. The number of shortlisted bidders for each franchise is not in itself a good indicator of the degree of competition which took place at any one time in the bidding process because the shortlists remained roughly the same size regardless of the number and aggressiveness of indicative bids. The competitive pressure to minimise subsidy requirements during the franchising process is very apparent from table 5.5. As Harris and Godward (1997) point out, total subsidy payable to the TOCs decreases from £1.8bn in 1997/98, the first full year of private sector operation, to £763m in 2003/04, the year in which the majority of franchises end. Subsidies continue to fall - or premiums continue to rise - for those TOCs whose franchises extend up to 15 years in length. Whereas only one TOC, Gatwick Express, was making premium payments to the Franchising Director in 1997/98, four of the 11 former Network SouthEast TOCs and five of the former InterCity TOCs will be doing so by the final year of their franchises, and a further TOC from each group will be receiving no subsidy (Knowles, 1998).

Train Operating Company	Franchise awarded / commenced	Franchise holder	Franchise length (years)
South West Trains	Dec 19, 1995 / Feb 4, 1996	Stagecoach Holdings	7
First Great Western	Dec 20, 1995 / Feb 4, 1996	Great Western Holdings	10
LTS Rail	May 9, 1996* / May 26, 1996*	Prism Rail	15
GNER	Mar 29, 1996 / Apr 28, 1996	Sea Containers	7
Gatwick Express	Apr 3, 1996 / Apr 28, 1996	National Express Group	15
Midland Mainline	Apr 22, 1996 / Apr 28, 1996	National Express Group	10
Connex South Central	Apr 12, 1996 / May 26, 1996	CGEA	7
Chiltern Railways	Jun 26, 1996 / Jul 21, 1996	M40 Trains	7
Connex South Eastern	Aug 21, 1996 / Oct 13, 1996	CGEA	15
Wales & West	Sep 17, 1996 / Oct 13, 1996	Prism Rail	7½
Cardiff Railway Company	Sep 17, 1996 / Oct 13, 1996	Prism Rail	7½
Thames Trains	Sep 19, 1996 / Oct 13, 1996	Victory Railways	7½
Island Line	Sep 20, 1996 / Oct 13, 1996	Stagecoach Holdings	5
Virgin CrossCountry	Nov 29, 1996 / Jan 5, 1997	Virgin Rail Group	15
First Great Eastern	Dec 4, 1996 / Jan 5, 1997	First Group	7¼
Anglia Railways	Dec 6, 1996 / Jan 5, 1997	GB Rail	7¼
West Anglia Great Northern	Dec 6, 1996 / Jan 5, 1997	Prism Rail	7¼
Merseyrail Electrics	Dec 20, 1996 / Jan 19, 1997	MTL Trust Holdings	7¼
First North Western	Feb 5, 1997 / Mar 2, 1997	Great Western Holdings	7¼
Silverlink	Feb 7, 1997 / Mar 2, 1997	National Express Group	7½
Northern Spirit	Feb 10, 1997 / Mar 2, 1997	MTL Trust Holdings	7
Thameslink	Feb 11, 1997 / Mar 2, 1997	Go-Ahead/VIA	7
Central Trains	Feb 17, 1997 / Mar 2, 1997	National Express Group	7
Virgin West Coast	Feb 19, 1997 / Mar 9, 1997	Virgin Rail Group	15
ScotRail	Feb 25, 1997 / April 1, 1997	National Express Group	7

Table 5.3. Franchise award/commencement dates, holder and length. Source: Knowles, 1998; OPRAF, 1998a.

	Nat. Expr.	Seoach	Prism	FirstGroup	MTL	Go-Ahead	CGEA	Sea Con.	Virgin	GB Rail	Govia	Halcrow	Cowie	Resurgence	GW Hold.	M40	M(E)BO
South West Trains		Y					(N) ¹	N						N	(Y) ²	(N) ¹	(N) ¹
First Great Western	N	N		(Y) ³			N	N									(Y) ²
LTS Rail		N	Y							N							N ³
GNER	N	N					(N) ⁴	Y									(N) ⁴
Gatwick Express	Y		N						N	N							
Midland Mainline	Y		N		N												N
Connex South Central	N	(N) ⁵					N										(N) ⁵
Chiltern Railways		N					N									(Y) ⁶	(Y) ⁶
Connex South Eastern		N		(N) ⁷			Y			N					N		(N) ⁷
Wales & West			Y														N
Cardiff Railway Company		N	Y									N					N
Thames Trains			N			(Y) ⁸			N							N	(Y) ⁸
Island Line		Y ⁹															
Virgin CrossCountry			N						Y					N			
First Great Eastern	N			Y			(N) ¹⁰										(N) ¹⁰
Anglia Railways	N		N	N						Y							
West Anglia Great Northern			Y	(N) ¹¹					N	N							(N) ¹¹
Merseyrail Electrics		N	N		Y	N									Y		
First North Western		N	N													N	
Silverlink	Y	N					N										
Northern Spirit					Y						(N) ¹²						(N) ¹²
Thameslink									N	N	Y ¹³		(N) ¹⁴				(N) ¹⁴
Central Trains	Y	N		(N) ¹⁵			N										(N) ¹⁵
Virgin West Coast		N						N	Y								
ScotRail	Y	N	N								N						N

Key: Y = successful bidder; N = shortlisted bidder. (Ys or Ns in parentheses indicate shared - or otherwise allied - bids.)

Notes

1. MBO bid was in conjunction with CGEA.
2. Great Western Holdings was an MBO bid in conjunction with FirstGroup and 3i.
3. MBO originally successful then revoked.
4. MBO bid in conjunction with CGEA.
5. MBO bid in conjunction with Stagecoach.
6. M40 Trains was an MBO bid in conjunction with Laing plc.
7. MBO bid in conjunction with FirstGroup.
8. MBO bid in conjunction with Go-Ahead.
9. No shortlist published.
10. MBO bid in conjunction with CGEA.
11. MBO bid in conjunction with FirstGroup.
12. MBO bid in conjunction with GoVia (see below).
13. GoVia is a partnership between Go-Ahead (65 per cent) and VIA GTI (35 per cent).
14. The MBO bid was in conjunction with Cowie.
15. The MBO bid was in conjunction with First Group.

Table 5.4. Shortlisted bidders in the franchising process. Source: Cormack and Pigott, 1997.

Train Operating Company	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Anglia Railways		8.8	36.2	26.9	22.8	16.5	13.4	8.8	6.5								
Cardiff Railway Company		10.2	20.6	18.7	17.6	16.3	15.5	14.7	14								
Central Trains		11.5	187.5	173.4	153.7	145.8	140.9	136.6	132.6								
Chiltern Railways		11.6	14.3	12.9	10.2	6.9	4.8	3.4	0.4								
Connex South Central		75.8	76	56.2	48.5	44.8	39.6	37.1	34.6								
Connex South Eastern		57.7	114.6	87.4	63.2	50.7	41.7	33.7	28.5	24.5	19.8	16.8	11.8	8.1	3.3	-1.3	-1.6
Virgin CrossCountry		30.6	115.9	95.5	80	72	66	49.2	38.4	21.5	13.4	6.9	3	0.8	0	-5	-10
Gatwick Express		-4.1	-6.2	-8.1	-10.1	-11	-11.8	-12.4	-13.7	-15.1	-16.7	-17.3	-18.8	-20.5	-22.1	-23.9	-1.9
First Great Eastern		5.6	28.6	14.4	8.4	2.8	-0.3	-5.2	-9.8								
GNER		61.4	55	37.4	17	6.4	2	0.1	0								
First Great Western	9.4	61.8	58.9	55.5	49.4	42.8	35.1	28.2	18.2	8.7	-2.7						
Island Line		0.9	1.9	1.9	1.9	1.8	0.9										
LTS Rail		25.4	27.6	25.8	24.1	22.6	21.2	19.9	18.7	17.6	16.5	15.5	14.5	13.6	12.8	12	1.8
Merseyrail Electrics		7.5	7.4	6.7	6.1	5.8	5.5	5.7	5.4								
Midland Mainline		16.1	8.2	2.5	0.9	-0.5	-2.6	-4.5	-6.4	-8.4	-10.5	-0.9					
First North Western		12.5	100.3	92.4	84.3	77.4	74.1	71.3	69								
Northern Spirit		12.3	224.5	197.1	175.8	164.3	156.3	150.5	145.6								
ScotRail			280.1	264.8	250.5	234.9	220.4	209.3	202.5								
Silverlink		4.2	49.3	36.5	30.6	27.3	23.8	20.6	17.4	16.3							
South West Trains	9.3	63.2	62.6	62.7	57.5	52.2	46.7	36.9									
Thameslink		1.3	2.5	-6.9	-16.7	-23.2	-24	-27.9	-29.4								
Thames Trains		18.7	33.5	25.6	17.5	14	7.8	3.9	0								
Wales & West		38.3	73.5	64.2	59.3	53.1	49.1	45.5	40.5								
West Anglia Great Northern		14	54.5	35.9	26.2	13.5	4.4	-15	-26.3								
Virgin West Coast		5.8	76.6	70.4	58	55.5	54	-4	-54.5	-57.7	-74.4	-130.9	-156.7	-173.3	-201.8	-209.1	-227.8
TOTAL	18.7	551.1	1703.9	1449.8	1236.7	1092.7	984.5	806.4	632.2								

Notes
Positive figures represent subsidies payable by OPRAF, negative figures represent premiums payable to OPRAF.
Figures in extreme left and right columns may indicate part-year payment/premiums, depending upon the commencement date of franchises.
Totals refer only to those subsidies/premiums determined in 1999. They will change from 2002/03 as new franchises are let.

Table 5.5. TOCs’ subsidy profiles, 1995/96 - 2011/12. Source: OPRAF, 1998.

Although the NAO (1996: 25) concluded that “a good level of competition” had been generated by OPRAF for the first three franchises, bids became very much more competitive immediately afterwards. Respondents who won TOCs shortly after South West Trains, First Great Western and LTS Rail had been let, noted:

“We put in quite an aggressive bid... We did a lot of work on it and we came to a view that was supported but looked quite aggressive compared to South West Trains. SWT, in retrospect, was easy, and if we’d have won we’d all be millionaires by now... But potentially we could be seen as one of those ground-breakers.”

“People applied very aggressive ratios to the costs and revenues... In the final lot of franchises... we lost by some substantial margin. We never really changed our risk profile throughout the whole process. We applied the same risk, slightly up or down depending on whether we liked the franchise or not, but essentially the same. We were very successful in the first half of the process, [but] in the final rounds we weren’t very close at all to the winning subsidy.”

The annual financial improvements needed by TOCs to compensate for declining subsidies or increasing premium payments are shown in figure 5.4 (figures 5.5 - 5.7 show this information by BR business sector). Although there is by no means a neat time/subsidy correlation, the important point to note is the significant increase in the financial improvements required before and after the first three franchises were let. GNER, the first InterCity-type operator to be franchised after First Great Western, needs to improve its financial performance by more than twice that of the latter. Other than Gatwick Express, no other former Inter-City franchise can afford to increase its revenue less than GNER. Similarly, Connex South Central must increase its annual revenues by more than three times the figure required of South West Trains and twice that of LTS Rail. Only Connex South Eastern has a less demanding financial task among the former Network SouthEast TOCs. A Regional Railways-style operator was not let in the first batch of franchises, but the minimum financial improvement required by a TOC in this group is 8.3 per cent per year, over six times that of South West Trains and over four times those of First Great Western and LTS Rail. All of the other companies in this group must improve their revenues by the same, or a higher, amount in order to remain profitable.

The ambitious targets set by private sector operators mean that substantial increases in revenue are required in order for the TOCs to remain financially viable - indeed, for some TOCs, the overall financial improvement required exceeds their ticket revenue at the beginning of the franchise (Knowles, 1998) - and these increases must be achieved by better marketing and/or provision of services, more stringent revenue protection and cost reduction. InterCity-type TOCs are in a good position to expand their businesses because

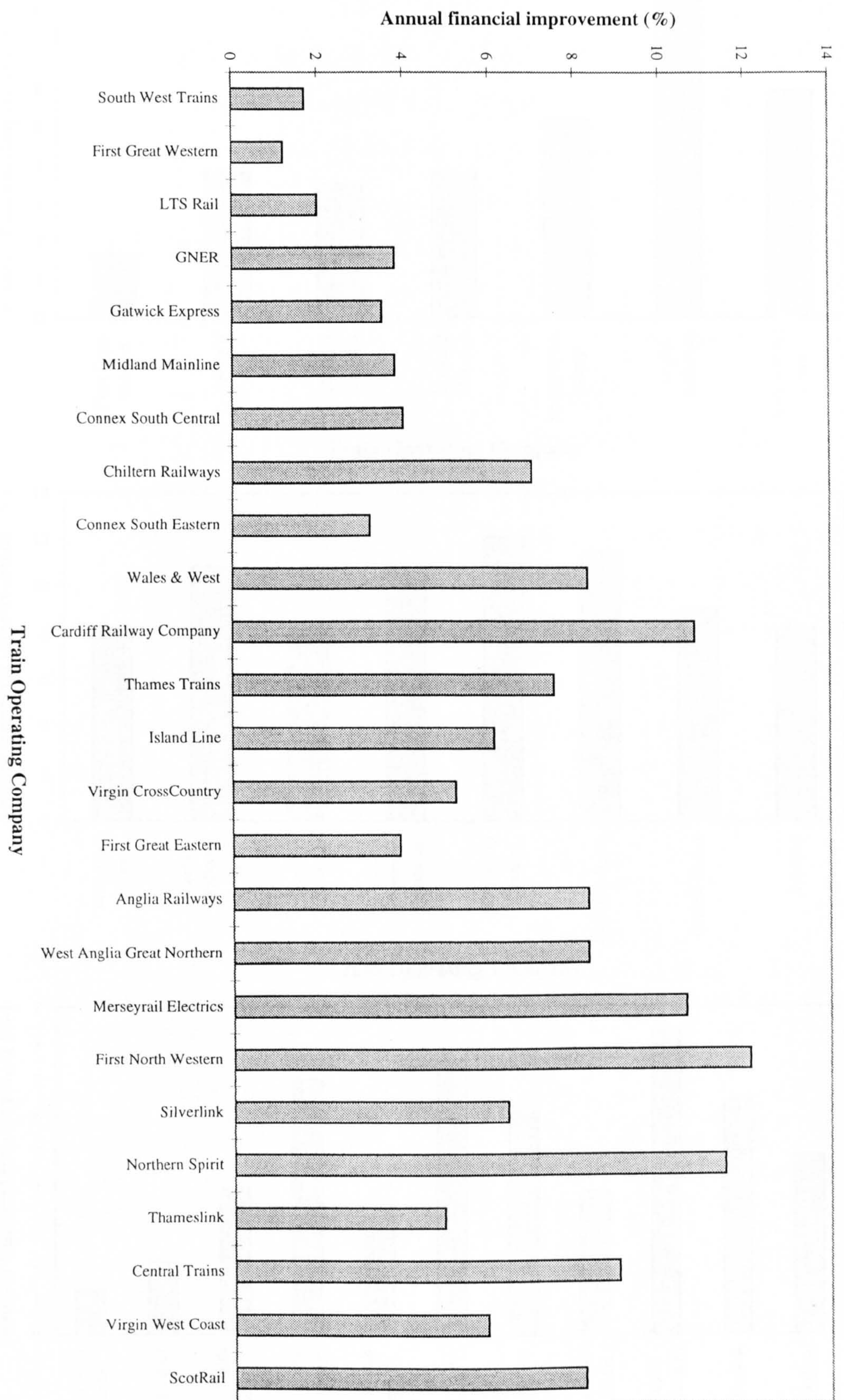
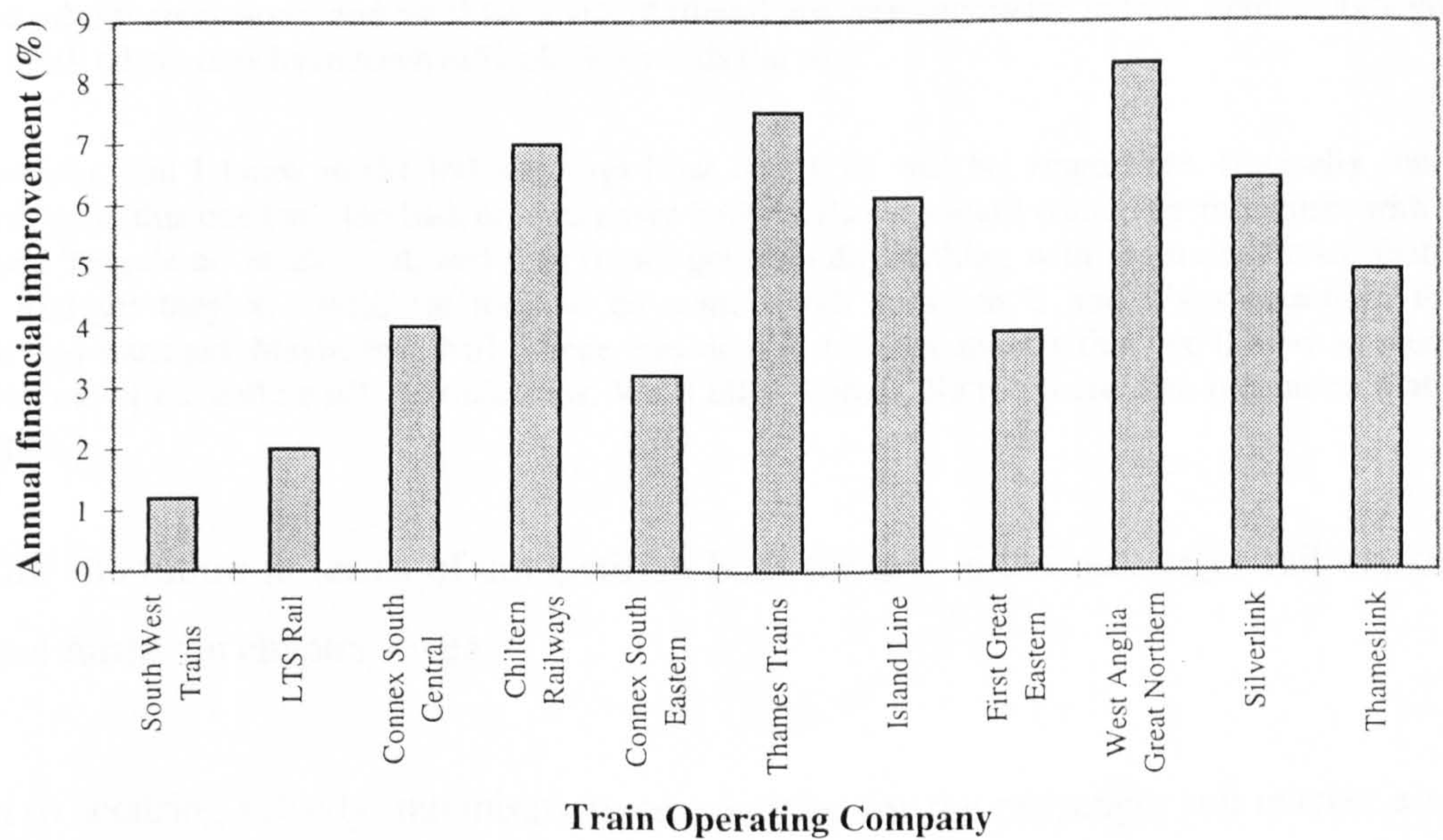
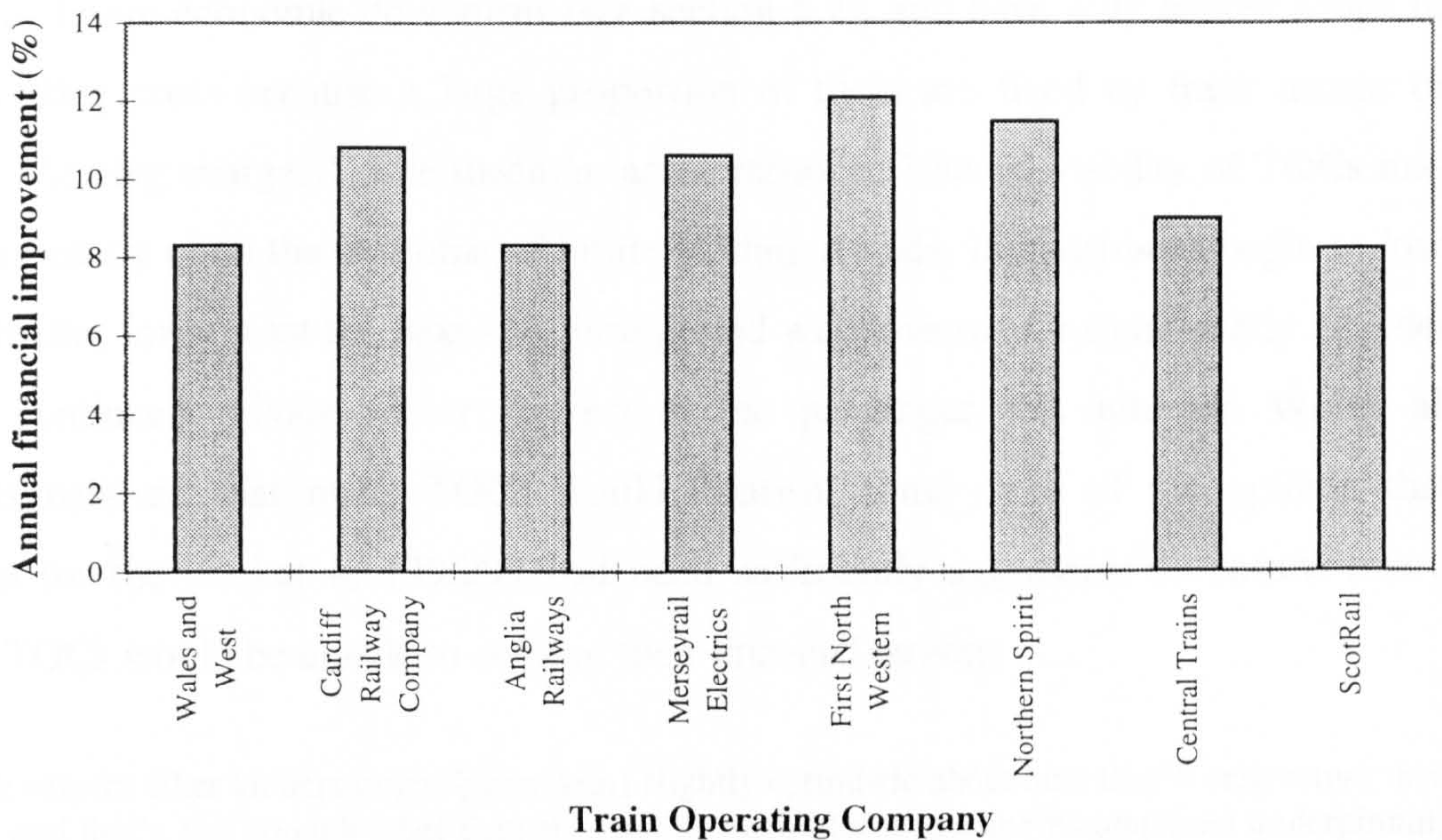
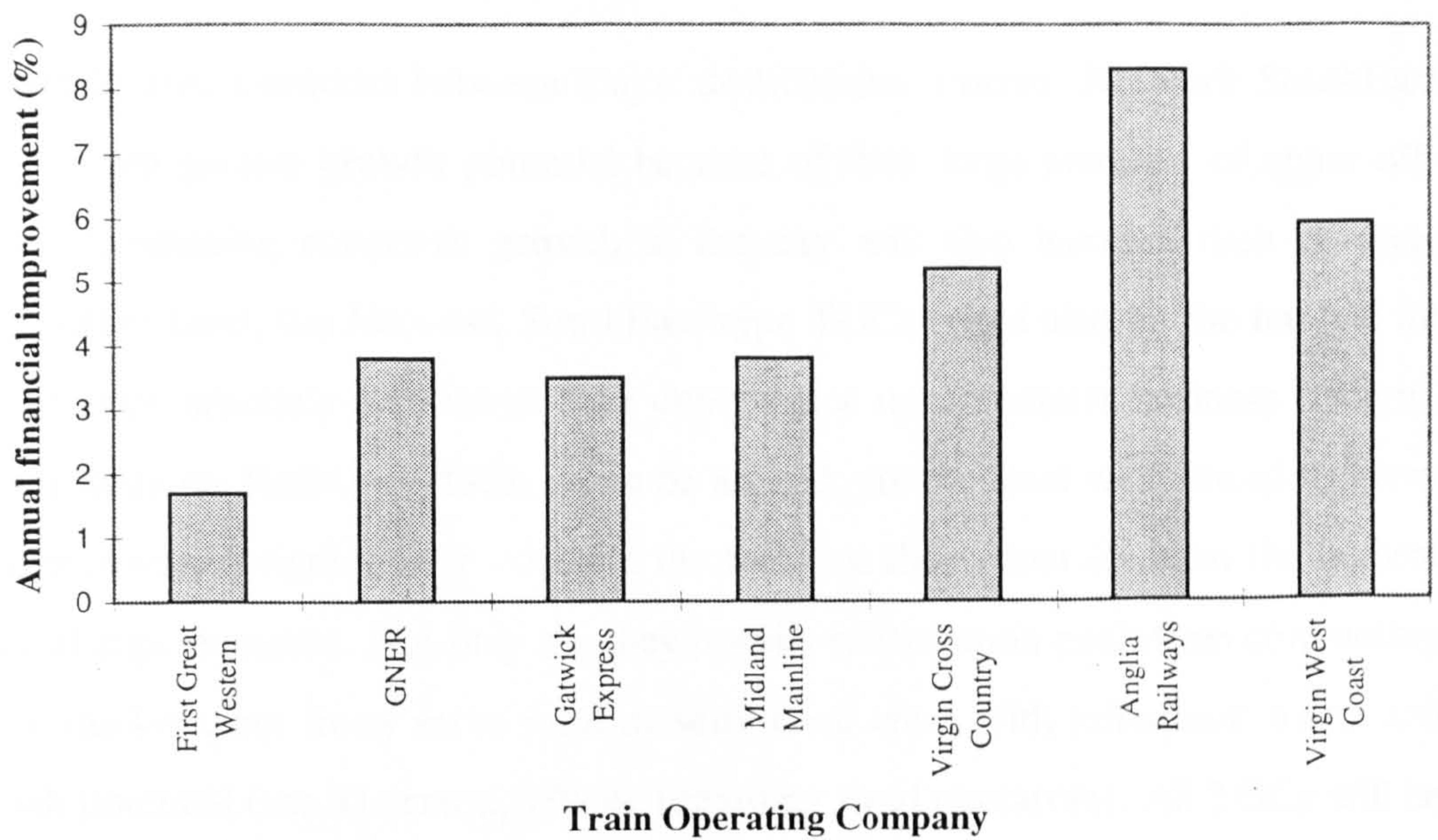


Figure. 5.4. Annual financial improvements needed by TOCs in order of letting. Source: Glover, 1997.



Figures 5.5 - 5.7. Annual financial improvements required by TOCs according to their former BR business sectors (InterCity, Regional Railways and Network SouthEast respectively). Source: Glover, 1997.

they serve heavily used corridors between major destinations. Former Network SouthEast TOCs have an even greater growth potential because of their large amounts of spare off-peak capacity. Continuing economic growth in the city will also increase their revenue bases. On the other hand, the Network SouthEast-type TOCs could also be the hardest hit in a future recession precisely because of their dependence on commuter business (Knight, 1998). Former Regional Railways TOCs, it can be argued, are the least well-placed to grow their passenger revenues significantly - despite the fact that they generally need the highest annual financial improvements. Not only are they heavily reliant upon peak-time commuting in their urban markets, but many serve rural or semi-rural areas with infrequent trains and limited growth potential (see Thornton, 1999a, regarding rural operators). All TOCs will be vulnerable to future economic downturns (see section 5.2), and have only limited scope to reduce operating costs because a large proportion of them are fixed by track access or rolling stock leasing charges.¹⁴ The medium- and long-term financial viability of TOCs may impact significantly upon the outcome of future bidding rounds. If franchisees begin to lose money, subsidies for at least the next franchise period will have to rise significantly in order to ensure continued private sector interest in the passenger rail industry. Whilst all respondents believed that many TOCs would flourish, some were of the opinion that competition for the market in 1996/97 had been sufficiently aggressive to ensure that a number of TOCs would be unable to achieve their financial targets:

“We suspect other bidders might [have been] slightly optimistic about how they’ll restructure their companies - and that’s bad enough - but then we look at some of the revenue assumptions underpinning some of these subsidy reductions, and we think some of [them] are very aggressive indeed. Something’s got to give... we think others may have some difficulties towards the end.”

“Everyone that I know in the industry says [that one TOC will be] impossible. Normally some people say ‘oh yeah, this one isn’t too bad, or ‘you never know’. It’s a standard commuter franchise, with a few rural lines. There’s no magic to it, and they’re not going to do anything with the train service that’s spectacular. And yet they’ve... well, we tried to do some rough sums on it and it’s spectacular, the improvement they must get. Maybe they will. I hope they do... But if they achieve that, we’ll have so much money flowing out of the coffers it’ll be ridiculous. We’ll all be heroes. So far, there’s no indication that’s going to happen.”

Prospects for the future in terms of competition both for and in the passenger rail market are discussed further in chapter seven.

In addition to securing subsidy minimisation, competition for the passenger rail market also manifested itself in terms of quality enhancements (Knowles, 1998). At first, although OPRAF had indicated that they would consider original bid enhancements where two or

¹⁴ Track access and rolling stock leasing costs are in large part fixed and amount to over 70 per cent of a

more tenders were similarly priced, at least three companies submitted non-compliant tenders which sought to provide a greatly improved quality of service in exchange for a high level of subsidy. One respondent, who submitted such a tender for South West Trains, offered to resign from his post as a bidding consultant because he was “miles out” in terms of subsidy from the winning bid. A feeling of disillusionment grew among some bidders, with respondents lamenting OPRAF’s apparent disinterest in non-compliant bids:

“[We thought we] could offer to improve the service in some way, presumably there might be some trade off in terms of the level of subsidy the government would be prepared to put in. I never saw any evidence of that taking place. It was ‘who will give me the lowest subsidy or greatest level of premium for taking this franchise off our hands?’ ...It certainly took us a painful lesson or two to realise that was the case... We were surprised to realise that all that quality stuff was just put to one side. ‘Very nice, thank you, but irrelevant.’”

But the fact that some bidders held these opinions did not serve to undermine the importance of qualitative elements in the franchising process, especially in later bids. In a climate of intensifying competition, the difference between the subsidy profiles of different bidders was reducing considerably. Respondents perceived that low subsidy requirements in themselves became insufficient to guarantee winning franchises and, as a result, the inclusion of - or at least a willingness to negotiate - a host of “goodies” in compliant bids became *de rigueur*.

“They [bidders] knew that we were explicit about the numbers, but we also said that we would look hard at the qualitative aspects of the deal. If we felt, in the round, that one bid might be slightly more expensive, but provided substantially better outputs, we may have chosen that. The bidders could not just have put in bids which were very low and offered nothing because they thought - and they would have been right - that we may have preferred another bid which provided more.”

To many bidders, including “goodies” in tenders made business, as well as bidding, sense. Respondents took the view that certain improvement initiatives, including those which required major investment, were business-case driven in the sense that, by ‘speculating to accumulate’, they would be able to improve their revenue predictions and thus secure a further reduction in the subsidy profile. More conservative bidders, who would only consider investment proposals if the franchise terms were extended beyond those which OPRAF was prepared to let, were now effectively eliminated from the process:

“Someone would say, ‘I know you’re offering a seven year franchise, but I’d like a 10 year one’. I’d say, ‘great, wonderful, when we’re offering one we’ll give you a call. In the meantime, we’ll deal with all the other people who are trying to buy what we’re trying to sell.’”

Table 5.6 outlines the key service quality enhancements which were secured by the Franchising Director during the competitive tendering process. All 25 franchisees made commitments to maintain service levels above those specified in the PSRs and/or provide more demanding improvements such as station or rolling stock upgrades. 22 franchises improved their targets for punctuality and/or reliability, and extra train services were secured in 18 TOCs (Knowles, 1998).

Train Operating Company	Rolling stock investment	Stations upgrade	New services	Improved passenger's charter
South West Trains	No	Yes	Bus links	Yes
First Great Western	Refurbished	No	Bus links	Yes
LTS Rail	Fleet replacement (new & refurb.)	Yes	Bus links, off peak	Yes
GNER	Refurbish	Yes	Bus links	Yes
Gatwick Express	New	No	Off peak	Yes
Midland Mainline	New and refurbished	Yes	Extra and faster	Yes
Connex South Central	No	Yes	Off peak and faster	Yes
Chiltern Railways	New	Yes	Extra and faster	Yes
Connex South Eastern	Fleet replacement	Yes	Extra and bus links	Yes
Wales and West	Refurbished	Yes	New routes	Yes
Cardiff Railway Company	No	Yes	New routes and bus link	Yes
Thames Trains	No	Yes	Extra and faster	Yes
Island Line	No	Yes	No	Yes
Virgin CrossCountry	Fleet replacement	Yes	Extra, faster and bus link	Yes
First Great Eastern	Refurbished	Yes	Extra and bus link	Yes
Anglia Railways	New and refurbished	Yes	Extra, faster and bus/air link	Yes
West Anglia Great Northern	Refurbished	Yes	Extra, faster and bus links	Yes
Merseyrail Electrics	No	Yes	No	No
First North Western	Yes	Yes	Extra and new	Yes
Silverlink	New and/or refurbished	Yes	Extra, new and bus link	Yes
Northern Spirit	Yes	Yes	Extra and faster	Yes
Thameslink	Refurbish	Yes	Extra	Yes
Central Trains	No	Yes	New, extra, bus link, park & ride	Yes
Virgin West Coast	Fleet replacement	Yes	Extra, faster and electrification	No
ScotRail	Yes	Yes	Extra	Yes

Table 5.6. Quality of service enhancements secured during the franchising process. Source: Knowles, 1998.

Notwithstanding the subsidy reductions and quality of service enhancements which resulted from the franchising process, some respondents maintained that the Franchising Director did little more than secure a 'cheap' railway, and that the government overlooked an ideal opportunity to insist upon myriad service improvements not included under current franchising contracts. As will become apparent in chapter seven, this argument is powerful one, and may impact significantly upon future franchising rounds. At this stage, however, it is sufficient to note that the intensity and outcomes of the competition generated by the franchising process significantly exceeded anything policy makers originally expected given the uncertainty which surrounded rail privatisation before competitive tendering began. The state was able to withdraw from the passenger rail industry by both transferring assets and reducing subsidy. The next section of this chapter seeks to ascertain, from a bidder's perspective, the key reasons why this situation arose.

5.5 Explaining competition for the market

Speaking in front of the Committee of Public Accounts in October 1996, Roger Salmon suggested that "a good level of competition" (NAO, 1996: 25) had been generated for the first three TOCs for two reasons, both of which were related to OPRAF's handling of the franchising process. Salmon postulated, first, that his decision to prevent BR from tendering in the early stages of the process and, second, that OPRAF's helping bidders better understand the market, were instrumental in encouraging private sector interest in South West Trains, First Great Western and LTS Rail (*House of Commons Papers*, 1996). Whilst to a degree Salmon's arguments appear self-serving, evidence suggests that OPRAF's actions were indeed important to the success of the franchising process because they helped facilitate a market by removing at least some of the uncertainty which surrounded the market at the time.

Although wishing to encourage privately-backed MEBO bids (Freeman, 1993), ministers consistently argued that the BRB should not be allowed to bid for the right to run TOCs (*The Times*, 1993). From an ideological point of view, the government's position was understandable given that the key aim of the 1993 Railways Act was to transfer the industry into the private sector. Letting BR bid for TOCs would have been the same as allowing the Post Office to buy BT. But the government's position had also been influenced by important practical considerations. First, allowing the BRB to submit tenders would probably have discouraged MEBO bids. Would-be franchisees in BR's employ were already facing the

dilemma of separating their responsibilities to the BRB from those to their bid partners, and allowing the Board to join the franchise competition would have created extreme conflicts of interest:

“It was difficult enough as it was, having duties to BR and to the State in general as they were paying your salary. You know, you’d accumulated all this knowledge [of how to run a railway] and then suddenly you are supposed to give all that knowledge to OPRAF and their agents so that [they] can get the best price for the franchise. If you also had your bosses, essentially, competing against you, then the conflicts become even more impossible.”

Second, the prospect of tenders being submitted by the BRB would almost certainly have discouraged externals from bidding because they viewed BR as having an unfair commercial advantage.¹⁵ Not only might the BRB have cross-subsidised its bids from other sections of its business (Wintour, 1993), but it was also perceived as having an infinite financial backer in the government. As a result, the Board may not have been forced to make commercial assessments of risk and return, and the possibility of its submitting extraordinarily low bids could have distorted the entire franchising process. One respondent, a MEBO-turned-external bidder, argued in addition that the BRB’s competitive position might have been strengthened by over-optimistic revenue projections made as a result of its approach to running the nationalised railway: “I mean, they always set impossible targets for the management which were regularly missed. If they’d actually believed those targets, then it would have been impossible to compete against them.”

Despite these arguments, the Transport Select Committee remained concerned that excluding the Board from the franchising process could result in railway expertise being lost from the industry, and recommended that the BRB be allowed to participate (*House of Commons Papers*, 1993a). The House of Lords agreed and, in summer 1993, peers including former transport minister Lord Peyton passed an amendment which required that the Board be allowed to submit bids (Wintour, 1993). Reluctantly, after the Railways Bill had ‘ping-ponged’ between the elected and unelected chambers, the government conceded that the BRB would be allowed to bid for TOCs, but that tenders would be invited subject to the discretion of the Franchising Director (House of Commons, 1993; *The Times*, 1993).¹⁶ Salmon announced in December 1994 that, in the interests of securing sufficient

¹⁵ Ford (1995) took issue with this point at a press conference in late 1995 during the following exchange between himself and Roger Salmon when he found out that BR would be unable to bid: “‘Why not?’ I asked. ‘Because private companies might be put off if they had to compete with BR’ said Mr Salmon. ‘Oh, come on, everyone knows that BR is “deeply inefficient” (Major J.) and “inadequate” (Major J. again) and the dynamic thrusting private sector companies will run rings around it.’”

¹⁶ Perhaps realising that the Secretary of State would simply instruct the Franchising Director behind closed doors to block BR bids, opponents of this compromise noted that the government had missed the point of

competition for the TOCs, he would 'provisionally' exclude the BRB from the initial franchising rounds (it was later confirmed that BR would not be allowed to bid in the first 13 rounds) (Smithers, 1994b). His decision appears to have been an important factor in determining whether or not some bidders involved themselves in the early franchise competitions. A respondent noted that:

"We clearly welcomed the fact that BR weren't able to bid because we felt BR would have a clear inside track. To put a bid together did require very significant effort, time resources and costs... If we felt we were bidding on an uneven playing field, then we would very seriously have reconsidered our position and I suspect, but of course this didn't happen so I don't know, but I suspect we may well have sat back a little bit to see what happened before we decided to go in or not. In other words, to see if BR were picking up five out of the first six, if you like. So we welcomed the scenario where BR weren't able to bid."

The BRB subsequently decided that it would not take part in any of the franchising rounds, even those it could legally have entered, after it became apparent that sufficient private sector interest had been generated in the process (Prynn, 1996a).

Salmon's second assertion was that competition had been generated for the first three franchises because of OPRAF's commitment to helping bidders understand the market for which they were bidding. It has already been noted in section 5.4 that passenger rail franchising was being conducted "with a paucity of detail" (Grantham, 1998: 132) and, in a confidential report to Brian Mawhinney in September 1995, the Franchising Director pointed out that early submissions to OPRAF had been "of variable quality which reflected bidders' immature understanding of the businesses concerned" (Salmon, quoted in Harper, 1995: 18). OPRAF responded to this problem pro-actively. In addition to providing a suite of basic information sources for bidders - long form reports from accountants, 'data rooms' which detailed virtually all aspects of TOCs' operational environments and sales documentation - the Franchising Director made himself available to all interested parties and sent his staff to 'troubleshoot' at corporate/MEBO board meetings. OPRAF's own systems were still very much in flux at this stage in the franchising process, but respondents acknowledged that OPRAF had made every effort to provide them with information as and when it became available.

The provision of information to external bidders was a particularly important task in order to ensure the maintenance of a level playing field between MEBOs and those from outside the industry. One respondent, a member of a MEBO team, suggested that internal bidders

the Lords' objections. Labour MPs had also foreseen that this tactic was a con (Webster and Prynn, 1993; Wintour, 1993).

probably had an inherent advantage over their competitors because of their 'inside' knowledge of the rail industry. Significantly, many of BR's middle-managers, including those who subsequently assembled MEBO bids, were involved in the process of establishing TOCs, and liaised with the consultants writing long-form reports: "I remember long nights sat in Samuel Montagu's offices drafting ITTs which became a bit of a bench mark for the future." To combat potential problems in this area, OPRAF enforced disclosure regulations to ensure that TOC managers passed on all relevant business information to external bidders. However, although respondents generally viewed these regulations as effective some, including those from MEBOs, acknowledged that there was a 'grey area' which incumbent managers exploited to secrete ideas and business propositions they had formulated as a result of their familiarity with the industry:

"Perhaps we had an inside track, sort of 'here's an idea of what we'll do, what do you think?' before it went to Sea Containers and so on... We knew stuff and said 'well we're not going to talk about that unless we're asked'... But we had a bright idea and, you know, we'll put that one in the bottom drawer, save that one. The other management teams were doing the same, clearly, it was obvious."

That said, it is important not to overstate the significance of this 'inside' information. MEBOs had no more access to financial performance data than external bidders because track records had only recently become available. In addition, externals bidding for more than one TOC accumulated the benefit of repeated exposure to the franchising process, something MEBO teams would clearly lack (although, as shown in table 5.4, some MEBOs were supported by experienced corporate bidders). Finally, it can be argued that any inherent advantage to MEBOs in terms of information was cancelled out by difficulties they experienced in raising bid-capital.¹⁷ Because banks in the UK were suspicious of rail privatisation (see section 5.1), some MEBOs were forced to seek funding from foreign institutions or venture capitalists whose high rates of interest impacted significantly on the cost - and hence the competitiveness - of their bids. Moreover, many venture capitalists were conservative with regard to the rail industry's future growth prospects, and refused to back MEBOs if their bids were predicated on optimistic revenue predictions:

¹⁷ A key characteristic of franchising is of course that it removes the need for bidders to inject a significant amount of capital into a business. However, in order to ensure that a franchisee could not simply walk away from a TOC if their business plans were to go awry, the Franchising Director demanded that each successful bidder pay capitalisation and a performance bond. Capitalisation covers the high level of fares paid to TOCs in advance (especially annual season tickets), and performance bonds, which vary in value depending on the TOC (First Great Western's is around £14m), are only refundable once a franchise term has been completed (see OPRAF, 1996a).

“Whereas many of us believed that franchises ought to be capable of generating growth of five per cent a year compound, the financial institutions wouldn’t accept that on the history of BR’s performance in previous years. So the maximum which would have got in the plan was three per cent compound.”

Corporate bidders, on the other hand, could take advantage of an established credit history, initiate a stock market flotation or even finance a bid from their own balance sheet to raise capital:

“Those with a healthy balance sheet who were prepared to provide finance for a franchise bid won the franchises because the venture capitalists on which the management teams depended wouldn’t match that optimism for revenue growth... We bid for [a TOC], for example. There was no way that in our bid there was a suggestion that subsidy could be removed altogether in the way that [the eventual winner] had done.”

Although most external bidders were generally satisfied that OPRAF had sought to eliminate information asymmetries between themselves and MEBOs, it is clearly possible that their views were coloured at least in part by the above considerations.

By excluding BR from the initial franchising rounds and helping bidders understand the market in which they were to become involved, OPRAF clearly removed some of the doubts about rail privatisation harboured by the private sector. However, even taken together, these two factors do not adequately explain why competition was generated for the South West Trains, First Great Western and LTS Rail franchises. Aside from the fact that OPRAF could only pass on information to bidders when it became available (and in some cases this was late into the tendering process), the Franchising Director could do little about the general level of uncertainty being sustained by media and political opposition to rail privatisation, and there was still no international precedent upon which bidders could draw to gain a better understanding of how the track authority model would work in practice. Two additional factors were found to augment the Franchising Director’s account of why bidders became involved in the initial franchising rounds.

First, there were bidders who had always supported the rail privatisation process, or who at least viewed it as an ideal means of adding further transport-related businesses to their portfolios, regardless of the uncertainty by which it was characterised. One bidder’s interest stemmed from the fact that privatisation would give him, as an ‘enthusiast’, the opportunity to run a railway, but others were more convinced that the proposals made commercial sense, especially in the medium to long-term. These latter bidders presumed that, given the increasing political, economic and environmental concerns about traffic congestion and pollution (see, for example, Hughes, 1993; Preston, 1980; Royal Commission on

Environmental Pollution, 1994; Whitelegg, 1992), rail was highly likely to be a growth industry in the future. Moreover, it was felt that any political risk associated with rail privatisation had been overstated because the Labour Party, if they were to form the next government, would be unlikely to renationalise the railways (see section 5.2). Indeed, perhaps ironically, one respondent noted that the prospects for a privately-owned railway were brighter under Labour than the Conservatives because the former were “more likely to be anti-car and that has to help train operators from a commercial point of view.”

Second, at least two bidders realised that they could use the general level of uncertainty surrounding the proposition to their advantage in the early bidding rounds. These respondents reasoned that many of their potential competitors were likely to distance themselves from the franchising process initially in order to gauge the outcome before committing themselves. Thus, although conservative bidders would ensure that they did not waste resources should franchising prove a failure, their entrepreneurial counterparts would be more likely secure a TOC at good value in the face of limited competition. Drawing upon their experience from earlier bus privatisations where this pattern had prevailed (see also Knowles, 1989; Wolmar, 1998), the bidders noted:

“With 25 franchises I suppose [being conservative at first] is a strategy you could justify, you don’t need to be one of the first three. Our counter to that is our experience... has generally been that you get the best value at the beginning of a privatisation, you get the best value for the relatively unfancied franchises. If you have an auction process where there’s 10 or 15 bidding, you tend to get more overpricing... than you would with [only] two or three.”

“There are advantages in the information not being very clear at the outset because people are inherently cautious and risk averse, whereas I suppose we’re a bit more entrepreneurial so these things can work to our advantage. Contrast that with what’s going on now [outside of rail privatisation]. If we tender for an airport, we might find that we were info. memo. number 87... That points to like 100 interested parties. From our point of view, that’s not a very good privatisation structure because we’re not going to get value for our shareholders. [But] if there’s only two or three serious bidders [we will].”

To their further advantage, early bidders were rewarded upon committing themselves to the process with the realisation that the limited information available to them in the early stages of the franchising process was not necessarily a handicap when it came to assembling a tender. Although “track records would have been nice,” the bidders became aware that other details could easily be estimated, especially at the non-binding, indicative bid stage of the process. For example, although the finalised PSRs were not available when ITTs were issued, it could be presumed that their contents would be similar to the draft documents which bidders had seen:

"I think it's always very easy [for people] to get diverted by relatively minute levels of information... The PSR did follow on by a few weeks, but anyone understanding the franchise and the terms of it knew within a minute proportion what level of service would be required. It really was, you know, whether the first departure in the morning had to be before 8.00 or 8.15, it was that sort of detail. So to be honest, I don't think that should have affected anyone's overall appraisal of the business."

Bidders who declined to submit tenders for any of the first three franchises realised in retrospect their mistake. One respondent opined (rather bitterly) that the initial bidders "got a better deal than they should have," although he did acknowledge that "there is an argument [which says] they deserved it because they were the first people to bid."

The speed at which competition intensified after the first three TOCs had been let surprised some bidders who had expected others (and, in some cases, themselves) to remain cautious for much of the process:

"We had expected [that] after these people had sat on the fence the first time that they would still be very cautious because of the uncertainty, the general election looming, all this sort of doom and gloom. This was a privatisation too far, all that business. [But] I don't think that happened. People did have the confidence to come in and come in big... We thought some of the outsiders might have been scared off as a lot of the banks were."

Salmon again suggested that his handling of the franchising process was at least in part responsible for the unexpected bullishness of the market (*House of Commons Papers*, 1996). Respondents acknowledged that they were confident in the system established by the Franchising Director and had no reservations about re-entering later rounds following unsuccessful bids. Using its experience from the initial franchising rounds, OPRAF had been able to standardise almost all procedures and sales documentation, and the business of letting franchises was streamlined considerably as a result. In addition, OPRAF quickly established a reputation for integrity among bidders. Respondents commended OPRAF regarding the transparency with which franchising was conducted, some noting that previous franchising rounds in which they had been involved, especially those in the bus industry, had been characterised by "suspicions and doubts, people with chips on their shoulder, people being aggrieved because they hadn't been rewarded in the way they thought they would and so on." OPRAF sought to avoid this by publishing the terms of winning bids to provide a benchmark against which unsuccessful bidders could review their submissions. Moreover, the Franchising Director was also concerned to ensure that his staff were beyond indiscretion. Only one respondent suspected unprofessionalism on the part of OPRAF (although no evidence could be found to confirm this) and the Franchising Director's diligence was appreciated by bidders:

"I never felt that OPRAF people would give injudicious or indiscreet comments to people which was terribly tempting for them if you're letting one of these things [a franchise]. 'Just push it up a bit more...' You never got a sense of them doing that which gave people some confidence."

"My cousin worked for OPRAF... He was absolutely obsessive about not being anywhere near me for two years! He had nothing to do with my bid. Even when they had senior management meetings and mentioned [this particular TOC], he would excuse himself. It became one of the OPRAF jokes, but it's actually a great tribute to him and to OPRAF's integrity that they take these issues so seriously."

Although OPRAF's continuing management of the franchising process provided a foundation upon which the market for TOCs could be established, easily the most significant reason for the increase in competition seems to have been a straightforward and very sudden change in market sentiment. Salmon recognised this:

"In each case the level of subsidy was ultimately set by competition and after people saw the first franchises sold, saw the reception of those sales on the stock market, saw that serious companies were interested saw the comment of the press, they became keener to bid and put in keener bids to me" (House of Commons Papers, 1996: 14).

The pessimism with which the private sector had previously viewed passenger rail privatisation transformed quickly into virtually unfettered optimism. Respondents had seen that the contractual minefield of passenger rail franchising could be negotiated, and that TOCs could pass into private hands with relatively few problems. Most importantly, however, they had seen that money could be made from rail privatisation. The successful bidders, particularly Stagecoach, had taken over TOCs at a level of subsidy which, when combined with forecasts of even minimal revenue growth, would ensure "a very handsome profit" (*The Times*, 1995: 28). Stagecoach had made few commitments to invest in South West Trains, and the bus operator's reputation as an aggressive cost-cutter led city analysts to predict profits of up to £12 million per year by 1998 (*The Times*, 1995).

The subsequent behaviour of Stagecoach Holdings was instrumental in alerting potential bidders to the benefits of rail franchising. At a presentation to the City after securing the South West Trains franchise, Stagecoach "did a very good job of informing their shareholders of the deal they had done." Derek Scott, then Stagecoach's financial director, told Grantham (1998: 144) that:

"As soon as we made a presentation to the City in December 1995 the genie was out of the box. [They said] 'these guys have bought a £280m turnover business, they say they'll average a nine percent margin in seven years and they've bought it for a pound.'"

In a volatile market unnerved by a sudden tumble on Wall Street (Pangalos, 1995), Stagecoach's share price rose by 17 per cent in the week after it had acquired South West Trains, and by a further seven per cent the following week. The *Financial Times* (1996) was later to comment that a key reason FirstBus's shares were performing poorly in relation to Stagecoach's was because the former had failed to obtain a controlling interest in any rail businesses (FirstBus did have a 24.5 per cent stake in Great Western Holdings).

Stagecoach's bravado, along with what was perceived as an aggressive bid from Connex Rail for the South Central franchise soon afterwards, "had the effect of galvanising the market, and suddenly lots of other bidders realised this was a market they wanted to be in." Although some bidders applied a consistent rate of return to their tenders throughout the process, others, especially those who had lost out in previous rounds, became much more aggressive as they attempted to win a franchise. A "must have" culture developed as bidders and investors grew increasingly confident of rail privatisation's financial allure:

"The bus companies got on the bandwagon when they saw how well Stagecoach shares were doing, and National Express, and they thought 'we must have a franchise!' Firstbus got Great Eastern, MTL got North east and so on. So, good luck!"

"Clearly other players came in, either desperate to win something because they had not yet won anything or to build a portfolio and time was running out."

"It's so easy to forget the circumstances. The early franchises had been quite a problem one way or another. They'd taken a hell of a long time to get away and the notion was around for a very long time that by the time of the general election it would be impossible to have let all these franchises. So I think people were... saying, 'oh yes, that's what's happening here and four have gone now [but] there's another 20 left'. Suddenly they discover that actually there are only another 10 left and half of those they didn't like the look of. So they really needed to win X, Y and Z."

As franchising progressed, one city analyst remarked that the competitive tendering process had become "a ridiculous pandemonium" (Nelson, 1997: 32). A respondent, who dealt with all bidders during the franchising round, suggested that this was so because ambition had blinded their judgement. Later tenders in particular, he argued, were characterised by hopeless short-termism in the sense that many bidders seemed to ignore potential future problems - such as the traditional link between the economy and railway performance or the potential impact of on-rail competition - in order to lower their subsidy requirements as far as possible. Thaler (1988), on the other hand, has contended that aggressive bidding of this kind results from corporate arrogance. The 'hubris hypothesis' (Thaler, 1988) predicts that companies will attempt to buck the market on the misplaced assumption that they can estimate the true value of a franchise better than the market. This is irrational in the sense that all bidders have access to the same information, and the theory suggests that the

winning bid will overestimate the true value of its object and present its originator with an unprofitable or loss-making business - the 'winner's curse' (Kennedy, 1995). It has already been noted that respondents believe some of their competitors to have been afflicted.¹⁸ The intensification of competition for the market generally resulted in those bidders who applied consistent rates of return to all their tenders failing to secure any TOCs in the later franchising rounds. One of these was Stagecoach. Despite bidding for virtually all the TOCs, the Scottish bus operator won only one, the eight-mile Island Line, after its initial success with South West Trains.

5.6 Competition for the market reviewed: the changing role of the state

This chapter has reviewed the development and outcome of passenger rail franchising against the background of rail privatisation policy evolution established in chapter four. It has shown that, partly as a result of the circumstances in which the track authority model was adopted, the private sector viewed rail privatisation as something of an uncertain proposition before the TOCs were put on the market in 1995. As a result, the development of franchising policy was heavily influenced by the government's need to convince potential bidders that acquiring TOCs would make commercial sense. Although the Treasury initially sought to maximise competitive opportunities in the new railway structure, it relented after the Department of Transport realised that such a policy could jeopardise the viability of the franchising process. Franchising policy thus became something of a paradox, whereby the Department of Transport's proposals, based on practicality rather than ideology, were more likely to promote competition for TOCs than the Treasury's. Nonetheless, even though their position had prevailed, senior policy makers within the Department of Transport and OPRAF remained sceptical as to whether meaningful competition for TOCs would actually materialise.

In the event, private sector interest in passenger rail franchising was remarkably buoyant. OPRAF's administrative competence, which removed at least some of the doubts surrounding rail privatisation and thus helped facilitate a market for TOCs, was at least partly responsible for this. More important, however, was the willingness of certain companies to take part in the initial franchising rounds and the sudden change in market sentiment that followed. A limited number of enthusiastic and entrepreneurial bidders were initially able to take advantage of the "doom and gloom" which surrounded rail privatisation to secure South West Trains, First Great Western and LTS Rail on favourable terms in the

¹⁸ Perhaps predictably, no bidder admitted to having been afflicted *themselves*.

absence of fierce competition from rivals. Bidders not involved in these franchising rounds quickly became aware that the contractual minefield of acquiring a TOC could be successfully negotiated and, more importantly, that money could be made from rail privatisation. As one respondent observed, bidders “[suddenly] thought, ‘we must have a franchise!’”

Before attention is turned to assessing rail privatisation in terms of its generating competition in the market, it is necessary in the context of this thesis to consider the impact of the franchising process upon the relationship between the railway industry and the state. It is argued here that the level of private sector interest in passenger rail franchising has altered this association in three key areas. First, because all 25 TOCs were let - the franchising equivalent of asset transfer - the state was able to shift much of the responsibility for the provision of rail services to private companies. In the same way that BT or British Gas own their means of production, franchisees now have albeit temporary control over the assets of the TOCs. It is true that the state has retained the right to stipulate minimum output standards in the form of PSRs but, as noted in chapter four, this compromise in neoliberal values was always inevitable in rail privatisation given the loss-making nature of most rail services. The outcome of rail privatisation was always going to be different from that of other network industries in this sense because the government clearly has a right to demand certain levels of service in respect of the financial support it provides to train operators (quality of service stipulations are discussed in chapter six).

The level of financial support is the second area in which franchising has redefined the state’s involvement with the rail industry. As a result of intense competition for TOCs, the subsidy required by franchisees will fall considerably below that which was required by BR at the time of letting. Whereas state support for TOCs was £2.1 billion in 1996/97, it should decline to £632 million by 2003/04, the year in which the majority of franchisees expire (OPRAF, 1998). Given that the track authority model significantly increased the overall level of subsidy required by the rail industry before privatisation (see chapter four), the figures should be interpreted with some caution. Even after sales revenues from Railtrack, the Roscos and other rail businesses are accounted for, the net costs of rail privatisation to the state could still be as high as £2.2 billion after 15 years (White, 1998). Net gains to the state, if there are to be any, depend upon the declining subsidy payments to TOCs which resulted from competition generated by the franchising process.

As this chapter has shown, the degree of competition generated for the market should result in subsidy falling considerably in comparison with that which was paid to BR at the point of privatisation (although it will remain above the amount received by BR prior to restructuring until at least 2001/02 (OPRAF, 1998)). White (1998) has calculated that, provided OPRAF support payments adhere to current forecasts, the savings which accrue will present a net gain to the state of some £240m by 2002/03. This will increase over time if overall subsidy payments reduce still further. Thus, the level of state involvement with the railway industry *in terms of financial support* will diminish from that which existed at the time of privatisation in this scenario. As noted in sections 5.4 and 5.5, some respondents suggested that the aggressive bids tendered by some franchisees are not sustainable, and that some TOCs, particularly those from the former Network SouthEast and Regional Railways business sectors let towards the end of the franchising process, could soon face financial difficulties. Should these TOCs go bankrupt, their franchises would (under current legislation) be re-let. Notwithstanding the hubris hypothesis, it is almost certain that the outcome would be financially less favourable to the state because potential bidders would be less likely to over-price a TOC given the increased private sector experience in operating rail businesses. Such subsidy rises could eliminate any net gains to the state or even, in the (admittedly) unlikely event that they were particularly significant, *increase* the amount of state involvement in the railways beyond that in 1996/97. Whilst it is certain that government contributions would be higher than at present had competition for the TOCs been less aggressive, the franchising process has not, as yet, diminished the financial role of the state in the passenger rail industry. The likelihood of this being achieved in the future is considered in more detail in chapter seven.

Finally, franchising competition produced an unexpected role for the market in terms of investment planning within the rail industry. Section 5.5 noted that the 'value for money' criterion on which franchises were let determined that the state would identify where significant investment (for example, replacement rolling stock) around the network was required, and that the market, through competitive tendering, would determine only the cost of that investment to the Treasury. However, as franchising progressed, and as competition between bidders became more intense, market forces began to both identify and pay for investment opportunities in the privatised railway to the extent that all 25 franchises were let on terms more favourable to rail users than the government had initially envisaged. Bidders improved - or at least signalled to OPRAF a willingness to improve - the qualitative aspects of their bids because they perceived that aggressive subsidy reduction would not in itself be

sufficient to secure a TOC. The nature and amount of improvements secured in this way clearly represents a degree of market, rather than state, determination of post-privatisation investment requirements. Although the state did not reduce its role in rail investment planning in an absolute sense, the degree of competition for franchises did result in the market increasing its relative involvement in this area. Having reviewed the evolution and outcome of the policy adopted to promote competition for the passenger rail market, this thesis now turns its attention to the development of competition within it.

Chapter Six

Competition in the passenger railway market

6.1 Introduction

Chapter five reviewed the development and outcomes of the franchising policy adopted to privatise the passenger rail industry. It was suggested that, despite the misgivings of senior policy makers, the level of competition for the market generated by the franchising process was high. The government's influence over the TOCs has diminished in the sense that ownership of the latter has been transferred to the private sector, although state financial support to the rail industry is currently higher than it was before denationalisation. The purpose of this chapter is to examine the extent to which competition had materialised *in* the passenger rail market by early 1998.¹ The chapter seeks to identify the opportunities for on-rail competition which existed at that time, to assess whether these were being exploited and to discuss their impact upon the relationship between the passenger rail industry and the state.

It will be remembered that the promotion of on-rail competition was a primary objective of the track authority model of rail privatisation. The 1992 Conservative Party manifesto stated that:

“We believe that the best way to produce profound and lasting improvements on the railways is to end BR's state monopoly... A significant number of companies have already said that they want to introduce new railway services as soon as the monopoly is ended. We will give them that chance” (Conservative Party, 1992: 35).

This was reiterated in *New Opportunities for the Railways*:

“The Government proposes to provide a right of access to the rail network for the private sector operators of passenger services... [Because of this] new operators will be allowed to provide services giving customers a choice stimulating improved services and value” (Department of Transport, 1992a: 4).

This chapter is divided into two main parts. The first (in section 6.2) reviews debates surrounding the appropriateness of on-rail competition, and begins by demonstrating that many potential opportunities for competition between passenger operators exist within the new industry structure. However, as noted in chapter five, and as will become clearer below, the plans advanced in the White Paper provoked concerns from observers regarding the compatibility of on-rail competition with the franchising process (*House of Commons*

Papers, 1993a; Gibb *et al.*, 1998). Although it was immediately clear to many that the pursuit of on-rail competition might jeopardise the entire rail privatisation exercise, it is suggested that, for various reasons, the government was initially reluctant to compromise its commitment to this form of market liberalisation. Indeed, it did not formally do so until ministers accepted that some competition would have to be 'moderated' in the 1993 publication *Gaining Access to the Railway Network* (Department of Transport, 1993b).

The principal argument of this chapter is developed in sections 6.3 and 6.4. The policies ultimately adopted by the government to moderate competition between TOCs are examined, and each is assessed in detail according to the extent to which the passenger rail market had been liberalised by early 1998. It is argued that, although certain types of competition were permitted and were clearly taking place, most significant competitive opportunities were being restricted by regulation and/or operational factors such as network capacity and rolling stock availability. As a result, much of the passenger rail market was still characterised by monopoly, and the industry was based on a comprehensive array of regulatory mechanisms designed to promote a form of surrogate competition comparable to that which governs the utilities discussed in chapter two.

6.2 On-rail competition and the formulation of competition policy

After encountering significant difficulties in adopting the track authority model (see chapter four), the government's priority following the publication of *New Opportunities for the Railways* was to make it work. The promotion of competition between train operators was therefore an important policy objective and the Treasury in particular, having sacrificed its original plan of train-path auctioning, was keen to ensure that the passenger railway market was liberalised as far as possible (see chapters four and five). In Parliament and in front of the Transport Select Committee, MacGregor and his Minister of State, Roger Freeman, delivered a number of speeches in support of the proposals. MacGregor claimed "it is important... that we carry forward our thinking" because publicly owned transportation systems "could not hold a candle to the market and competition as the best ways of determining what the travelling public... want" (*Hansard*, 1992b: Cols 1161-1162). The track authority option would be "a great deal better than what we have at the moment, a monolithic system with no competition in it" (*House of Commons Papers*, 1992d: 21) and,

¹ Interviews in the field were completed by this time, almost four years after BR was initially restructured (see chapter one). Prospects for the future will be discussed in chapter seven.

Freeman noted, open access competition would “start in April 1994,” following the reorganisation of BR (*Hansard*, 1993e: Cols 411-412w).

The industry structure envisaged in *New Opportunities for the Railways* provided for at least three different types of on-rail competition - competitive new entry, competition along shared route miles and competition along duplicated routes - and these could occur both between TOCs and non-franchised operators and between TOCs themselves. In addition, the potential for some indirect competition - by emulation - also existed. Each of these types of competition can in turn be characterised by price, where operators would seek to undercut each others' fares, or by quality of service, where an operator might seek to offer a quicker, more convenient or more comfortable journey than its competitors. A combination of both these elements would also be possible (and highly likely).

Competitive new entry rests upon the theory of contestable markets (Baumol, 1982). The theory maintains that incumbents will be incentivised to produce efficiently because of the threat of new market entry from potential competitors. The open access regime allows for the initiation of new services either to compete with those already provided by incumbent TOCs, or to link destination pairs currently unconnected by direct trains on a scheduled or charter basis (Swift, 1997a). These services can be provided in either of two ways: a TOC can expand its operations into the 'patch' of a counterpart, or a non-franchised company can enter the market specifically to provide them (Department of Transport, 1994). Regardless of who works non-franchised services, they are not eligible for subsidy and must be run on a commercial basis. Thus, if a TOC initiates new services of this kind, it must do so *in addition to* the conditions of its original franchise. On the other hand, a non-franchised operator is not constrained by a PSR and, as such, may choose to operate only one service a day on one route if this is considered to be the most profitable option.

In order for Baumol's theory to hold, the market to which it applies must be perfectly contestable, i.e. incumbents and potential new entrants must be symmetrically placed, there must be an absence of sunk costs and 'hit and run' entry must be possible.² In a thorough

² As noted by Shires *et al.* (1994a), symmetrical placing means that the incumbent and potential new entrants are subject to the same regulations, possess similar market knowledge, have access to the same technology and so on. A sunk cost is any asset which cannot be used for the production of other goods, or whose value cannot be recouped on the second hand market. The separation of infrastructure and operations, and the establishment of Roscos, has removed many sunk costs from the industry, but a remaining example might be certain staff training costs (e.g. drivers). Finally, 'hit and run' entry is the ability to penetrate a market briefly and exploit a profit opportunity without the prior knowledge of the incumbent.

analysis, Shires *et al.* (1994a) conclude that the passenger rail market is not perfectly contestable, principally because long lead times in timetable planning make 'hit and run' entry difficult (although they do note that some competitive threats could exist in certain markets, such as the provision of first class accommodation. In contrast, of course, the open access regime proposed by the Conservatives (Department of Transport, 1992a) assumes by its very nature that many more competitive opportunities exist, such as those for heavily used flows between destination pairs serviced by only one TOC. In this case, another operator - either a different TOC expanding the extent of its operations, or a non-franchised company - could initiate new, open access services along that route to compete with the incumbent. The contestability of the passenger rail market is discussed in terms of this thesis in section 6.3.1.

Competition on the passenger railway network is not solely dependent upon opportunities for new entry. Despite considerations of market liberalisation being absent when the franchise boundaries were decided (see chapter five), there is considerable overlap in the operating territories of some TOCs. Competition along shared route miles can therefore occur where two or more TOCs operate along the same stretch of track (ORR, 1994b). The potential for this type of competition was considerable because, as noted in chapter five, more than half of all rail journeys (56.4 per cent) in 1994 could be made with more than one operator (ORR, 1994a). Good examples of this are London to Gatwick Airport (Connex South Central, Gatwick Express and Thameslink), London Euston to Birmingham (Virgin Trains and Silverlink), and Penzance to Exeter (Virgin Trains, Great Western and Wales and West).

Likewise, competition along duplicated routes can also occur without competitive new entry. This kind of competition arises when each route is worked by a different TOC (ORR, 1994a) and can exist in two scenarios. The first is between the origin/destination points of the duplicated routes, and examples are London to Glasgow (Virgin Trains via Preston, and Great North Eastern Railway (GNER) via York) and London to Exeter (Great Western via Westbury and South West Trains via Salisbury - see figure 6.1). The second scenario is between stations *along* duplicated routes and their origin/destination points (hereinafter competition 'along route corridors'). As a respondent pointed out,

"If you look at the geography of railway lines emanating out of London, up as far as Milton Keynes, Northampton, Bedford, Huntingdon and Peterborough, then there's not more than 10 miles quite often [between] these particular services. If you live in one of the villages [between these lines] you can go either way."

To illustrate, a customer living in Dunstable can either ‘turn left out of his drive’ to use a Silverlink service from Leighton Buzzard to London, or ‘turn right out of his drive’ to use a Thameslink service from Luton to London (see figure 6.2). In this example, the TOCs might focus their efforts on shifting an imaginary line which exists between their two routes; Silverlink would want to move the line as far to the right as possible, thus capturing Thameslink’s customers, whilst Thameslink would seek to do precisely the opposite. Although this kind of competition can result in additional revenue generation, it was indicated that it is not always as significant as it might seem because of the relatively small populations situated between the larger towns served by the train. Moreover, because of the distance people in these ‘hinterland’ areas must travel to reach a station, they are significantly less likely to consider using the train for non-commuter journeys (Lowndes, 1997).

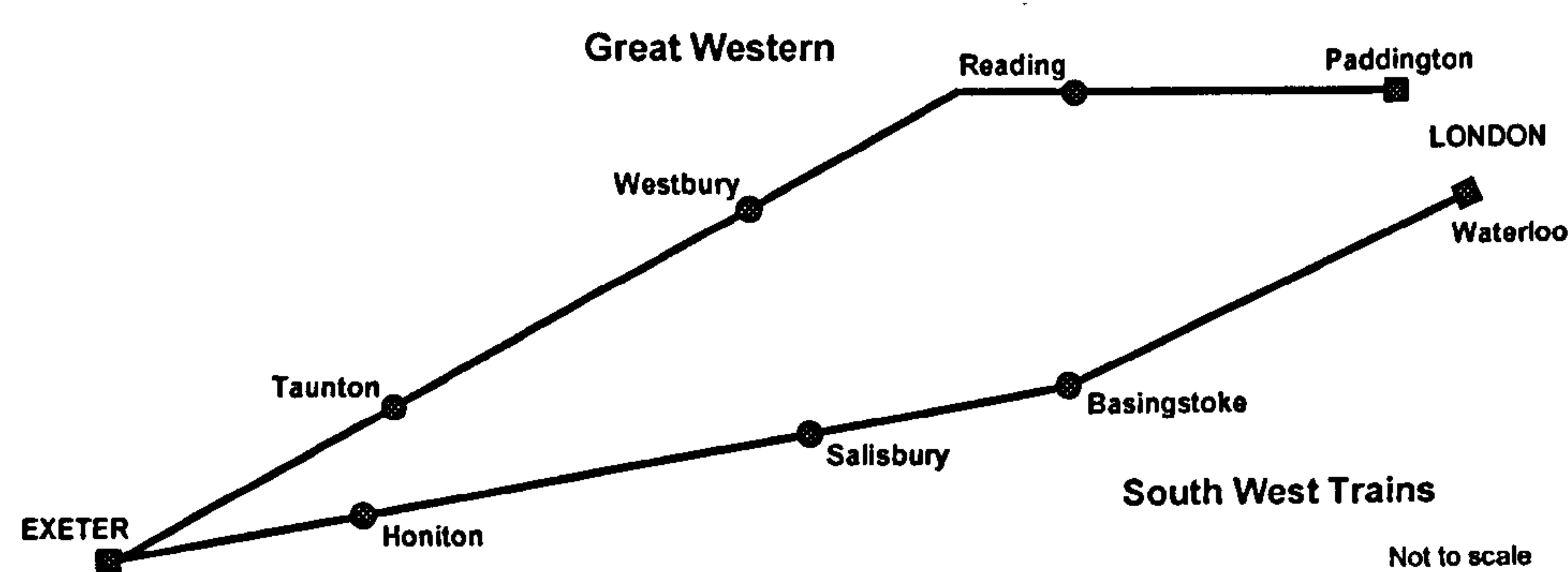


Figure 6.1. Duplicated routes between London and Exeter.

Finally, competition by emulation does not require franchises to be in direct competition with each other (although they can be). This kind of competition, also known as ‘yardstick’ competition (Foster, 1992) and ‘comparative’ competition (Williams, 1992), rests on the assumption that companies are keen to be - and be perceived by others as being - leaders in their field. The concept is not new in the railway industry. As noted by Waghorn (1905: 26), in 1876 the Midland Railway Company “adopted the practice of conveying third class passengers by all trains... [and] whether other companies approved or not, they were all compelled... to place themselves on an equality with the Midland Company.” An example of how competition by emulation could occur between TOCs was given by a respondent:

“If Richard Branson and James Sherwood are together at a function, and Branson’s sounding off about how much money he’s spending on tilting trains and how wonderful his staff are, you can bet your bottom dollar Sherwood doesn’t want to be put in the shade by Branson... There’s going to be the pride, the competition of standards. So a report in the FT that says ‘the standard of service on GNER’s restaurant car is much better than on Virgin Trains’ will count for a lot.”

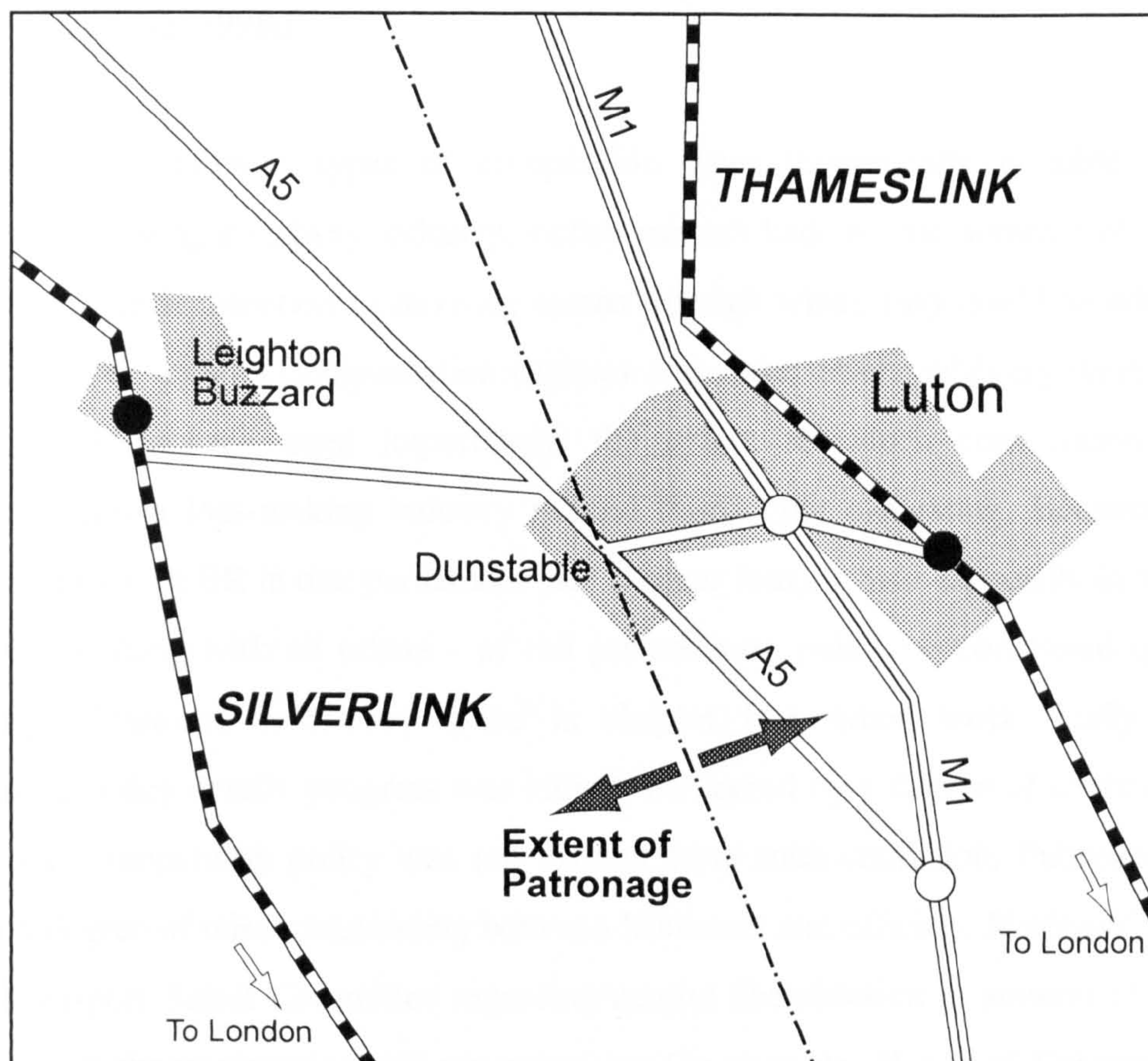


Figure 6.2. Competition along route corridors.

As noted in chapter two, competition by emulation was initially regarded as a potentially useful regulatory tool when the water industry was privatised because it was thought capable of providing yardsticks from which comparative performance could be judged. However, it was quickly discovered that comparisons were difficult because of the greatly varying characteristics of each water company - considerable differences existed in costs and other measures of efficiency or service quality (Foster, 1992). Perhaps fearing similar difficulties within the railway industry, policy makers did not view competition by emulation as a regulatory aid. Instead, it was principally seen as a means of complementing on-track competition to generate additional innovation among TOCs:

“We believed that by allowing many different private sector companies to run the railways - 25 franchises - different ideas about innovation, about service delivery, about pricing, about marketing, about management, about the type of rolling stock, would emerge. And you’d have not one idea, a monolithic idea, British Rail’s idea, but you’d have many ideas about how to compete.”

The scope for competition by emulation has been formally recognised by the industry and those around it through such events as the Railway Innovation Awards, which honour innovations made by TOCs regardless of whether they compete directly with each other (*Modern Railways*, 1998d).

Although these different types of competition were theoretically possible within the reorganised passenger railway industry, policy makers had, by the summer of 1992, paid comparatively little attention to devising means through which they could be administered. Complex issues such as compensation regimes and ticket interavailability were still to be resolved and, perhaps most importantly, the extent to which competition could be introduced into a loss-making industry needed thoroughly evaluating. Because ministers wanted to privatise BR in one parliament (see chapter four), it was especially important that this aspect - along with all others - of rail privatisation policy be completed quickly and efficiently. However, as already noted in chapter five, when work finally began on formulating policy details, progress was initially hampered by a degree of confusion among key actors. Competition policy was not exempt from such confusion. Published evidence hints at a degree of misunderstanding between Ministers and officials. Ministers' statements to the Transport Select Committee regarding market liberalisation in autumn 1992 were at variance with those of senior civil servants (see, for example, *House of Commons Papers*, 1992c, 1992d), and it is unlikely this was deliberate as "there was obviously no overt dichotomy between officials and ministers because that has to be unthinkable."

Perhaps as a direct consequence of the above, the government was initially reluctant to compromise its commitment to on-rail competition despite concerns raised in relation to its appropriateness in the passenger rail industry (*House of Commons Papers*, 1992c; 1992e; 1992f). Regarding competitive new entry, commentators suggested that the concept of open access competition could be incompatible with the franchising process to such an extent that it might jeopardise the entire rail privatisation exercise (Gibb *et al.*, 1998). Although in 1992 no decisions had been taken regarding the specifications of individual franchises (Department of Transport, 1992b), it was regarded as probable - and of course turned out to be the case - that most TOCs would be allocated a varied portfolio of routes, some highly lucrative, others less so. A franchisee would therefore need to earn enough profit on its remunerative lines, given its level of subsidy, to ensure an adequate financial return on its whole operation. Meanwhile, non-franchised operators running on lucrative trainpaths

would not have the same obligation to maintain uneconomic services and would thus be able to undercut franchisees. The prospect of revenue dilution on high-earning routes would drastically reduce or even eliminate a franchisee's profitability (Foster, 1994; Shaw *et al.*, 1998) and, without being able to plan their businesses to any reasonable degree of certainty, potential franchisees would either require extremely high subsidies or refrain from bidding altogether. The Transport Select Committee acquired evidence from potential franchisees indicating that open access would create difficulties for franchise bidders in predicting costs and revenues from service operation (*House of Commons Papers*, 1993a) and Sea Containers Ltd noted that "it is not clear to us why anyone should bother with a franchise if the [potentially more lucrative] alternative of open access is available" (*House of Commons Papers*, 1992e: 194).

Despite these concerns, the Department of Transport's document *The Franchising of Passenger Rail Services*, published in October of 1992, noted that although franchisees would have an exclusive claim on grant awarded in respect of their contract, they could "not [expect] an exclusive right to run all the services on any particular route" (Department of Transport, 1992b: 15). Suggestions which challenged this assertion were countered (*House of Commons Papers*, 1992d), the views of the BRB were overlooked (see below) and the government's attitude was increasingly viewed as dogmatic. The government's failure to rule out open access competition added to the general level of uncertainty surrounding passenger rail franchising (see chapter five), and questions were asked as to whether ministers were pursuing ideology at the expense of improving railway services (*House of Commons Papers*, 1992g). James Sherwood, a prospective franchisee, felt "the problem [was] that no-one [had] looked yet at the private sector and said 'how is he going to make a profit from this business?'" (*House of Commons Papers*, 1992e: 196).

As late as November 1992, Freeman insisted that the Transport Committee was "mistaken to suggest that the government has concluded that franchising and open access are incompatible" (*House of Commons Papers*, 1992a: 304), but the government's official position changed soon afterwards. It seems probable that ministers were forced to abandon plans for universal open access to the network after receiving written responses from potential franchisees to *The Franchising of Passenger Rail Services* (*House of Commons Papers*, 1993a). Contradicting his earlier stance, Freeman indicated in December 1992 that the government was now ready to allow some operators exclusivity in order to expedite the franchising process (Tomkins, 1992c). It was officially recognised the following month that

open access competition “just wasn’t [going to be] practicable,” and MacGregor accepted that “the prospect of unlimited competition was a major deterrent to prospective franchise holders” (Smithers, 1993b: 3). *Gaining Access to the Railway Network: the Government’s Proposals*, published by the Department of Transport in February 1993, stated accordingly that the government now acknowledged that there was a:

“...potential tension between liberalising access for private sector operators and successfully franchising British Rail’s existing passenger services. This means that to the extent that it is necessary to ensure the success of the first generation of franchises, on-track competition between operators of passenger services may have to be moderated for a limited and specified period” (Department of Transport, 1993b: 7).

Whatever form competition policy was to take, its outcome was likely to involve a significant reduction in the potential for competitive new entry into the passenger rail market.

Coinciding with the debate about competitive new entry, questions were also being raised regarding the potential role and scope of price competition along shared and separate route miles. Chapter four identified how these kinds of competition - which, of course, could arise in the absence of open access operators - might create difficulties regarding the establishment of (for example) inter-operator compensation regimes and the maintenance of network benefits. Although the concept of franchising had partially addressed these problems by reducing the number of operators using the network, potentially serious difficulties remained. In particular, concerns revolved around the assertion that competition along shared and separate route miles would erode ticket interavailability (*House of Commons Papers*, 1992e, 1993a). Under a system of interavailability, customers can use one ticket to travel between an origin/destination pair on trains operated by any TOC. Although many different ticket *types* may exist (Open return, Day return, Saver return and so on), and certain restrictions may be attached (for example, it may not be possible to travel before 09.30 on a Saver ticket), each operator accepts all tickets, applies the same restrictions and, crucially, charges the same price for them (revenue is subsequently divided among the operators according to passenger miles travelled on each); price competition cannot therefore be permitted under a system of total interavailability. This is in contrast to a fully liberalised market, where each TOC can set *dedicated* fares at varying prices and with different restrictions, for use only on its own services. Operators can voluntarily agree to issue and accept each other’s tickets, but they are not compelled to do so. If interavailability ceases to function, rail loses its ability to provide customers with a ‘turn up

and go' service which was widely believed to account for a significant proportion of its business (Curwen, 1997).

New Opportunities for the Railways (Department of Transport, 1992a: 19-20) had noted that although the government was concerned to ensure that "customers continue to enjoy the advantages they get from a national rail system... in the arrangements made for... ticketing," it would be "for the train operators to make arrangements to accept each other's tickets." During its investigations into the future of the railways, the Transport Select Committee found consistent hostility towards this position (*House of Commons Papers*, 1993a). As BRB chairman John Welsby pointed out, it was unlikely that voluntary interavailability would feature in a liberalised regime because where more than one operator ran services between an origin/destination pair they would have no incentive to accept each other's tickets:

"... as a private sector operator... the last thing I may actually wish to have is your tickets on my train or vice versa. [I] would advise the Secretary of State very strongly... that in the interests of the customer there has got to be interavailability of tickets" (*House of Commons Papers*, 1993a: lxxx).

Welsby's view was corroborated by evidence from the deregulated bus industry, where only 25 per cent of operators accepted each other's tickets (see chapter seven), and the experience of Stagecoach, the only company to have recent experience of running a private passenger train service (see chapter five). The Scottish-based transport operator argued that the government should compel private operators to accept each others' tickets. Its overnight services had been disadvantaged by a lack of interavailability, and the company argued that, if necessary, TOCs should have a revenue allocation system forced upon them (*House of Commons Papers*, 1992e).³

As with its stance on competitive new entry, the government was initially sceptical of measures which would curtail the prospects for market liberalisation in the new railway industry. By late 1992, again following the receipt of responses to *The Franchising of Passenger Rail Services* (Department of Transport, 1992b), ministers had been forced to concede that the regulatory authorities should at least have the power to insist on interavailability. The *Draft Objectives for the Franchising Director* (quoted in *House of Commons Papers*, 1993a: para 16) noted that the policy of the government was that ticket interavailability should be considered where "the benefits clearly outweigh the benefits of

³ The lack of ticket interavailability was one factor which contributed towards the subsequent removal of the Stagecoach Rail overnight service.

competition or service diversity.” Thus, with competitive new entry already to be restricted, an interavailability requirement would, depending on its scope, remove some or all of the remaining potential for price competition between private train operators on the passenger network.

It is of course possible to contend, contrary to the argument presented here, that the government delayed its decision to moderate competition until early 1993 simply because it wanted to canvass and consider the views of a wide variety of interested parties before subscribing to a definitive course of action. Indeed, one respondent suggested that this was the case, and that he consistently sought to:

“...listen to as much advice as possible, for example the consultative committees, for example clearly the professional advice of British Rail, and the advice of some of the lobby groups and pressure groups who took an interest in British Rail... It was, I hope, a listening and improving process.”

But ministers had heard the views of most interested parties by the early autumn of 1992 through both the Transport Select Committee’s hearings and media reports. Moreover, some respondents indicated that the government was being somewhat dogmatic in its defence of on-rail competition. It was argued that the government “did not listen to the industry, or to people who were not totally committed to their method of privatising the railway.” With regard to the views of British Rail:

“...they just weren’t listening. Right from the beginning... they felt... that BR was in ‘anti’ mode. They switched off and weren’t really listening to what BR had to say. It was... very short sighted on their part. BR was not trying to wreck it. They were almost paranoid about the fact that BR was trying to wreck it.”⁴

Particularly within the Treasury, which remained the principal exponent of the track authority model, policy makers were fixated by the potential advantages of on-rail competition to the extent that they neglected to consider its potential drawbacks:

“...at some points in the early stages [key actors were] being theoretical and what was becoming very evident [elsewhere], ...that we were heading for competition for the market rather than in the market, didn’t dawn on them.”⁵

⁴ Many respondents within government maintained that the BRB was anti-privatisation and behaved in a negative manner towards the process. However, evidence would indicate that although the Board disagreed with the track authority model, it did not oppose the concept of divestiture *per se*. Nor did it fight the government’s plans in a pro-active way: “there’s no question, if they’d [the BRB] wanted to wreck it, they could have, quite easily.”

⁵ One respondent argued that he “certainly did not believe, [and his] colleagues certainly did not believe, that on-track, head to head competition was going to happen... We realised that it was much more

Thus, the period between July and December 1992 had effectively been wasted, and when Ministers finally accepted the need to restrict competition in late 1992, they did not know how it would be done. Whilst giving evidence to the Transport Select Committee, MacGregor suggested that restricting competition might be the remit of the Franchising Director or the Rail Regulator, but no details were provided as to how or when regulation might be forthcoming (*House of Commons Papers*, 1993a). After firing a number of questions regarding details which caused MacGregor to stumble, Committee member Andrew MacKinlay suggested to the Secretary of State that “you do not know, do you sir?” (*House of Commons Papers*, 1993a: 744). MacGregor acknowledged that the issue needed further consideration: “I think it is important to stress that... there is still, at this stage, quite a lot of detailed information... to be filled out” (*House of Commons Papers*, 1993a: 728).⁶

This task of ‘filling out’ was ultimately devolved to the Offices of the Rail Regulator and the Franchising Director, and each adopted regulatory regimes which, between them, sought to ‘moderate’ on-track competition (Charlton *et al.*, 1997). Competitive new entry would be restricted by the regulator’s policy of ‘Controlled Competition In Contestable Markets’ (CCICM) (ORR, 1994c), and price competition along shared route miles would be limited by the Franchising Director’s ‘Compulsory Interavailability’ (CI) requirement (OPRAF, 1996). Perhaps in an attempt to secure at least some market liberalisation, no administrative restrictions were placed on competition along duplicated routes or competition by emulation; however, what had become very clear by early 1993 was that the outcome of rail privatisation policy, at least in terms of on-track competition, would be substantially different to that which had been envisaged in *New Opportunities for the Railways*. Indeed, in February 1993 the Labour Party’s transport spokesman, John Prescott, scoffed (rather presciently, as it turned out) that:

“if the proposals will not lead to competition in the provision of services... instead of the public monopoly about which the government are so concerned, we shall have what the Secretary of State called ‘exclusive service’ - in other words, a private monopoly. We shall be replacing a public monopoly with a private one” (*Hansard*, 1993b: 176-177).

The following sections of this chapter examine CCICM and CI, and assess each in detail according to the extent to which the passenger rail market had been liberalised by early 1998. As noted in section 6.1, it is argued that, although certain types of competition were

complicated than that...” However, this response contradicts those of his colleagues and, more importantly, his own comments some years previously in documentary sources.

⁶ One respondent from the Department of Transport, when asked if policy makers had any idea at this stage how competition would be moderated, answered simply: “no”.

permitted and were clearly taking place, most significant competitive opportunities were still being restricted by regulation and/or operational restrictions.

6.3 The scope for competition in the passenger rail market

6.3.1 Controlled Competition In Contestable Markets and competitive new entry

CCICM was implemented by the ORR following a period of consultation with interested parties. The Regulator's paper, *Competition for railway passenger services: a consultation document* (ORR, 1994b), stressed the need for policy both to moderate open access competition in the short term, but to retain a degree of flexibility in the longer term should market liberalisation become appropriate in the future. The paper suggested four policy options, three of which, 'negotiated charges', 'equalised access charges' and 'access deficit charges' were financial mechanisms based upon different means of charging operators for access to the rail network (see appendix five). The mechanistic approaches were ultimately regarded as unsuitable by the ORR either (a) because they were not capable of moderating competition at all, and therefore did not address the problem at hand, and/or (b) because they created barriers to entry, some artificial, which would have been difficult to surmount in the future (ORR, 1994b; 1994c). CCICM was the fourth option suggested. In contrast to the mechanistic approaches, CCICM was predominantly administrative in nature, and was perceived as being the most likely to achieve the ORR's stated policy goals of providing sufficient immediate moderation of competition and long-term flexibility.

CCICM achieves the ORR's goals by operating in two stages. Stage one accords TOCs "effective exclusivity" (OPRAF, 1996: 65) until late 1999, whilst stage two imposes fewer restrictions to competitive open access entry and will last from late 1999 until at least 2002 (ORR, 1998a). Possible outcomes and implications of stage two of CCICM are considered in chapter seven. Stage one of CCICM works by defining TOCs' markets as a series of 'point-to-point flows', and by protecting these flows from competitive open access entry subject to certain restrictions (ORR, 1994c). Point-to-point flows comprise services operated by a TOC between any two destinations on its network. For example, a Great Western service from Plymouth to London Paddington will serve a number of point to point flows - Plymouth to Exeter St David's, Exeter St David's to Taunton, Taunton to London Paddington and so on - not just Plymouth to London Paddington. For stage one of CCICM, TOCs identify all point to point flows within their network and nominate those on which they require protection. The Regulator protects nominated flows by controlling Railtrack's ability to sell access rights to other operators.

CCICM thus restricts competitive new entry by making virtually all of the passenger rail market incontestable. It places incumbents and potential new entrants asymmetrically, thereby preventing hit and run entry - crudely, the regulations mean that incumbents are allowed to operate trains whereas potential new entrants are not. In practice, the policy has been largely effective, resulting in only “very limited opportunities for train operators to introduce new services” (ORR, 1998a: 1) although this, as the Regulator points out, “is not surprising [as it is] the natural consequence of granting effective exclusivity” to TOCs in stage one of CCICM (ORR, 1998a: i). The “very limited opportunities” to which the Regulator refers arise where TOCs have joined existing access rights together to create a new direct service between an origin/destination pair already served by another operator (ORR, 1997). CCICM did not envisage this scenario would arise, and it was regarded as something of a ‘grey area’ by TOCs until Wales and West Passenger Trains sought regulatory approval to combine two of its paths between Manchester and Penzance (Batchelor, 1997). A respondent pointed out that, in Wales and West’s judgement,

“...it was absolutely necessary for the industry to establish how the rules of this particular game were going to be played. And it had better be done early, because they’ve got a seven and a half year franchise and every day ticks away and it’s getting very costly for them not to have taken action that day... Therefore it was desperately important that they understood [whether] there was a market which was not being fulfilled.”

The affected operator, Virgin Trains, initially suggested that the proposal would breach the principles of CCICM because it was “purely a poaching exercise.” The Regulator ruled in Wales and West’s favour, but Virgin, rather than pursuing its initial grievance, accepted the Regulator’s decision:

“It was quite interesting what Virgin’s final reaction to that was, [because] although they had initially opposed it, when the Regulator announced his decision they welcomed it because CrossCountry, with its rather complex access rights, may have considerable opportunities to do the same sort of thing.”

Following the Regulator’s decision, respondents confirmed that other TOCs were examining opportunities for combining access rights to introduce competitive new services. In particular, this was the case where TOCs had a number of ‘dormant’ access rights which, although included in the franchising process, were not being used when contracts were let:

“One of the nice things about the... franchises we have got is that there were actually track access agreements in place that weren’t being exercised... It is easy for us to reactivate those access agreements at no extra cost, and [combine them with others] without fear of anyone else calling foul and saying ‘oh you can’t do it because you’re poaching... our business.’”

However, the number of TOCs with potentially lucrative dormant access rights is low and, by early 1998, this kind of competition was not in evidence elsewhere around the network.

Whereas CCICM prevents most competitive new entry, it does not forbid the initiation of what are termed 'non-competitive' open access services (ORR, 1994c). As such, there are two types of flow which TOCs generally cannot nominate for protection - non-material flows, and flows where the TOC does not serve both the origin and destination points. A flow is non-material if it represents less than 0.2 per cent of a TOC's total farebox revenue. New entry on such flows is obviously unlikely but, if it were to take place, could not significantly affect the incumbent's total income and is therefore deemed uncompetitive. Where TOCs do not serve both the origin and destination points of a flow - for example, Virgin Trains does not serve Aberystwyth to London - they cannot nominate that flow because such action might prevent an open access operator (say, Central Trains) from developing a new, direct service along it. A new 'niche' service such as this would benefit passengers in mid-Wales and compete with Virgin in the sense that it provide an alternative for those customers travelling from mid-Wales to London, who would otherwise have had to change onto a Virgin Trains service at Wolverhampton. However, Central's service would not run in direct competition with Virgin's operations beyond Wolverhampton because it would not be able to pick up passengers on Virgin's protected flows to London.

An interesting quirk of CCICM is that it seems to have stimulated a degree of competition among operators for the right to provide potentially lucrative niche services - in other words, competition for non-competitive new entry. This kind of competition was particularly evident during the franchising process, with a number of bids including plans for niche service provision (notable examples are North Western Trains' Rochdale, Blackpool and Newton-le-Willows to London trains and Connex South Central's Rugby to Gatwick Airport services). Post-franchising opportunities for non-competitive entry still exist (such as Central Trains' operations into Manchester and Stansted airports), and one respondent suggested that there remains some degree of competition between TOCs to identify them:

"I don't think there's any doubt that if we didn't go to [a destination], somebody else would... It's obviously important to get in on these routes which we think have got an opportunity as soon as possible."

Other TOCs shared this view, with one noting that "there's enough niches neglected... [which] need to be filled."

6.3.2 Compulsory Interavailability and competition along shared route miles

Although CCICM protects TOCs from the threat of competitive new entry, it does nothing to address competition along shared route miles which could have resulted had TOCs introduced an unrestricted range of dedicated tickets at the expense of interavailable ones. As noted in section 6.2, the policy of Compulsory Interavailability (CI) was formulated by the Franchising Director to deal with this issue. CI ensures the continued interavailability of virtually all ticket types on all but one flow on the network. As will become evident, some price competition is permitted by CI, although relatively little had actually materialised by early 1998. CI works in two stages. First, it identifies a 'lead operator' for each interavailable flow served by more than one TOC (as with CCICM, CI defines point to point journeys as flows). The lead operator is usually the TOC with the greatest commercial interest over any given flow. Second, the lead operator is required to create fares for the flow, which other TOCs (secondary operators) running trains along it must honour. In this way, a customer can buy one ticket and use it to travel on "the trains of different passenger operators which run in parallel on the same flow" (OPRAF, 1996: 185). Revenue is 'pooled' and divided among operators by Operational Research Computer Allocation of Tickets to Services (ORCATS), a computerised allocation system, according to passenger miles travelled (see section 6.3.3).

The Franchising Director considers that "the benefits of inter-availability will be outweighed by the potential benefits of price competition" (OPRAF, 1996: 186) only on the London to Gatwick Airport line, and competition on this stretch of railway has developed quickly. Although it is by no means cut-throat, differential pricing is evident and all three companies have engaged in ambitious advertising campaigns to promote their rival services.⁷ As one respondent pointed out:

"You [can] go to Victoria station now and see how much [another operator] is investing in competing with us down what is considered to be a lucrative piece of railway. You'll see if you walk around the station there's a lot of effort being concentrated on what's perceived to be a lucrative corridor."

Elsewhere, CI ensures the interavailability of most tickets. Lead operators are permitted to offer dedicated fares for only four ticket types: first class, temporary, special and certain kinds of advance purchase. Each of these fares can be sold for use solely on a lead

⁷ Standard single fares are £9.50 on Gatwick Express and Thameslink's trains, and £8.20 on Connex South Central's - although there are actually more than 35 different fares in existence between London and Gatwick Airport.

operator's services and, as such, the associated revenue bypasses the ORCATS system and goes directly to the relevant TOC. Secondary operators are given more freedom. In addition to the above, they are in fact allowed to set dedicated fares for all of their other ticket types. These fares co-exist with their interavailable counterparts to provide opportunities for price competition notwithstanding the CI regulations. Revenue generated in this way also avoids ORCATS. Although all these opportunities for price competition might appear significant, it is shown below that, predominantly for operational reasons, they were often somewhat limited in practice.

First class facilities along shared route miles were usually provided by 'long distance' operators - especially former InterCity TOCs - and it was generally the case that only one operator offered this standard of accommodation over flows to which CI applied. There were, of course, exceptions - for example, first class was provided between Penzance and Bristol by Great Western and Virgin Trains; between London Paddington and Worcester by Great Western and Thames Trains; and between London King's Cross and Peterborough by GNER and West Anglia Great Northern (WAGN) (Railtrack, 1998). In addition, Thameslink offered dedicated first class travel cards and a season ticket (Thameslink, 1997), but other instances of competition for the first class market between operators were rare despite the apparent logic of discounting tickets to fill currently under-used capacity (*Modern Railways*, 1998e).

Temporary fares were used by TOCs predominantly to facilitate short-term promotions such as such as Midland Main Line's 'Chatsworth Day Out' offer (Midland Main Line, 1997a). In order to qualify for exemption from CI, temporary fares created by TOCs must not exceed 12 weeks' (17 weeks if the TOC is not a lead operator) duration (OPRAF, 1996). Although they resulted in pockets of price competition between TOCs, the effects of temporary fares were transient and, therefore, limited in nature. Indeed, this type of fare was designed specifically to prevent operators from gaining a sustainable competitive advantage over other TOCs (OPRAF, 1996).

Special fares are an obscure collection of ticket types bunched together at the time of privatisation "because they could not be included in the compulsory interavailability regulations in any other way." Special fares are unique in the way that they are retailed; predominantly, they are created for localised user groups in order to account for discounts negotiated with TOCs (OPRAF, 1996). An example would be the Bournemouth Rail Travel

Association, where members can purchase discounted tickets for travel with South West Trains from Bournemouth station. Although the potential for this kind of competition existed at stations served by more than one operator, a respondent confirmed that no special fares had been created by any operator since privatisation.

Dedicated, advance purchase fares provide more scope for competition than those mentioned above and generally fall into two categories, season tickets and 'Apex'-style tickets. Season tickets, as the name implies, entitle the holder to use services over a given flow or flows for a specified period of time, usually between one week and one year from the date of purchase. The tickets are primarily sold to commuters in and around the major conurbations, although they are also available on other routes. Price competition for the season ticket market was certainly evident, and perhaps the most widely known example was WAGN's Peterborough to London ticket (WAGN, 1997). In early 1998, an interavailable annual season ticket from Peterborough to King's Cross cost £4,600, whereas WAGN's dedicated alternative was priced at £3,556. The scope for further price competition for season tickets along shared route miles was restricted to the relatively small number of commuter stations served by more than one operator.⁸ In addition, considerations of train loading were critical. Dedicated season tickets could work well from distant or semi-distant commuter nodes such as Peterborough because the amount of customers carried by each train during rush hours was 'manageable' from a TOC's point of view - in other words, it was possible to check customers' tickets after they had boarded the train. In contrast, trains serving more centrally located commuter stations - particularly in the south east - frequently ran in excess of their load factor requirements (OPRAF, 1998b) and revenue protection would have been fraught with difficulty.⁹ As noted by a respondent,

"In a suburban railway like this, you can't do that [sell dedicated tickets]. I mean, we carry 80,000 people into London every morning and take them home again at night. You just can't tag people like that. I think in the long term we might have smart cards and all sorts of things, and you might be able to have real person-specific journeys... But at the moment you can't do that."

Apex-style tickets are principally aimed at the leisure market and offer a discounted rate of travel for customers making journeys of around 100 miles or more provided certain

⁸ Aside from Gatwick Airport, the principal examples are Bedford, Colchester, Croydon, Luton, Milton Keynes, Peterborough, Reading, Slough, Sutton and Watford. Dedicated standard class season tickets are available from Peterborough (WAGN), Bedford and Luton (Thameslink) and from Southend (LTS Rail).

⁹ Load factor requirements pertain to the amount of people south eastern commuter TOCs are supposed to carry on a train at any given time. The requirements form one strand of the 'surrogate' competition

conditions are met (this usually involves specifying dates and times of travel: see, for example, ATOC, 1998; Central Trains, 1997; GNER, 1997; Midland Main Line, 1997b; Virgin Rail Group, 1997). As with season tickets, it was possible to identify some instances of Apex competition between operators along shared route miles (see Bradshaw, 1997).¹⁰ Indeed, one respondent pointed out that Apex-style fares were a useful means of poaching business from another TOC:

“If people are travelling by rail anyway then they’re fair game. They’re easier to attract than a new person who has their company BMW. If somebody’s already travelling by rail, I’d like them to travel with us... Being brutally honest... it’s quite fun to grow your market where another operator has to pay.”

There is no doubt that the range and number of Apex-style tickets has increased considerably since privatisation.¹¹ Nevertheless, there was little prospect of an explosion in Apex competition between operators. Apex fares are usually available only over longer distances, because requiring passengers to book days in advance for short journeys (say, Plymouth to Newton Abbot) is wholly impractical in operational terms. Thus, the journeys to which Apex tickets could sensibly be applied were frequently, though by no means exclusively, offered by only one operator. For example, Virgin’s Value Fares (Virgin Rail Group, 1997) relate to discounted tickets between London and many destinations along the West Coast Main Line (WCML) such as Stafford, Crewe, Preston and Carlisle, and direct travel between London and any of these destinations was only possible with Virgin Trains. When reviewing the extent of Apex-style competition, one respondent pointed out that:

“It’s actually quite difficult [for a lead operator to compete on price] given the almost-total operation of interavailability... You could probably quote a hundred examples of it around the network, but a hundred examples in relation to the millions of flows that exist isn’t enormous.”

Finally, TOCs are permitted to offer dedicated fares for all their ticket types which pertain to flows on which they are a secondary operator. This was regarded by a prominent industry regulator as the primary opportunity for price competition, and was “generally considered to be more significant than ‘special’ or ‘Apex’ tickets.” However, aside from the fact that secondary operators’ dedicated tickets do not represent true competition - they are something of a one-sided bargain as the lead operator cannot respond - there were still two operational factors which prevented some operators from competing along their secondary

measures imposed upon TOCs by the Regulator and the Franchising Director, and these are discussed in section 6.4.

¹⁰ London to Birmingham, Bristol, Coventry, Exeter, Glasgow, Leeds and Manchester; the South West to Manchester; Portsmouth to Manchester and Birmingham to Cardiff being principal examples.

flows. First, irregular service patterns were a problem. Although many flows existed where secondary TOCs offered a frequent alternative to the lead operator’s services (such as Silverlink’s London Euston to Birmingham New Street trains), there were also instances where the opposite was the case (for example the North Wales Line). Some secondary operators could not address this issue because of the limited availability of rolling stock and trainpaths, especially during busy periods:

“Nobody that I know of has any peak rolling stock capacity spare. Not everybody’s peak coincides with everybody else’s peak, although there is a certain commonality. But I think you’ll find that, with a trivial number of exceptions, everybody’s rolling stock is fully utilised in the peak.”

“There are some constraints in terms of... track capacity. Full stop. There are only so many trains you can run safely down one line... There will be some places where the simple constraints of capacity will mean competition has some limits.”

Second, the bureaucracy involved in establishing dedicated fares on heavily loss-making lines - initiating TOCs have to create new flows and recalculate ORCATS revenue allocations over pre-existing ones (see footnote 12 below) - outweighed the economic advantages secondary operators felt would have accrued, and some TOCs were dissuaded from the exercise for this reason. As such, only seven operators had introduced dedicated, walk-on fares by early 1998 (see table 6.1).

Operator	Route
First Great Eastern	Ipswich to all Great Eastern Stations and London Liverpool Street
First North Western	Manchester and Blackpool to London Euston
Midland Mainline	Bedford to London first class
ScotRail	Sleepers to London
Silverlink	Birmingham New Street to Silverlink stations and London Euston
Thameslink	Bedford and stations to Luton first class travelcard.
WAGN	Peterborough to London King’s Cross and other selected WAGN stations (including travelcard)

Table 6.1. Availability of dedicated, walk-on fares from secondary operators.

6.3.3 Competition for interavailable revenue

In addition to the opportunities for price competition discussed above, it was also possible to identify a kind of quality of service competition promoted by CI which is related to the ORCATS mechanism used to allocate interavailable revenue between TOCs. For each interavailable fare, ORCATS shares the total amount of revenue among the relevant TOCs according to the number of passenger miles travelled on each of their services in respect of that fare. ORCATS calculates passenger miles by taking into account factors such as

¹¹ Apex-style fares on the railway were both invented, and promoted, by BR.

timetabling and speed of journey, and by making assumptions about passenger behaviour based on historical survey evidence (KPMG, 1996).

A simple example illustrates this concept. Two operators, 'A' and 'B', run services throughout the day between two sizeable towns. Operator A's trains are non-stop, depart on the hour and complete the journey in 30 minutes. Operator B's trains, on the other hand, call at all intermediate stations, depart at 10 minutes past the hour and have a journey time of 45 minutes. In this example, ORCATS will assume that, because passengers generally prefer a superior service, more people will use operator A's trains - perhaps eight out of every 10 - and the revenue will be divided between the two TOCs accordingly. ORCATS' obvious shortcoming is that it cannot provide an entirely accurate record of passenger movements because its calculations are based on assumptions derived from one historical survey rather than continuous flowcounts. Thus, it is perfectly possible for the relative loading of operators' trains to change whilst the ORCATS allocations remain static.¹² Operators were aware of this situation but, according to respondents, generally accepted the ORCATS allocations in lieu of a more technologically advanced alternative:

"It's not an exact science, there's a few hundred thousand pounds slopping around in the system - which all sounds very unprofessional - but, if you're not careful, you end up having to sell [dedicated] tickets which restrict people's freedom."

Competition for interavailable revenue occurred when TOCs introduced additional services, or re-timetable existing services, between an origin and destination pair because such action caused a reapportionment of ORCATS revenue between operators. There were difficulties in identifying genuine examples of this kind of competition - for example, re-timetable might have been imposed on an operator by external forces such as long-term engineering or the actions of another TOC on a different route - but in general it could be categorised as either *generative service provision* or *ORCATS raiding*.¹³

A generative service is regarded as one which materially improves the overall level of service for passengers (ORR, 1998a). Referring back to the above example, a generative service might result if operator A introduced a new, fast train between the two towns at

¹² When an operator introduces a dedicated ticket, he is required to compensate the other operator(s) on the affected flow because it is highly probable that passenger behaviour will change. If this change is likely to be large, the lead operator may conduct a new survey to replace the existing one (this happened on flows between Peterborough and London and Ipswich and London). In other cases, recourse to a survey may not be necessary, and the initiating operator can seek agreement from the others on the basis of an estimate.

07.30 to provide a half-hourly, instead of an hourly, service during the morning peak. The generative service would (in theory) reap a double 'reward' for operator A: first, the apportionment of existing interavailable revenue would shift marginally in its favour because ORCATS would assume that some people who took the 07.10 stopper would now take the 07.30 fast; second, the overall improvement in journey opportunities should encourage more commuters to take the train, and increase the interavailable revenue pool for that flow. Thus, operator A should receive a larger proportion of income from an expanded revenue pool.

On the other hand, ORCATS raiding is a mischievous and cynical tactic rarely motivated by a desire to improve the level of service. Although ORCATS raiding was recently outlawed by industry regulations, operators could still attempt it by manipulating their train times to increase the share of interavailable revenue beyond that to which they were actually entitled. An ORCATS raid would occur if operator B retimed its 07.10 stopping train to form a new, fast service to depart five minutes before operator A's 07:00 train. Because operator B's new train would reach its destination ahead of operator A's, ORCATS would now assume that most people would patronise the new service as opposed to the pre-existing one. In reality, of course, this may not necessarily be the case - perhaps a connecting bus does not arrive until 06.56 - but the likely result would be that the 06.55 would run nearly-empty and earn operator B a disproportionately large share of the interavailable revenue at operator A's expense. Such an abstractive technique would not generally increase rail business because it leads to unnecessary service bunching at the expense of a more practical regular interval timetable (Jones *et al.*, 1993; ORR, 1998a).

It was clear in early 1998 that both generative service provision and ORCATS raiding took place. However, attempting to gauge the extent of each was problematic because their precise definitions were open to subjective interpretation. As a respondent explained, the distinction between a generative, new service and an ORCATS raid is easily blurred:

"The economics of railways fundamentally are such that [even] a good, creative new service, [which] generates some new business, is going to abstract [from another incumbent]. It's probably going to abstract more than it generates. So when is a good, innovative service not an ORCATS raid? ...You have to make judgements."

¹³ Some additional complexities, providing more opportunities for ORCATS-based competition, have recently emerged within the industry, but these are likely to impact on future developments and, as such, are highlighted in chapter seven.

In order to allow a degree of analytical consistency, respondents were asked to consider competition for interavailable revenue in terms of the ORR's (1997: 18) position on the subject. This states that "where the demand of passengers to travel between two points is evenly spread over a given period," generative new rail services will ensure that "the overall pattern of rail services should be similarly spread over that period." Essentially, then, generative services were defined narrowly as those which promoted a regular interval timetable, whereas ORCATS raids were those which resulted in unnecessary service bunching.¹⁴

It was not expected that respondents would necessarily admit to ORCATS raiding themselves, but it was anticipated that they would accuse others of the practice where they felt it was taking place. Following the above definition, respondents suggested that some ORCATS raiding was evident in the period immediately following privatisation (see also *Rail Privatisation News*, 1997). It was pointed out that, in some ways, this was unsurprising:

"With the almost total operation of interavailability... [the new structure] encourages people to play the system which is in place - by that I mean the ORCATS system... A lot of opportunities [for competition] may well... be very related to what ORCATS will reward them [operators] with."¹⁵

In some cases, opportunities to ORCATS raid were 'inherited' by the TOCs as a consequence of the franchising process, and one respondent admitted that they provided a welcome source of additional revenue:

"... we have inherited a situation at [one terminus]. We run three trains a day out of [there]. I think it's fair to say that we don't really carry many people on those services, but it gives us a slice of the large revenue that is available... For our 21 carriages in each direction we get a very large slice of revenue, thank you very much, which doesn't in any way equate to the number of people that we actually carry."

However, although ORCATS was initially seen to offer TOCs financial advantages, it was suggested that raids were quickly reducing in number. Not only was this a function of the regulations, but also it was because ORCATS raids were increasingly found to be poor business practice as their effects would probably be short-term and possibly even counter productive:

"We are talking about a network and, to some extent, if you go and raid somebody else's business, sooner or later somebody's going to turn round and do it to you."

¹⁴ Even so, interviewees' responses could not be corroborated satisfactorily with reference to timetables. For example, where services beginning in entirely different areas converge, could it be classed as an ORCATS raid if one arrives minutes before the other? Liaison with the ORR was necessary, and analytical judgements are to a certain extent subjective.

¹⁵ This passage is a joining together of two short quotes, although the intent of each has been retained.

“I just think it’s a no-brainer, you know. I’ll do it this time and then 15 other guys will do it to me. It’s just nonsense. I’m not interested in wasting... the limited amount of resources and energy that my business has got in robbing another company.”

Numerous respondents believed that the decrease in ORCATS raids was symptomatic of a wider trend of industry maturity developing amongst TOCs, whereby the corporate culture had begun to embrace the virtues of long-term planning rather than short term gain. In particular,

“...there’s a natural, well I would suggest natural, human behavioural thing which says ‘having restructured an industry which has created separate entities who are all needing to be the best, [and] to have a vision about how they can be the best, inevitably there’s a natural emotive pressure on TOCs to do better than other TOCs’. To some extent, that will cause some reaction in terms of ‘let’s attack another TOC and see how we can take their business away’. I think there’ll be an element of that. [However], there’s a re-maturing process that the industry is going through. It’s probably going through it faster than many people would have perhaps dared to think possible... That maturing process... that’s coming about quite quickly.”

Thus, whereas “one or two companies started taking the odd swipe at each other... there’s comparatively little of that [now].” The issue of industry maturity, and its potential effect on competition, is considered in more detail in chapter seven.

Instances of competition for interavailable revenue were therefore based more around the provision of generative new services. One respondent, who had seen his own revenue decline over a flow following the extension of a service by another TOC, argued that this was very much the case. He pointed out that the other operator’s services produced an enhanced timetable following a major investment programme:

“We’d seen a very large reduction, it was around £400,000... It was quite easy to see the swathe of cash that had been removed... Now, one could say ‘is that an ORCATS raid?’ But it’s a consequence of investing... and I can’t cry about new [investment] on the railway.”

However, although generative service provision was growing in popularity, it had not developed as widely as some, particularly those in the ORR, wanted to see. One respondent lamented that there was still “limited case law” regarding competition for interavailable revenue.¹⁶

6.3.4 Unregulated competitive opportunities

Section 6.2 noted that, although competitive new entry and price competition along shared route miles were restricted by regulation, competition along shared route miles was not.

¹⁶ The ORR deals with all applications to run new services.

Likewise, no regulatory measures were deployed against competition by emulation. Aside from the fact that it is practically impossible to legislate against the latter, the most likely reason for leaving these kinds of competition unregulated was because it allowed the government to claim that they had successfully liberalised at least some of the passenger railway market. As a respondent pointed out, this ensured “a couple of bits of it, sort of feather in the cap... [so they could say] ‘look, we told you so.’”

The potential for competition along duplicated route miles was, in theory at least, substantial. Despite the network rationalisation which has taken place over the past 50 years (BRB, 1962; Henshaw, 1991), it was possible to identify more than 80 instances on the passenger railway where competition between origin/destination pairs could have taken place (see appendix six). In practice, however, the opportunities for such competition were considerably more limited than this figure might suggest, and this was the case for three main reasons. First, some significant potential for competition was passed up when the geography of TOCs was being determined. As noted in chapter five, delays in policy formulation at ministerial level left officials with little time to design the franchise map, and TOCs were based upon BR’s profit centres as the latter provided the quickest and easiest division of passenger services. A respondent confirmed that, because of timescale pressure, the promotion of on-rail competition was “not at all, absolutely not at all” a consideration of officials when they created the TOCs. As a result, at least 40 duplicated lines were allocated to one company when they could technically have been split between two (see appendix six). A notable example was London to Cambridge where the two routes, one from Liverpool Street and the other from King’s Cross, were both served by WAGN.

Second, some franchises operating along duplicated routes were sold to the same owner (Knowles, 1998). Several examples of this were evident, especially in the Connex SouthCentral/Connex South Eastern operating areas. One respondent pointed out that, even though the potential existed for him to introduce a new, competitive service, there would be little point because his colleagues elsewhere in the group were already planning something similar: “we would see any plans to go to [a destination] as being better dealt with by [our sister company] rather than ourselves.” Third, many of the remaining duplicated routes either served relatively insignificant markets and/or offered journeys which were not realistically comparable, and were therefore neglected as candidates for competitive marketing by TOCs for these reasons. An example is Liverpool to Chester, operated by Merseyrail Electrics and First North Western. The Merseyrail Electrics service departs

every half hour throughout the day and takes 38 minutes, whereas First North Western Trains depart every hour or two hours (depending on the time of day), do not run before 8am and after 7.30pm, and take almost twice as long. A respondent rubbished the possibility of competition existing or being likely to exist on this route.

Despite the substantial number of theoretical opportunities for competition along duplicated route miles, there were in practice only a small number of meaningful examples scattered around the network (see also Adamson *et al.*, 1991), in particular: London - Birmingham, London - Bristol, London - Leeds, London - Exeter, London - Southend and London - Glasgow. Price and quality of service competition was evident on all these corridors, especially between London and Birmingham where in excess of 100 fares were being offered for the journey (BBC, 1996). Perhaps more significant on a network-wide basis were opportunities for competition along route corridors. This kind of competition was found to be possible in numerous places, but respondents indicated that it was taken most seriously by TOCs along six commuter corridors between London and the northern Home Counties (South West Trains and Thames Trains, Thames Trains and Chiltern Railways, Chiltern Railways and Silverlink, Silverlink and Thameslink, Thameslink and WAGN and Great Eastern and LTS Rail). It was argued that these instances were “not to be underestimated as real, *de facto* competition,” and one company had amended its timetables to take account of “the fact that [another operator] is there... [In part] it’s to improve our competitive position *vis á vis* the other operator.”

The final area where competition between operators was possible in the new railway industry was competition by emulation. Although discounted as meaningless by some commentators (see, for example, *The Economist*, 1991), there was evidence to suggest that competitive opportunities opening up in this area were taken seriously by TOCs, and did influence managerial decisions to a considerable extent:

“There certainly will be - and you can see it now - quite a lot of competition by emulation...There’s a lot of watching over the fence going on in the industry, and everyone’s keen to make use of other people’s good ideas.”

Competition by emulation did not seem to greatly influence the pricing policies of most TOCs. It was not the case, for example, that GNER would be particularly concerned that their average fare per passenger mile was slightly different to Great Western’s. There was some indication that each operator was keen to be perceived as well-managed, both

financially and operationally, but the principal effect of competition by emulation was to provide a yardstick by which TOCs can measure their service standards relative to those of other operators:

“We’re keen to be seen as innovators within the industry, and your measures of that are other TOCs. So we’re very much in competition to be seen delivering a better service... than any of the other operators. Competition by emulation, that’s where it is at the moment. We’re in competition in terms of column inches and city profile.”

“We see competition regarding service as very straightforward. We aim to provide the best customer service that anybody will be able to experience on a railway train in this country. Now on that basis... the competition, if there is such a thing in that field, has got a lot to live up to.”

As a result, innovations in excess of those secured during the franchising process (see chapter five) had been initiated by TOCs eager to be perceived as market leaders in service quality. Examples from around the network, introduced by various TOCs, were: continuing improvements to dedicated phone enquiry/booking services, complimentary refreshments for all passengers, a ‘family carriage’ provided for parents with young children, improved train cleanliness and revised catering arrangements.

Of particular importance to TOCs, especially former InterCity ones, were the opinions of business travellers. Business people were regarded as the most widely travelled type of customer, and therefore the most likely to compare the relative service standards of each operator. As a respondent pointed out:

“On this railway, you are talking about your customers being at the top end of the market. They are people who get around. I should imagine if you surveyed our customers and said ‘when did you go on this line or that other line?’ that it wouldn’t be very long ago, and that they would be perfectly ready to make comparisons between us and [the others]. They know what’s out there.”

Innovations aimed at business travellers since privatisation include first class lounges, inclusive first class tickets (car parking, journey, food/drink and onward travel for one price), dedicated business coaches in standard class, frequent travellers’ clubs and negotiated discounts with car rental companies.

6.3.5 Summary - the extent of on-rail competition

The previous four sections assessed CCICM and CI in terms of the extent to which the passenger railway had been liberalised by early 1998. It was suggested that: competitive new entry was possible where TOCs joined existing access rights together or introduced ‘non-competitive’ new services; competition along shared route miles could take place between London and Gatwick Airport; lead operators could offer dedicated first class,

temporary, special and dedicated advance purchase fares, whilst other operators could sell TOC-specific tickets of all types; a kind of service competition was possible along shared route miles as a result of the ORCATS revenue allocation system; and competition could also occur unregulated along duplicated route miles and by emulation.

There was therefore scope for competition in the new railway structure in early 1998, and TOCs were beginning to exploit some of the competitive opportunities presented to them. But such market liberalisation must be viewed in relation to both that which would have been possible in the absence of CCICM and CI, and the operational restrictions which prevented competition from developing where the regulations would have allowed it. CCICM made virtually all of the passenger railway market incontestable by placing incumbents and potential new entrants asymmetrically. Without it, allowing for some operational constraints such as capacity constraints and the availability of rolling stock,¹⁷ every line in Britain would have been subject to the threat of competitive new entry (admittedly this would have been slight on uneconomic lines). As things stood in early 1998, there were only “very limited opportunities for train operators to introduce new services” anywhere on the passenger railway network (ORR, 1998a: 1). CI limited price competition for the majority of fares on all but the London to Gatwick Airport line. In the absence of CI, competition such as that developing there would have been feasible along all shared route miles. Instead, lead operators were permitted to compete using only four ticket types and, as this analysis has shown, various operating factors frequently limited opportunities for market liberalisation even in these circumstances. To a limited extent, the same was true for secondary operators despite their freedom to compete with all ticket types. Although the ORCATS allocation system associated with CI did encourage a kind of service competition for interavailable revenue, this was generally marginal and had not developed widely.

Opportunities for competition along duplicated route miles, a potentially significant form of market liberalisation, had failed to materialise on all but a handful of corridors. Despite being unregulated, various factors - such as a failure to allocate duplicated route miles among adjacent, potentially competing TOCs - had curtailed its development. Only competition by emulation, unrestricted by regulatory and operational factors, was acknowledged by a wide range of TOCs as a competitive force which existed around the industry as a whole. However, the presence of this indirect form of competition, combined

¹⁷ It is likely these would have been overcome much quicker in the absence of CCICM because Railtrack and TOCs would have been incentivised to invest sooner.

with the limited examples of direct competition noted above, were not sufficient to move the Regulator from his view that:

“The new railway structure is built on different forms of monopoly in the supply of railway services... The supply of passenger train services is based on 25 territorial franchises with full protection from competition... [G]enerally, passengers... have limited choice in respect of the particular train services they wish to use” (Swift, 1997x: 8).

Although the Conservatives’ initial intention was to meaningfully liberalise the passenger rail market, ministers were ultimately forced to adopt regulatory measures designed to prevent the competition they had originally wanted to promote (Charlton *et al.*, 1997); all the direct forms of on-rail competition identified in section 6.2 were heavily constrained. Against this background, one respondent suggested that restructuring the railway industry to promote direct, on-rail competition was a “complete and utter waste of time”. Although this view may be challenged as circumstances change in the future (see chapter seven), in early 1998 there was a strong sense in which 25 regional monopolies had, with relatively few exceptions, replaced BR’s national one (Shaw *et al.*, 1998).

6.4 Surrogate competition and the continuing role of the state

The creation of a new generation of privatised monopolies has obvious regulatory implications. As already discussed in chapters four and five, there was always likely to be a degree of regulation in the privatised passenger railway industry. Minimum service levels, in the form of PSRs, were necessary to ensure that operators ran an acceptable number of trains in respect of subsidy being paid. In addition, further safeguards were perhaps inevitable in the London area because the prospects for on-rail competition developing along its congested lines were recognised as slim. These regulations were most likely to apply to TOCs by way of fares’ control and through quality of service stipulations. *New Opportunities for the Railways* (Department of Transport, 1992a) made clear that the government would stipulate ‘broad’ regulatory objectives, and that the Franchising Director would translate these into specific minimum standards by which private train operators would be contractually bound. Beyond these, the general tenor of the White Paper suggested that ministers saw market forces, rather than government intervention, as the principal stimulant of service improvements. However, in the subsequent absence of competition, it would appear that the regulation ultimately adopted to govern the passenger rail market is more extensive than the government initially envisaged. Indeed, in early 1998, it impacted upon the production and distribution of railway services to the extent that John Welsby, then Chairman and Chief Executive of the BRB, believed that the TOCs “finished

up with fewer managerial degrees of freedom than were previously enjoyed by BR under state ownership” (Welsby, 1997: 5).

Chapter two noted that the regulation established to control BT, BG and the water industry represented a form of surrogate competition in that it sought to mimic the effects of actual competition by keeping prices down and efficiency up (*The Economist*, 1995c). Surrogate competition consists of economic and social regulation (see chapter two) and, as was the case with the above utilities, both components were imposed upon the passenger rail industry. The need for economic regulation was not discussed in any detail by *New Opportunities for the Railways* (Department of Transport, 1992a), and nothing was added in *The Franchising of Passenger Rail Services* (Department of Transport, 1992b). In 1993, the Transport Select Committee concluded that RPI minus ‘x’ style regulation should be imposed upon all franchised services (*House of Commons Papers*, 1993a), but the government maintained that the market should determine the level of fares TOCs could charge in all areas except those where they enjoyed significant market power, such as London (*House of Commons Papers*, 1993c).

The government’s final decision on ticket price regulation was not forthcoming until after the adoption of CCICM and the principle of CI, and it is likely that fares policy was influenced at least in part by the outcome of the ORR and OPRAF’s deliberations. Although the precise extent to which the passenger rail market would be liberalised was still unknown, it was clear that there would be significantly less scope for competition than the government had initially planned. Given the fact that a key argument underpinning the track authority model is that competition from other modes of transport does not impact sufficiently upon rail performance (see chapter four), the case for market determination of fares had been weakened considerably. Media speculation regarding the level of fares after privatisation was also becoming intense (Shaw *et al.*, 1998), and reports predicting ticket price increases of between 50 and 130 per cent were helping to make the rail sell-off the most unpopular privatisation ever undertaken in Britain (*The Guardian*, 1993; *The Economist*, 1996b). The combination of these factors led to the announcement on May 16, 1995 of a policy to regulate fares - as the Transport Select Committee had originally recommended - across the entire network.

The government’s decision to adopt fares regulation represented a notable reversal of a ten-year-old policy of increasing BR’s ticket prices above the rate of inflation. Whilst BR was

state-owned, ministers had sought to shift the burden of BR's operating loss progressively from the taxpayer to the passenger. It was claimed in 1993 that this policy would continue after privatisation (*House of Commons Papers*, 1993c), but the adoption of comprehensive fares regulation clearly limited the extent to which this would be the case (indeed, the policy was described by one commentator as "a multi-billion pound sweetener to get passenger backing for privatisation" (Barrie, 1995: 1)). Details of the regulation are found in literature released jointly by the Department of Transport and the Office of Passenger Rail Franchising (1996). As in previous divestitures, TOCs' fares are regulated by the RPI minus 'x' formula. 'X' presently stands at one (having previously been at zero), where it will remain for four years. The government also created a tariff basket and only included certain fares within it, namely: unrestricted standard class return fares (which permit outward and return travel on any train), some single fares for short journeys, 'saver' fares (which, subject to certain conditions, offer a discounted rate for most journeys over 50 miles) and certain standard class season ticket fares including all weekly tickets. Some Passenger Transport Executives (PTEs) are entitled to set fares in their commuter markets and, as such, these will remain unregulated by the Franchising Director. In London, Cardiff, Edinburgh and Greater Manchester, the Franchising Director himself takes a comprehensive approach to regulating commuter fares. A performance incentive applies whereby a TOC's failure to meet agreed punctuality and reliability standards can result in the price cap being adjusted to RPI minus three for certain tickets. Although the RPI minus one formula is not as stringent as it is in other utility industries (for example, the formula used to regulate BT is now RPI minus 7.5 (Office of Telecommunications, 1997)), it is still regarded by the former Rail Regulator as "radical, almost socialist, planning by a Conservative 'free market' government" (Swift, 1997c: 7).

In terms of social regulation, *New Opportunities for the Railways* noted that minimum levels of service (in the form of PSRs) would be required, and certain quality of service standards - such as punctuality and reliability - would be expected of all operators (Department of Transport, 1992a). It has already been suggested that the imposition of PSRs was inevitable inasmuch as the government clearly has a right to expect certain level of output in respect of the subsidy it pays. But in the market-orientated context of the White Paper as a whole, it was not entirely clear how far ministers intended quality standards to be enforced specifically by regulation (see, for example, *House of Commons Papers*, 1993a). As noted above, the government committed itself only to setting 'broad' objectives, leaving the Franchising Director free to determine detailed regulation for TOCs "*as appropriate*"

(Department of Transport, 1992a: 7. *Italics added*). In this sense, the White Paper might be interpreted as advocating the maintenance of quality standards through a combination of regulation and market forces depending on the operating characteristics unique to each TOC. Thus with the exception of PSR obligations, contestable lines might have been subject only to minimal social regulation, whereas routes on which the threat of competition was remote would have had more exacting requirements imposed upon them.

As it turned out, the only piece of social regulation to vary substantially between TOCs was the PSR, each one being written according to the social, operational and market conditions particular to the services operated by the TOC it governed (see chapter five). The remaining safeguards were based upon BR's National Conditions of Carriage (NCC) (BRB, 1996), and were applied more or less equally to all operators to reflect the high number of incontestable lines across the network.¹⁸ TOCs were required, as BR had been since the introduction of the Citizen's Charter, to produce a 'user-friendly' summary of the NCC in the form of a 'Passenger's Charter.' The charters had to set out TOCs' commitments as regards operating punctual and reliable trains, as well as: ensuring acceptable train capacities, providing information on services, fares and facilities, meeting the needs of disabled travellers, and disseminating information in advance of delays and non-emergency engineering works. In all cases, TOCs' charters had to contain provisions at least as favourable as those offered by BR. (Some operators had elected to offer certain improvements over the standards aspired to by BR, and a comparison in table 6.2 of BR and Wales and West Passenger Railway's charters demonstrates this.) TOCs' performance in each area of their charters is monitored by OPRAF through customer satisfaction surveys and formal incentive regimes (OPRAF, 1997).¹⁹ Finally, TOCs are obliged to participate in ticketing and other schemes organised by the Association of Train Operating Companies (ATOC) in order to secure the additional provision of network-wide products. Examples of such products are the National Rail Enquiries Service (NRES) and discount railcard schemes.

The imposition of economic and social regulation upon TOCs represents continuing statutory involvement in the passenger rail industry, just as it did in the utility privatisations

¹⁸ Although those operators providing services into the major conurbations are subject to some additional stipulations in certain circumstances.

¹⁹ Interestingly, the customer satisfaction surveys did not allow simple comparisons between operators because they were not standardised. In this sense, an opportunity for stimulating a degree of yardstick competition was being lost; OPRAF has recognised this and is now seeking to impose uniform standards on TOCs' surveys.

of the 1980s. Despite a change of ownership, the absence of competition meant that the state could not withdraw from the affairs of the rail companies in any simple sense. At stake again was the *form* of government intervention rather than its existence (Thompson, 1990). As noted in chapter two, Foster (1992), when discussing the utility sell-offs, argued that the regulation adopted after privatisation was more systematic and penetrating than anything which had existed under nationalisation. Ministers addressed the constitutional loophole which had enabled them only to issue nationalised industries with instructions of a ‘general character’, and constructed regimes which conferred specific and detailed powers upon regulators to tackle areas of poor performance. Furthermore, the independence from government of the utility regulators has been called into question as evidence indicates that ministers sometimes used pressure to ‘inform’ the day to day decisions of regulatory authorities (Jenkins, 1995).



Criteria	 BR (Regional)	 Wales & West	Improvement ?
Punctuality	90% of long distance trains to arrive within 10 minutes of schedule.	90% of long distance trains to arrive within 10 minutes of schedule. To improve to 92% by 1998.	Yes
Reliability	99% of services to run	99% of services to run. To improve to 99.5% by 1998.	Yes
Compensation (one-off journeys)	20% of price paid for journey refunded if delayed for >1 hour.	20% of price paid for journey refunded if delayed for >1 hour. Increases to 50% refund for delays >2 hours.	Yes
Compensation (season tickets)	5% discount on monthly or longer season tickets if punctuality <87% or reliability <98% for preceeding year. 10% discount if both punctuality and reliability below those thresholds.	5% discount for monthly season tickets if punctuality <87% or reliability <98% for preceeding year. 10% discount if both punctuality and reliability below these thresholds. For annual season tickets, above discounts rise to 7% and 14% respectively.	Yes
Ticket Office queueing	Maximum five minutes peak. Maximum three minutes off-peak.	Maximum five minutes peak. Maximum three minutes off-peak.	No
Information	Timetables at all stations. Notice of engineering work at affected stations. Notice in advance if advertised, on-board catering is cancelled.	Timetables at all stations. PA or freephone or information boards at all stations by 1999. 7 days' notice of engineering work at affected stations. Advance notice of cancellation of advertised, on-board catering service.	Yes
Disabled Travellers	48 hours' notice for assistance at staffed stations.	24 hours' notice for assistance at staffed stations.	Yes

Table 6.2. A comparison of key commitments in the passenger’s charters of BR and Wales and West Passenger Trains Ltd. Sources: BRB, 1992; Wales and West Passenger Trains, 1997.

The economic and social regulation imposed upon the passenger railway shares these characteristics. The requirements are more stringent than those which governed BR in the sense that TOCs, like the utilities, can now be formally punished for failing to meet prescribed standards (see BRB, 1992, 1996; OPRAF, 1996; 1997). Whereas any specific command to BR like “‘make sure the 8.15am from Victoria runs on time’ would have been legally unenforceable” (Howe, quoted in Foster, 1992: 114), the Franchising Director fines operators whose trains are delayed, too short or cancelled, and penalties imposed on TOCs for their failure to meet NRES performance targets has confirmed the Regulator’s equal willingness to enforce quality standards (OPRAF, 1997; ORR, 1997b).

Neither the Rail Regulator nor the Franchising Director are protected from potential and actual ministerial interference in their affairs. Although the Regulator is officially independent from government (see chapter four), he was obliged to take into account guidance issued to him by the Secretary of State until January 1st, 1996 (House of Commons, 1993). It was under such guidance that CCICM, detailed earlier in this chapter, was formulated. Even now, however, ministers still reserve the right to change his brief informally, through ‘moral suasion’, or formally through legislation in the same way they do with the utility regulators (Veljanovski, 1987). In 1997, for example, the Regulator signed a ‘concordat’ setting out a framework for co-operation and communication between his office and the government, and this was followed by a request from the Deputy Prime Minister, John Prescott, for the Regulator to review his *laissez faire* position on regulating the Roscos (ORR, 1997c, ORR, 1998b). Press speculation has also suggested that Prescott refused to renew John Swift’s contract in 1998 because the latter had not pursued a significantly interventionist approach to regulating the railway industry (Prynn, 1999).

The Franchising Director does not operate with the same constitutional independence as the Regulator because he is required to function according to the OIG issued to him by the Secretary of State (OPRAF, 1997). In this sense, he is even more susceptible to the whim of government. On a macro level, the Labour administration has amended and rewritten the OIG (although this was in part to update OPRAF’s duties), whilst on a micro level the Conservatives, particularly Brian Mawhinney, pursued policies against the better judgement of Roger Salmon (Grantham, 1998). The most significant example of this was the RPI minus ‘x’ regulation outlined above which, according to a respondent, was regarded by Mawhinney as one of his more notable achievements as Secretary of State for Transport.

One policy maker noted that he found past experience with utility regulation highly instructive when he came to construct and implement the regimes which would govern the passenger rail industry. Certainly it would appear that, as with the privatisations of BT, BG and the water industry, the government had again secured “not so much a change in the content of rules, or a departure from regulatory objectives, [but simply] an adjustment to the means of enforcement” (Hancher and Moran, 1989: 131). Of course, it was always likely that fares controls and quality of service regulation would be imposed in areas such as the London commuter market where the potential for competition developing was slim. Given the market-orientated thrust of *New Opportunities for the Railways*, it is unlikely that the government originally intended to maintain such an extensive role for the state in the affairs of the whole passenger rail industry. Nevertheless, having failed meaningfully to liberalise the passenger rail market, ministers were forced to create a regulatory system which was capable of exerting significant control over TOCs once they had been transferred to the private sector.

6.5 Conclusion

This chapter has assessed rail privatisation policy in terms of the extent to which the passenger rail market had been liberalised by early 1998, four years after BR was reorganised prior to its divestiture. After three major utility sell-offs where the conflict between privatisation and liberalisation was “no longer a conflict... but a rout” (Kay and Thompson, 1986: 31) and regulation was required to act as surrogate competition, senior Conservatives became dissatisfied with the outcome of network industry disposal policy. The liberalisation of the CEGB’s market emerged as a key aim of the electricity industry privatisation, and major structural reform was undertaken in order to achieve this. This notable reorientation of policy resulted in the creation of genuine competition among electricity generators and eradicated the need for economic and social regulation (Littlechild, 1993). The policy adopted to privatise BR essentially represented further experimentation with that used to divest the electricity industry (Gibb *et al.*, 1998).

Clearly, the passenger rail industry was (and remains) different in character to the electricity industry in several respects. Perhaps most importantly, BR was heavily dependent upon public subsidy, and ministers had acknowledged that they would continue to provide train operators with financial support in order to secure the provision of loss-making, socially necessary services following privatisation. In this sense, a degree of statutory involvement in the privatised rail industry was inevitable so long as it received government subsidy.

Nevertheless, ministers strongly advocated the promotion of actual, rather than surrogate, competition as the best means of securing service enhancements (Department of Transport, 1992a). Crucially, however, rail privatisation policy was not adopted by ministers as a result of a coherent analysis of its potential outcomes, and limited consideration had been given to many key issues when *New Opportunities for the Railways* was published. It was not entirely understood whether vertical separation would be appropriate for the loss-making rail industry and, fundamentally in terms of this thesis, policy makers had not properly considered whether promoting competition in the passenger rail market was a viable proposition.

This chapter has shown that, in the short term at least, it was at best only partially so. By early 1998, the outcome of the policy used to privatise the passenger rail industry differed considerably from the government's original intention. Despite BR's undergoing a complex restructuring exercise designed to promote on-rail competition, it can be argued that BR's monopoly has, with relatively few exceptions, been reconstituted in the private sector. Although some competition was clearly possible, the number of competitive opportunities available was notably fewer than ministers had initially envisaged. As a result, a host of regulatory mechanisms, comparable with those imposed on BT, BG and the water industry, were required to enforce a regime of surrogate competition capable of governing the behaviour of TOCs. Chapter two suggested that the privatisation of the utilities throughout the 1980s was as much - if not more - of an exercise in the formulation of regulatory mechanisms and institutions as it was an attempt to promote competition and reduce state control over the industries. This trend has indubitably continued in the passenger rail industry.

A regulatory 'domino effect' developed in four stages. First, as noted above, ministers' concerns regarding the consequences of mass service withdrawals resulted in continuing subsidy and PSRs. Second, the threat posed to the completion of the franchising process by on-rail competition - both from open access operations and the erosion of ticket interavailability - prompted regulation to *prevent* the very competition ministers had originally wanted to promote (Charlton *et al.*, 1997). The regimes which were formulated to undertake this task, CCICM and CI, are manifestations of ministers' realisation that on-rail competition could not be, at least in the short term, an entirely realisable outcome of rail privatisation policy. Vertical separation was efficacious when the electricity companies were privatised because the industry was profitable. Difficulties were almost certain to be

encountered with the track authority model of rail privatisation because competition between train operators could threaten the viability of many services; private sector companies would simply not compete with each other for the right to lose money. The fact that this point was overlooked perhaps gives a further indication of just how little policy makers understood the likely implications of vertically separating the railway industry when *New Opportunities for the Railways* was published. Third, economic regulation was made necessary by the re-emergence of monopoly and, finally, this was complemented by social regulation in the form of quality of service stipulations designed to provide a 'surrogate' competition regime with comparable objectives to those imposed on the utility industries in the 1980s. Whether or not the relationship between competition and regulation in the passenger rail industry will change in years to come remains uncertain. A discussion of this issue is contained in the following, and concluding, chapter of this thesis.

Chapter Seven

Conclusions and prospects for the future

7.1 Introduction

As noted in chapter one, the central aim of this thesis is to evaluate the extent to which the promotion of competition was an appropriate policy goal in the privatisation of British Rail. In pursuit of this aim, the study set out to critically evaluate the evolution, outcome and future prospects of the policy adopted to liberalise BR's market, and to closely examine the translation of neoliberal political philosophy into practical policy measures. As such, there are three key objectives. These are: (a) to establish why and how the liberalisation of the passenger train market became an important goal of rail privatisation policy; (b) to assess the outcome of rail privatisation policy in terms of the extent to which the passenger rail market has been liberalised; and (c) to review the future prospects for competition developing between passenger train operators. The preceding analysis has so far addressed the first and second of these objectives. This chapter will examine and discuss the third objective and present overall conclusions in relation to the central aim of the study. However, for the purposes of clarity, this chapter will first summarise the key findings of the study so far.

7.2 Expectations and outcomes of the 'free' market approach

7.2.1 *Expectations*

This study began by examining how and why the liberalisation of the passenger train market became an important goal of rail privatisation policy. Chapter one noted that the privatisation of BR followed the sales of numerous British transport concerns, including those of Sealink, British Airways, the British Airports Authority and the National and Scottish Bus Companies. Given the nature of BR's business, it is perhaps logical to assume that the method adopted to sell off the railways was directly related to those employed in previous transport divestitures, particularly the bus industry. However, it was suggested in chapters one and four that BR was viewed primarily as a network industry by key policy makers, and that the track authority model used to sell it can be seen as further experimentation with the method used to sell the CEGB.

Chapter two therefore examined the divestiture of the network industries in order to establish a background against which the evolution of rail privatisation policy could be

examined. It outlined the key assumptions of neoliberalism, the ideology on which the economic strategy of the New Right was based, and explored the interaction between the abstract ideals of political philosophy and privatisation policy in practice. It was suggested that the Conservative Right, the original protagonists of the policy, saw privatisation as a means of enhancing individual liberty, the fundamental concern of neoliberal theory, by: a) promoting competition, rather than monopoly, to allow voluntary exchange between individuals; and b) reducing the powers of the state to control an industry and the production/distribution of its goods and services. In addition, market liberalisation and state downsizing were expected to result in improved industrial efficiency, innovation and customer care.

Nevertheless, as Gamble (1994) points out, the 1980s did not see the successful unfolding of a New Right ideological masterplan. Key neoliberal goals were undoubtedly marginalised as privatisation policy unravelled in practice, and this is evidenced by the sale of network industries as regulated monopolies. When BT, BG and the water industry were divested, the Conservatives failed to meaningfully liberalise their markets and, as a result, were forced to create regulatory mechanisms and institutions designed to create regimes of 'surrogate' competition to prevent the utilities from abusing their market positions (see chapter two). It was contended that such regulation represented a significant and continuing role for the state in the affairs of the utilities despite a transfer of ownership to the private sector (indeed, Ridley (1991: 83) revealingly boasted that "the utilities which we have privatised... are more easily controlled when they are in the private sector"). Evidence also showed that the utilities' performance, in the absence of competition, had not matched that of companies such as the NFC which had been sold into an already competitive market place.

It was in this context that ministers considered the privatisation of the electricity industry. The Conservatives' 1987 election manifesto (Conservative Party, 1987) re-emphasised the importance of the key neoliberal values of individualism and freedom, and asserted that a key means of promoting them would be to introduce competition into the markets of state-owned industries prior to their divestitures. The Conservatives had espoused competition in theory but eschewed it in practice throughout the network industry privatisation programme, and there was therefore no reason to assume that a genuine move towards market liberalisation would take place before the electricity industry was sold. Nevertheless, for various reasons, including an improving economy and ministerial dissatisfaction with the performance of the privatised utilities (see chapter two), a notable reorientation of policy

was announced which advanced plans to liberalise the electricity generating industry prior its divestiture in 1991 (Veljanovski, 1989). The results of the CEGB sale were encouraging for the government - competition increased, the role of the state decreased and the performance of the electricity generating industry improved significantly (Littlechild, 1993; Lowndes, 1997; Offer, 1999) - and the Conservatives' renewed commitment to neoliberal values was extended within the industrial sector throughout the early and mid 1990s. Competition was introduced into the telecommunications and gas industries, and electricity supply was also liberalised.

The next large network industry privatisation was that of BR. The government's commitment to selling the railways was announced in the 1992 White Paper *New Opportunities for the Railways* (Department of Transport, 1992a), at a time when the economy had relapsed into recession and the state of government finances had worsened considerably. Nevertheless, encouraged by developments in the electricity industry, ministers made clear their intention that BR should not be privatised as a monopoly. They insisted that competition should be introduced into all aspects of railway operation in order to reduce the role of the state in the railway industry and harness the "management skills, flair and entrepreneurial spirit of the private sector" (Department of Transport, 1992a: i; Welsby and Nicholls, 1999) to improve services for customers. The need for intra-industry competition was questioned by many, including rail industry chairmen and pressure groups such as Transport 2000, in that BR already faced competition from other modes of transport (Shaw *et al.*, 1998). In some contrast, however, the White Paper seemed to agree with Starkie (1984: 16), who had suggested that disaggregating BR was essential because the competitive effect from other transport modes was not sufficient as the railway was "still not as efficient as it might be."

Numerous methods of rail privatisation were proposed by academics, think tanks, MPs and officials, but the model ultimately adopted was the 'track authority' initially suggested by Gylie (1984) and Starkie (1984). The Treasury was particularly supportive of the track authority model because it appeared to be analogous with the method used to sell the CEGB; i.e., it was known to be capable of promoting competition and reducing the role of the state in network industries. Various technological factors had prevented competition from being extended beyond the generating section of the electricity industry, but Treasury officials considered that rail privatisation would allow further experimentation with the concept of vertical separation. A final policy decision was not taken without some debate in

government, although opposition to the Treasury's plans was rather ineffective. The Department of Transport had been considering rail privatisation since 1980s and had favoured various models at different times. Successive Secretaries of State for Transport disliked the track authority model but seemed unable to offer an alternative. Even after the Department had forced a compromise from the Treasury following a 1991 joint working paper (see chapter four), it could not commit itself to the deal it had brokered because Malcolm Rifkind, then Secretary of State for Transport, was not persuaded by the report's conclusions. A period of stalemate, which hampered policy development, ensued before the impending 1992 general election forced policy makers to resolve their differences hastily. Although the government stated that rail privatisation might take up to 10 years (*Financial Times*, 1992b), the real intention was to complete it before the next general election, due by 1997 at the latest. Thus, as a respondent noted,

“...the deal was brokered not in the context of considered papers or great meeting; [it] was brokered by a guy... in the policy unit at Number 10 essentially - almost literally - walking around Whitehall with the bit for the manifesto. That was the way the final deal was done.”

A new Secretary of State for Transport, John MacGregor, was charged with the responsibility for enacting rail privatisation and he conducted a brief policy review immediately after the election. Although MacGregor ostensibly set out to select the most appropriate from a range of policies (despite the pre-election push, the manifesto was still somewhat vague), it seems likely that he knew in advance that the track authority model was effectively the only option as others had either been ruled out in earlier cabinet discussions or were insufficiently developed with no time to examine them further. As one respondent pointed out,

“Put it this way. MacGregor stood back and reviewed the options to familiarise himself with his brief at Transport. He just wanted to make sure that vertical separation would work. He may have said in public, ‘we’re doing another consultation,’ but in reality we all knew what the outcome would be... The Treasury won.”

The policy of rail privatisation advanced in *New Opportunities of the Railways* was not the result of a coherent exercise in policy analysis. Although the track authority model was the best understood of the policy options available to MacGregor, the superiority attached to it was distinctly relative. Because of the pre-election delay in adopting a definitive policy option, civil servants had been prevented from undertaking a detailed assessment of the potential outcomes of vertical separation as applied to the rail industry. The Treasury had by

now identified that its analogy between the separation of generation and distribution activities in the electricity industry and the creation of a track authority for the railways was not perfect, and had accordingly suggested a number of refinements. It had also been accepted that there were differences between the electricity and rail industries, notably in that the latter lost money and, if service levels were to be maintained (a political imperative), there would be a continuing role for the state in terms of both subsidy provision and service requirements in respect of that subsidy. Beyond this, however, the government's understanding of the track authority model of rail privatisation was limited. Although the Treasury's assumption was that the model used to sell the CEGB could, with only a few minor changes, be transferred to the privatisation of BR and achieve similar results, policy makers could not be sure that this would be the case. When *New Opportunities for the Railways* was published, key areas of policy were still to be devised; crucially in terms of this thesis, the opportunities for, and even appropriateness of, service competition and its potential impact upon the relationship between the railways and the state had not been investigated. It was not known whether vertical separation would promote actual, rather than surrogate, competition.

7.2.2 Outcomes

It was against this background that the thesis turned to assess the outcome of rail privatisation policy in terms of the extent to which the passenger rail market has been liberalised. Chapter five reviewed the policy of franchising adopted to promote competition for the market. It was shown that, at least partly as a result of the muddled circumstances in which the track authority model was adopted by ministers, the private sector viewed rail privatisation as something of an uncertain proposition. In an attempt to ensure that meaningful competition for the market would be realised, the development of franchising policy was heavily influenced by the government's need to convince potential bidders that acquiring TOCs would make commercial sense. The Treasury had initially sought to maximise competition by making franchises short (to minimise the amount of time between tendering rounds) and numerous (to maximise the number of tenders in any given round). The Department of Transport, which had begun to enter into dialogue with potential bidders, quickly realised that such a policy could in fact threaten the viability of the franchising process by deterring bidders from submitting tenders (see chapter five). The Treasury was forced to accept the Department of Transport's analysis when it recognised the financial implications of an unsuccessful franchising process, and the policy of franchising became characterised by something of a paradox; the Department of Transport's

proposals, based on practicality rather than ideology, were more likely to promote competition than the Treasury's, whose motivation had been the other way around. Nonetheless, even though their position had prevailed, senior policy makers within the Department of Transport and OPRAF remained sceptical as to whether meaningful competition for TOCs would actually materialise.

In the event, private sector interest in passenger rail franchising was remarkably buoyant. OPRAF's administrative competence, which removed at least some of the doubts surrounding rail privatisation and thus helped facilitate a market for TOCs, was at least partly responsible for this. More important, however, was the willingness of certain companies to take part in the initial franchising rounds and the sudden change in market sentiment that followed. A small number of enthusiastic bidders was able to take advantage of the uncertainty surrounding rail privatisation to secure South West Trains, First Great Western and LTS Rail on favourable terms in the absence of much competition from rivals. Bidders not involved in these initial tenders quickly realised that money could be made out of rail privatisation and, as a respondent recalled, "[suddenly] thought, 'we must have a franchise!'"

The high degree of competition for the market generated by the franchising process affected the relationship between the passenger railway industry and the state in three key areas. First, the letting of all 25 franchises meant that the state was able to shift the provision of rail services to private companies. Ministers retained the right to stipulate minimum output standards in the form of PSRs (and also surrogate competition measures - see below) but, as noted above, this compromise of neoliberal values was inevitable given the loss-making nature of many rail services. The outcome of rail privatisation was always going to be different from that of other network industry sales because the state clearly has a right to demand certain levels of service in respect of the subsidy it provides.

The level of financial support is the second area in which franchising has redefined the state's involvement with the passenger railway industry. As explained in chapter four, the amount of subsidy payable to the rail industry has significantly increased since privatisation as a direct result of vertical separation. By splitting BR into 92 separate companies, the government vastly increased the transaction costs within the industry because each new business needed to trade at a profit. White (1998) has calculated that, even when sales revenues from Railtrack, the Roscos and other rail businesses are accounted for, privatising

BR could incur a net cost to the state of as much as £2.2 billion. Net gains to the state, if there are to be any, depend upon the declining subsidy/increasing premium payments to/from TOCs which resulted from competition generated by the franchising process. Provided these payments adhere to current forecasts, the savings which accrue will result in a net gain to the state of around £240 million by 2002/03, and this will increase over time if subsidy/premium payments reduce/increase further. Thus, the level of state involvement in the passenger railway industry in terms of financial support will decrease from that which existed at the time of privatisation in this scenario. However, as pointed out in chapter five, there is some doubt as to whether this will be the case (see also section 7.3.1).

Finally, franchising competition resulted in an unexpected role for the market in terms of investment planning within the rail industry. Although the government had originally envisaged that significant investment around the network would take place only where it signalled a willingness to fund it, market forces led franchise bidders into identifying several further investment programmes on a commercial basis. Bidders improved - or at least signalled to OPRAF a willingness to improve - the qualitative aspects of their bids because they perceived that aggressive subsidy reduction would not in itself be sufficient to secure a TOC. All 25 franchises were ultimately let on terms more favourable to rail users than the government had originally envisaged (although see section 7.3.1 below). The nature and amount of improvements secured in this way clearly represents a degree of market, rather than state, determination of investment requirements in the privatised railway. Although the state did not reduce its role absolutely, the degree of competition for franchises did result in the market increasing its relative involvement in this area.

The extent to which competition had materialised in the passenger rail market by early 1998 was reviewed in chapter six. Although, as noted above, the government had accepted that a degree of statutory involvement in this market was inevitable so long as it was financially supported, ministers strongly advocated the promotion of actual, rather than surrogate, competition as the best means of securing service enhancements (Department of Transport, 1992a). The chapter showed that, despite the claims of many commentators that franchising and 'open access' competition were incompatible owing to the need of train operators to cross-subsidise their businesses, the government - particularly the Treasury - was reluctant to concede that this was the case. Ministers' failure to rule out open access competition at an early stage added to the general level of uncertainty surrounding rail privatisation (see

above), and questions were asked as to whether ministers were pursuing ideology at the expense of improving railway services (*House of Commons Papers*, 1992g).

In early 1993, MacGregor was forced to announce that certain restrictions to the proposed open access regime would have to be introduced as “the prospect of unlimited competition was [going to be] a major deterrent to prospective franchise holders” (Smithers, 1993b: 3), and it became apparent that the outcome of rail privatisation in terms of on-rail competition would be significantly different to that which the government had originally intended. It was argued in chapter six that, despite BR’s undergoing a complex restructuring exercise designed to promote on-rail competition, its monopoly has, with relatively few exceptions, been reconstituted in the private sector. Although some competition was clearly possible and taking place, the number of competitive opportunities available was severely constrained by regulations - CCICM and CI - which had been designed to prevent the very competition ministers had originally wanted to promote (Charlton *et al.*, 1997). Furthermore, operational factors such as rolling stock availability and/or network capacity were militating against market liberalisation. As a result, a host of regulatory mechanisms, comparable with those imposed upon BT, British Gas and the water industry, were required to enforce a regime of surrogate competition capable of governing the behaviour of TOCs.

It was suggested in chapter two that the privatisation of the utilities during the 1980s was as much, if not more, an exercise in the formulation of regulatory mechanisms and institutions as it was an attempt to promote competition and reduce state control over the industries. This trend has indubitably continued in the passenger rail industry. Vertical separation was efficacious when the electricity companies were privatised because the industry was profitable, but difficulties were almost certain to be encountered with the track authority model of rail privatisation because on-rail competition could threaten the financial viability of many TOCs. The fact that this point was overlooked perhaps gives a further indication of just how little policy makers understood the likely implications of the track authority model of rail privatisation when *New Opportunities for the Railways* (Department of Transport, 1992a) was published.

Against this background, it is possible to draw two key conclusions in relation to the central aim of the study, which is to assess the extent to which the promotion of competition was an appropriate policy goal in the privatisation of British Rail. First, competition for the market would appear to be a workable and successful policy option whereas competition in

the market is less so; and second, the success of franchising seems to have occurred despite the muddled circumstances in which the track authority model was adopted whereas the failure of open access would seem to reflect them. In the context of the uncertainty which characterised the rail privatisation exercise, OPRAF's achievements, in the words of one respondent, "were quite exceptional." Had Roger Salmon and his successor, John O'Brien, failed, the franchising process might have been left uncompleted, the TOCs may have been let at significantly higher subsidy levels and private sector-driven investment in the railway could have been lower. As things stand, the government managed to transfer the assets of all 25 train operators to the private sector and, provided that TOCs meet their subsidy reduction targets, the amount of competition generated in the franchising process should reduce the amount of operating subsidy to a level below that given to BR before its restructuring in 1994. Furthermore, the quality of services provided to passengers should improve by more than the government had originally intended.

On the other hand, competition in the market had not, by early 1998, materialised to anything like the degree which the government had originally hoped. It seems that an initial failure to understand key intricacies of the railway industry resulted in ministers being unduly optimistic about the prospects for open access competition developing quickly around the network. The government's decision to promote on-rail competition is all the more surprising given that competition for the market is often introduced as a substitute for competition in the market where the latter is not possible because an industry loses money (Foster, 1992). In the past, policy makers had selected one instead of the other, rather than both simultaneously, and ministers would no doubt have been aware of this given that the Conservatives introduced competitive tendering regimes throughout the 1980s and early 1990s in many areas of the public sector (Gibb *et al.*, 1996; Pirie, 1988). The lack of on-rail competition in the new railway industry might be regarded as a major disappointment in policy making terms given that the *raison d'être* of the track authority model was to promote it. It should be remembered that vertically separating BR was directly responsible for the inflated transaction costs, and thus subsidies, now incurred by the railway industry. The government's attempt to introduce competition in the market has been considerably less effective than its efforts to promote franchising (indeed, the success of the latter is being relied upon to recapture the costs of the former). In light of this, it might be argued that restructuring BR to promote an open access regime was unnecessarily complex and expensive. A different method of rail privatisation, such as sectorisation or the regional model, would have been compatible with franchising (see chapter four) and might have

achieved similar levels of on-rail competition at a significantly reduced cost. The government's attempts to promote on-track competition expose practical limitations of neoliberal theory and illustrate ministers' apparent failure to acknowledge some of the difficulties involved in translating philosophy into policy.

Although these conclusions may appear logical, however, they can at this stage only be tentative. Whilst in some respects they confirm the speculative analyses of others such as Preston (1997) (who suggested that there would be a healthy level of competition *for* the market) and Shires *et al.* (1994) (who argued that promoting competition *in* the market would be problematic), they are provisional in the sense that the policy to which they relate was implemented only a short time ago. Although *New Opportunities for the Railways* was published in July 1992, and BR was restructured in April 1994, most TOCs have been in private hands for only two years and the new industry structure is still, to a certain extent, 'bedding in'. To illustrate, although much on-rail competition is currently prevented by CCICM and CI, these regulations are soon to be relaxed (OPRAF, 1999; ORR, 1998a) to provide new opportunities for market liberalisation. It is therefore the case that further conclusions arising from this study need to be informed at least in part by a discussion about the prospects for rail competition in the foreseeable future.¹ It is acknowledged that such conclusions will be unavoidably speculative; however, recent events have revealed a number of trends which shed some light on possible policy outcomes. These are examined in the following sections of this chapter.

7.3 Future prospects: competition for the market

Speaking in late 1997 and early 1998, when interviews for this thesis were undertaken, respondents were confident that their involvement in passenger rail franchising would be long-term. Passenger numbers were increasing throughout the industry and, because many TOCs were still in their first year of private operation, their subsidies had not yet begun to decline (Department of the Environment, Transport and the Regions (DETR), 1999; Hope, 1997).² Although there had been some suggestion that certain bidders would face a tough

¹ That is, until the current generation of seven-year franchises expire in 2003/04. Attempting to foretell developments beyond this point is of limited value because of the potential for circumstances to become rather unpredictable in the longer-term.

² It should be noted that published passenger journey figures do not allow a direct comparison of trends before and after privatisation. Passenger journeys are estimated from ticket sales, and the post-privatisation figures include an element of double counting; a journey involving more than one operator is now scored against each operator, whereas for BR a through-ticketed journey was counted only once, irrespective of any changes made (DETR, 1999). Nevertheless, as will be shown below, it is generally agreed that passenger numbers are rising as significant real-terms revenue increases have also been recorded by TOCs.

task offsetting their future subsidy reductions (see chapter five), respondents were keen to stress that they saw no reasons to dissuade or preclude them from bidding in future franchise rounds.³ Indeed, several franchisees have elected not to wait until 2003/04 to expand their TOC portfolios, staging successful takeover bids within the last year (FirstGroup, Laing and Go-Ahead have bought out Great Western Holdings, M40 Trains and Victory Railway Holdings respectively; Stagecoach has purchased a 49 per cent share in Virgin Trains, and FirstGroup is currently seeking further acquisitions (Morgan, 1998a; *Rail*, 1999b)). In addition to this internal optimism, media reports suggested that unsuccessful bidders and other companies outside the rail industry had maintained an interest in procuring TOCs in the future (Prynn, 1996). The combination of these factors would suggest that, in early 1998 at least, key industry actors and observers shared the opinion that TOCs would continue to perform well throughout their franchise periods. If this were so, demand for franchises at the next bidding round would be likely to remain high and the future success of franchising would be guaranteed through the continued private sector operation of passenger train services, perhaps at further-reducing levels of subsidy and with increased private investment.

Since 1997, the aggregate number of passenger journeys made on the British passenger railway network has continued to grow (see figure 7.1). Furthermore, this growth has been accompanied by a significant increase in farebox revenues, from £2,355 million in 1994/95 to £2,845 million in 1997/98 (see figure 7.2).⁴ Such trends have led some commentators (see, for example, *Rail*, 1999c) to express a considerable degree of optimism about the future financial viability of TOCs. Although such optimism is encouraging, there is a case to be made suggesting that, at least in part, it is somewhat misplaced. Despite the aggregate growth in passenger numbers and associated revenues, the financial performance of certain TOCs is worsening as the amount of subsidy they receive decreases. Moreover, it can be argued that the prospects for growth of the order required by most TOCs continuing throughout their franchise periods is slim. Should certain TOCs become unprofitable, or even loss-making, before the next tendering round begins, the success of franchising in the future would not be assured. Demand for TOCs is likely to be low if potential bidders, given

³ Concerns were raised about franchise length (in particular that seven years was too short given the long investment lead/recovery times) although no-one seemed to believe that this would impact on bidders' willingness to submit future tenders. Similarly, since imparting their views on long-term involvement, some respondents have sold their companies to rivals or partners who mounted takeover bids. Whilst it could be argued that this demonstrates only a short-term commitment to the industry, many of these vendors have retained employment in the railways and could, of course, bid in their own right again in the future.

⁴ In 1997/98 prices.

their industry experience (or industry-watching experience), come to regard them as commercially unattractive; the government would be forced to let such franchises at more generous terms in order to secure continued private sector operation of train services, and this would result in higher subsidy levels and, presumably, a reduced amount of commercially-driven investment.

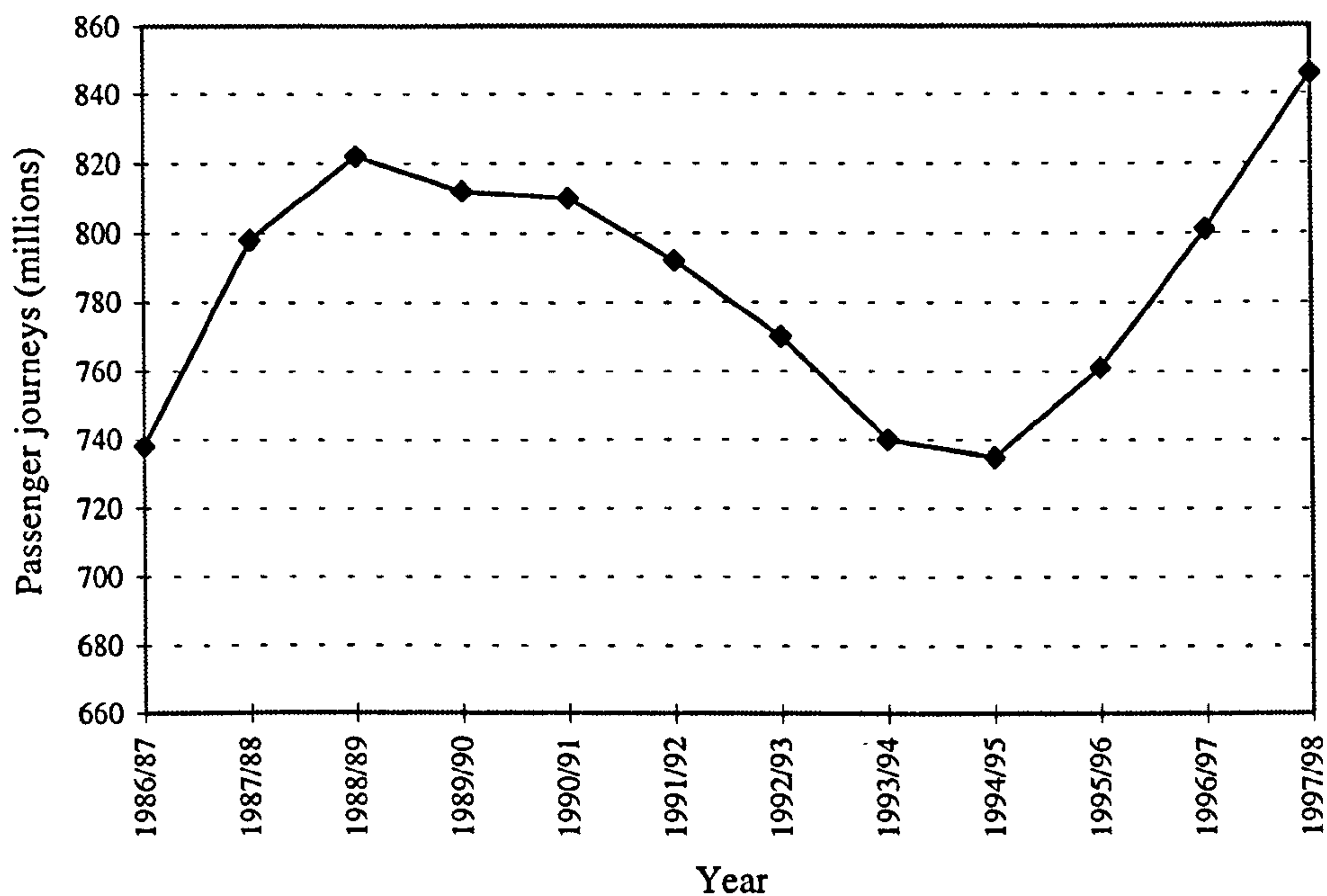


Figure 7.1. Passenger rail journeys, 1986/87 - 1997-98. Source: DETR, 1999. Figures for the whole 1998/99 are not yet available, although early indications are that passenger numbers are still rising.

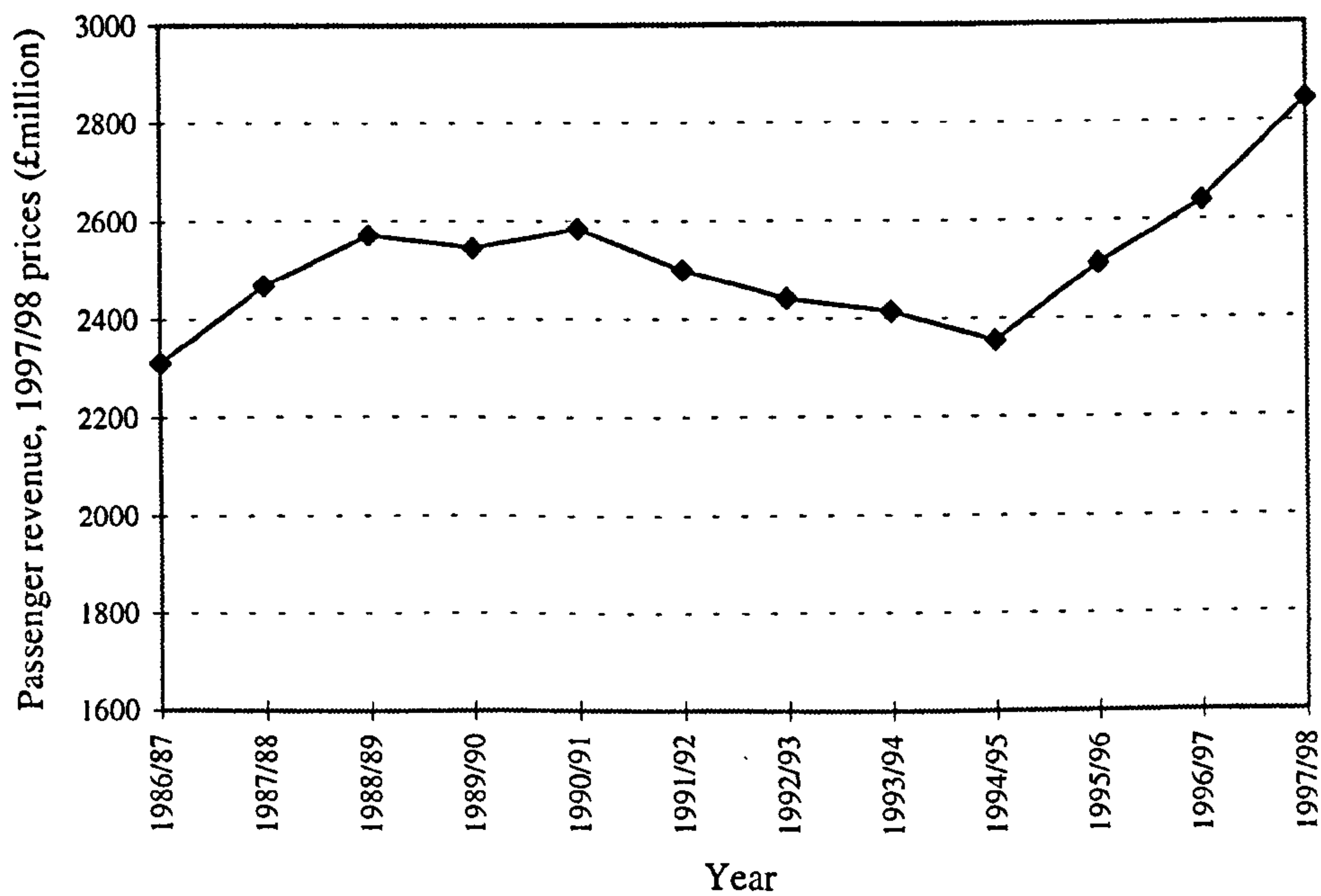


Figure 7.2. Passenger rail revenues, 1986/87 - 1997/98. Source: DETR, 1999. Figures for the whole of 1998/99 are not yet available, although early indications are that passenger revenues are still rising.

It will be remembered that all TOCs need to attract more passengers in order to grow their revenue base and offset declining subsidy levels. Scope for cost-cutting does exist - operators have, for example, restructured their workforces and begun to renegotiate certain contracts - but most costs are fixed. Some TOCs, particularly South West Trains, First Great Western and LTS Rail (the first three to have been let) require only a small annual financial improvement of between 1.3 and two per cent. On the other hand, many operators need to secure more ambitious improvements of at least five per cent per annum, with some of the former Regional Railways TOCs needing up to 12 per cent (see figure 5.4). Although the above growth figures suggest that almost all TOCs should be achieving, or coming close to achieving, their targets, this is not in fact the case. Significantly, the DETR's figures are aggregates and do not therefore take into account variations in performance between different operators.

It was predicted in chapter five that the former InterCity TOCs are in a good position to expand their businesses, whilst Regional Railways operators could be particularly vulnerable in the future. Former Network SouthEast TOCs, although arguably having the greatest growth potential, could also be the hardest hit in a future recession because of their dependence on commuter business. The initial financial results of TOCs since privatisation generally support these predictions (see table 7.1). Operators of InterCity-type services are performing particularly well, with First Great Western, GNER, Virgin Trains and Gatwick Express all announcing significant pre-tax profits for 1997/98 (Knight, 1999). Conversely, almost all former Regional Railways operators are beginning to encounter financial difficulties. Although the TOCs are witnessing passenger growth, this is at too low a level to offset the large reductions in subsidy they are facing (see, for example, Prism Rail plc, 1998). MTL Trust Holdings, which owns Northern Spirit and Merseyrail Electrics, managed to increase the profitability of its rail operations in 1998/99, but is now faced with very large cuts in subsidy and industry feeling is that these operations will move into loss this year. Indeed, MTL has been forced to postpone plans to sell its rail businesses - despite trying to offload them - because it has been unable to find a buyer (*Transit*, 1998; Morgan, 1998b). With regard to other operators, Prism Rail has announced that its substantial fall in profits in the first half of 1998/99 was due to its Wales and West and Cardiff Railway companies incurring losses, whilst First Group has publicly written off any chance of making money from its First North Western business (Wolmar, 1999a). Anglia is currently the exception. The company, whose operations are a combination of Regional and InterCity-type services, has remained in the black, although its pre-tax profits have fallen by 44 per

cent this year following a £9.3 million reduction in subsidy (see chapter five). Tellingly, former Regional Railways TOCs are beginning to argue that some of their services should be cut as it will be impossible to maintain them in the face of falling subsidies:

“The rail industry is lobbying the government to allow it to cut ‘unused’ rural services in, it claims, a desperate attempt to avert financial disaster because subsidies are falling by almost £1bn. Measures were put in place at privatisation to protect such services, but rail companies say they are now unsustainable” (Thornton and Clement, 1999: 14. Inverted commas added.)

Company	1996/97	1997/98
Gatwick Express	1.3	3.54
First Great Western	14.28	27.783
GNER	-0.374	15.221
Midland Mainline	1.546	4.77
Virgin Cross Country	7.3	3.296
Virgin West Coast	20.4	21.193
Chiltern Railways	0.957	2.013
Connex South Central	-7.774	-2.8
Connex South Eastern	-16.794	
First Great Eastern	8.7	
Island Line	-0.168	
LTS Rail	0.927	
Silverlink	1.852	
South West Trains	6.632	
Thames Trains/Thameslink ¹	5.7	7.9
WAGN	-3.655	14.0
Anglia	6.6	2.915
Cardiff Railway Company	-2.427	
Central Trains	-6.482	0.7
First North Western	11.095	-0.785
Merseyrail Electrics	1.098	
Northern Spirit	-2.201	
ScotRail	-3.975	-3.057
Wales and West	-0.168	-4.0

Table 7.1. TOCs’ operating profits/losses, 1996/97 - 1997/98. Sources: Leathley and Nelson, 1999; Knight, 1998. Figures for 1996/97 represent only part of the year for some TOCs and cannot be compared meaningfully with those from 1997/98. However, incipient trends of profit and loss are apparent (operating profit/loss figures are shown to avoid potential distortions from exceptional costs in the first year figures).

Note: 1. Go-Ahead Group combined results for both companies.

The fortunes of former NSE operators have been mixed. South West Trains and LTS Rail, with relatively generous levels of support, have both increased their profitability since privatisation. Thames Trains and Chiltern Railways have performed well although, as a

respondent pointed out, this was partially expected given that both networks underwent total route modernisation shortly before they were sold. WAGN, also the recipient of a new train fleet, has reported a healthy profit in the last financial year (Leathley and Nelson, 1999). At the other end of the spectrum, Island Line has yet to make a profit, and both Connex South Central and Connex South Eastern have remained in the red despite both franchises requiring relatively modest annual financial improvements (four per cent for South Central, 3.4 per cent for South Eastern (Glover, 1997)). Total replacement of slam-door stock is planned for Connex South Eastern and this, combined with line speed improvements being investigated by Railtrack, might assist the operator in the same way that modernisation transformed the fortunes of Thames and Chiltern. There are no major stock replacement schemes planned for Connex South Central and Island Line, however.

Thus, in terms of financial viability, something of a two-tier railway seems to be developing with, on the one hand, a group of financially successful TOCs trading profitably and, on the other hand, a number of TOCs who are either already losing money or are expected to move into loss this year. Of course, it does not necessarily follow that this trend will continue in the future. The figures presented above refer to only the first (part) year or two years of private operation. Those TOCs currently experiencing significant growth could witness a slowdown or even a contraction, especially if, for example, overcrowding began to deter customers from using their services. Conversely, many operators - including almost all former Regional Railways TOCs - are currently receiving new and/or refurbished rolling stock which will enable them to enhance both their standards and levels of service to attract more customers on to the railways. That said, there are two key factors which suggest that significant levels of growth will not be sustained by most operators over the coming years.

First, network capacity constraints will prevent certain operators from running more trains, especially along busy routes at the busiest times of day (such trains are generally the most lucrative). The former InterCity TOCs will be less affected by capacity constraints over the length of their franchises because most have already negotiated access rights with Railtrack which allow for frequency improvements despite current infrastructural constraints. Virgin Trains will benefit from the complete rebuilding of the West Coast Main Line (WCML) which is set to create a substantial number of additional trainpaths, but others, such as First Great Western, Midland Mainline and Anglia, guaranteed extra services as part of their franchise agreements when capacity was still available. The remaining TOCs will be more seriously affected. Chiltern Railways has recently been forced to cut around three per cent

of its services into Marylebone because it was running more trains than the infrastructure could cope with despite the recent modernisation of the route (Thornton, 1999b). Capacity constraints will also prevent major expansion by both Connex businesses, Silverlink, Thameslink, Thames Trains and WAGN because of congestion in and around their respective London termini (although WAGN is introducing a quarter-hourly Stansted Skytrain service shortly) (Knight, 1998). The Regional TOCs will also face difficulties in increasing service frequencies around major centres such as Birmingham and Leeds - partly as a result of increased InterCity-type services - although there is considerable scope to introduce new inter-urban services between smaller population centres such as Portsmouth and Penzance and these may prove particularly lucrative if timetabled and marketed sensibly (see section 7.3.2) (*Modern Railways*, 1999a).

Railtrack acknowledges that congestion is a barrier to growth in the railway industry. Its Network Management Statement (Railtrack, 1999) identifies 30 'bottlenecks' around the network which are currently running at, or near, capacity. Although work to alleviate congestion is underway at 11 of these, solutions to most congestion problems will not be implemented before the current generation of seven-year franchises expire. If growth continues at current levels, franchisees with longer contracts could also face capacity problems after 2008; Railtrack has forecast a further 30 per cent growth in passenger numbers over the next ten years, but admits that "even this level of growth, although unprecedented this century, is at the lower end of the range that our customers [i.e. the TOCs] aspire to achieve" (quoted in *Rail*, 1999c: 22). Railtrack has been accused by many of being risk-averse and has faced considerable pressure from the Rail Regulator who suggested that the company has behaved like a public sector utility. Nevertheless, it may be that Railtrack's relatively conservative forecast reflects future trading conditions more accurately than that of its customers given the second key factor which could impact upon all operators' passenger growth, namely a general economic slowdown (Prynn, 1996b).

Chapter five noted that while the fortunes of many industries are tied up with the overall performance of the economy, this is especially true of the railways (Nash and Preston, 1993). The onset of a recession reduces not only the amount of rail commuters, but also impacts adversely on the demand for leisure travel as potential customers re-evaluate their expenditure priorities. Economists appear unable to decide on the likelihood of an economic downturn occurring in the near future. At the time of the 1999 budget, many experts believed that the Chancellor's expectations for growth were far too optimistic and that the

economy would stagnate over the next couple of years (Kaletsky, 1999). More recently, economists' opinions have changed and it is now believed that prospects are somewhat brighter (Murray, 1999). Nevertheless, the typically cyclical nature of the British economy - particularly over the past two decades - would suggest that an economic slowdown will occur before too long (it remains to be seen whether politicians' talk about eradicating the 'boom/bust' cycle is credible) and the analysis will proceed on this basis.

Optimists have argued that the effects of a future recession on the railway industry would not be as adverse as those of previous economic slowdowns. Wolmar (1999b), for example, suggests that a good proportion of the growth which has taken place since privatisation has been structural and will not, therefore, be eroded by a future economic downturn. He further predicts that modal switch will continue as motorists, aggravated by road congestion and real-terms increases in driving costs, become increasingly disillusioned with car travel. Wolmar (1999c) argues that the recent growth in passenger numbers is greater than in previous economic booms, and also that the fares regulation introduced at the time of privatisation is now assisting rail's competitive position *vis á vis* the private car. Whereas BR could have choked off excess demand through large fare increases, the privatised TOCs are required to peg the price of at least some tickets to the rate of inflation (see chapter six).

But it is nonetheless questionable whether optimistic predictions such as Wolmar's will be proven correct. For a start, although the recent growth in passenger numbers has been impressive, it is unclear how far it can be attributed to the effects of privatisation because the 'revival' of the railway industry began around 18 months before its divestiture (DETR, 1999). Fares regulation, whilst protecting four key ticket types, does not control popular *SuperSaver* and *Apex* leisure tickets and some operators, particularly Virgin, have increased the cost of these fares significantly in relation to regulated ones. Furthermore, TOCs' performance since 1996/97 has been patchy. Whereas certain operators, such as GNER and Midland Mainline, have invested heavily in service improvements and transformed their approach to customer care, others have been criticised for allowing standards to decline (Knight and Harris, 1999). Punctuality and reliability, the key indicators used to measure operators' performance, are on average no better now than they were under BR (DETR, 1999). Customer complaints to Rail Users' Consultative Committees have risen to record levels, doubling since the last full year of BR operation (Bray, 1999),⁵ whilst media

⁵ Whilst it is true that customers have been more encouraged to seek compensation following privatisation than before, such a large increase hardly signifies high levels of customer satisfaction.

reporting of railway issues has frequently been negative. In combination, these factors can hardly have done much to encourage large numbers of new *long-term* customers on to the railway system. The recent growth of rail passenger numbers has also taken place against a background of a seemingly inexorable rise in car ownership, and recent figures suggest that the amount of car journeys made on Britain's roads could still almost double over the next 25 years (DETR, 1998a). People do not buy cars to leave them sitting on the drive - despite the potential threat of traffic congestion - and will be less likely to take the train in times of recession because rail travel would represent unnecessary expenditure when a private vehicle is already being paid for (trains are still considerably more expensive to use than cars despite rail fares regulation and recent increases in fuel duty (Leathley, 1999)).⁶

It can therefore still be argued that much of the current increase in patronage is a result of general economic expansion rather than structural growth attributable to the effects of rail privatisation or road congestion; if this is the case, experience suggests that passenger numbers will start to fall as the economy begins to make the transition from 'boom' to 'bust'. But even if the bulk of the current growth is structural, and a recession causes passenger numbers only to level off rather than decline, many TOCs could still find themselves in financial difficulties in the future. Subsidies will continue to shrink after the economy slows down, and passenger numbers *at the point when recession starts* may not be sufficient to offset the reduced government support TOCs will receive in subsequent years. Certain operators, particularly those who have relatively generous subsidies and/or have experienced greater than expected growth before recession, could well be unaffected but it is unlikely that others will be in such a happy position.

This section has painted a somewhat gloomy picture of the financial outlook for some train operators. Despite the encouraging level of aggregate growth experienced since 1994/95, it has suggested that this is unlikely to continue in the coming years. In terms of the prospects for competition in the 2003/04 franchising round, declining or stagnating passenger numbers will almost certainly have an adverse impact. Certain TOCs will of course remain attractive to potential bidders, especially those which currently enjoy relatively generous subsidy profiles and any which, notwithstanding the capacity and economic problems outlined above, achieve high levels of growth throughout their franchise periods. Such TOCs will

⁶ Particularly where more than one person are making a journey together. Although some innovative ticketing has been introduced (for example Midland Mainline's *Foursight*), the cost of taking the train hugely exceeds that of using the car. Five people travelling from Plymouth to Taunton and back pay a combined fare of £92.50 by rail, compared with around £18 by road.

probably be let at terms more favourable to the government than their current contracts. On the other hand, many TOCs will almost certainly appear less enticing, and may well have to be let by government with a more generous level of financial support than that paid when the franchises expire (see also Powell, 1997). The key question is whether the relative benefits secured when letting the more attractive TOCs will be enough to offset the relative disbenefits incurred when letting those with less appeal. There is of course a chance that this will happen; moreover, the premiums paid by Virgin Trains, Midland Mainline, Gatwick Express and First Great Western (all of whom have 10 or 15 year contracts) will help stabilise the overall level of subsidy paid to the industry after 2003/04. However, should a number of TOCs move into a loss-making position by the end of their franchise periods, the government may find itself having to increase, rather than continuing to decrease, the amount of financial support it pays. Although this is not to suggest that the government would be unable to find buyers for loss-making TOCs after 2003/04, ministers may have to accept that there will be less competition and, as a result, it will cost more to secure a similar level of privatised passenger services after the next franchising round. Any net gain which the state might have expected rail privatisation to deliver in the early 2000s will most likely be delayed.

7.4 Future prospects: competition in the market

Although there is little on-rail competition at present, the relaxation of several regulatory and operational restrictions over the coming five years will present a number of new opportunities for market liberalisation. Significantly, the Regulator and Franchising Director are to moderate the requirements of CCICM and CI to permit more competition between TOCs. The relaxation of CI involves OPRAF allowing lead operators to create dedicated fares on a permanent basis (at present only secondary operators are permitted to do this - see chapter six). At first glance, such a step would seem rather drastic as it might be considered tantamount to abolishing CI altogether; why have a compulsory inter-availability requirement if all operators can create their own dedicated fares? In practice, however, this amendment to CI will have little affect on the current trading environment. In order to create a new fare, operators must apply to, and obtain permission from, OPRAF. According to his OIG, the Franchising Director will still be required to view inter-availability as a key priority and a respondent from OPRAF suggested that, although he expects many applications, few will be sanctioned. Any additional competition for interavailable revenue will be limited to ORCATS raids (see below) and that which is currently permitted by CI.

The relaxation of CCICM is more noteworthy. Chapter six noted that stage one of CCICM restricts competitive new entry by making virtually all of the passenger rail market incontestable. Because it places incumbents and potential new entrants asymmetrically, CCICM currently prevents 'hit and run' entry - crudely, the regulations mean that incumbents are allowed to operate trains whereas potential new entrants are not. Stage two of CCICM will begin in September of this year and will last until at least 2002 (ORR, 1998a).⁷ Following the changes, CCICM will continue to be administered on a point-to-point flow basis (see chapter six), although now only 80 per cent - as opposed to 100 per cent at present - of the farebox revenue will be protected on nominated flows. To illustrate, if First Great Western's Plymouth to London Paddington service raises £10 million per year, an open access rival could introduce new services on that route to compete for up to £2 million of that revenue.⁸ Flows not nominated for protection will, as under stage one, be open to full competition, although it is again expected that these flows will be found on uneconomic lines along which there is no real prospect of new services being initiated.

As with changes to fares under CI, permission from the Regulator is needed before new services can be introduced under stage two of CCICM. Unlike the Franchising Director, the Regulator is not subject to OIG from the Secretary of State and, unless TOCs seek to run primarily abstractive trains (i.e. ORCATS raids), new services should be sanctioned because the ORR has stated that it wishes to encourage competition (ORR, 1997a). The potential impact of stage two, despite the capacity constraints outlined in section 7.3.1, could therefore be fairly significant. With the exception of West Coast flows, which have received ongoing protection from competition in light of Virgin's investment undertakings on the route, some InterCity- and many inter-urban- flows will be liberalised to present a considerable number of opportunities for new inter-peak and weekend services. Stage two of CCICM will introduce a degree of contestability to a large number of key routes around the network.⁹

⁷ It is not known whether the Regulator will further relax CCICM after 2002, but any change will be incremental in nature (ORR, 1994c) and it is safe to assume here that the regulations will remain relatively constant until 2004.

⁸ In certain circumstances, especially where two or more operators share a flow and none earn over 80 per cent of the revenue from that flow, open access services will not be allowed as it is deemed that some competition already exists (although this is of course severely limited by CI - see chapter six). An example is the Thameslink/Midland Mainline flow between Bedford and London.

⁹ Takeovers (see section 7.3.1) could impact upon the amount of on-rail competition which develops if a TOC is bought out by its neighbour. This has not happened to date and, unless OPRAF and the ORR change their current policies, is unlikely to before 2003/04 because both regulatory bodies are reluctant to jeopardise the potential for competition between adjacent TOCs.

Complementing these regulatory changes is the fact that many TOCs have ordered new rolling stock. With the notable exception of former Network SouthEast TOCs, the bulk of whose train movements are in peak hours, operators have had little spare off-peak rolling stock since privatisation because BR was unable to maintain train sets made redundant during the last recession (Knight, 1998). A hiatus of orders for new trains during the railways' lengthy divestiture served to compound this problem (*Rail*, 1998). Since 1996/97, however, many TOCs have placed substantial orders for new train sets both as part of, and in addition to, their franchise commitments. Many of these are now being delivered and the introduction of new trains will leave TOCs and/or Roscos (depending on the lease agreement) with spare sets which franchisees can use to bolster their existing services or compete with other operators. Either way, rolling stock will increasingly become available for TOCs to provide additional train services around the network where capacity constraints allow.

Although it is established that additional competitive opportunities will exist from this September, it still remains to be seen whether TOCs will choose to exploit them. Respondents were divided on this issue, but it appears that some TOCs intend to run competitive new services whilst others will refrain from doing so to concentrate on consolidating their current operations. Some of this latter group of franchisees were of the opinion that, whilst competition is usually to be encouraged, it is not yet appropriate specifically between TOCs for reasons outlined in chapter six - i.e. it cannot work effectively whilst the industry runs at a significant loss. Besides, one respondent argued, TOCs already face demanding surrogate competition, not only in the form of RPI minus 'x' and quality of service regulations, but also because the financial effects of declining subsidies/increasing premiums substantially reduce operators' overall incomes (see also Shaw, 1999). It was thought that more time was needed before properly informed decisions about open access could be made.

Other respondents were more opposed to on-rail competition in principle. Echoing the arguments advanced by former BR chairmen and pressure groups such as Transport 2000 when the track authority model was first being considered by the Conservatives (see chapter four), the respondents argued that on-rail competition is unnecessary as TOCs already face competition with other transport modes, notably the private car:

“Of course, on-rail competition misses the point which is that rail has a pathetically small market share in most markets and that the competition is not out there wanting to use different trains, it’s on the roads and that’s where we have to work hard and compete.”

“The idea of competition between rail companies is a bit of a distraction if you’re trying to encourage more people to use trains generally... It potentially dissipates the effort if the rail operators are competing against themselves when they should actually be competing against other forms of transport.”

It was further suggested that on-rail competition forces TOCs to concentrate on increasing their share of the existing market rather than seeking its *overall* growth, and that this would be to the detriment of the passenger rail industry. One respondent noted that market research conducted by his company had revealed that some rail users were already finding rail travel more complex following the demise of BR. The respondent suggested that increasing on-rail competition would make matters worse since the complexities facing customers would multiply. It may of course be the case that rail users would come to accept additional complications which arise from on-rail competition in the same way that utility customers now grapple with the liberalised telecommunications, gas and electricity markets. It was nevertheless suggested that TOCs should focus in future on co-operation, rather than competition, in their efforts to provide a ‘seamless’ alternative to the car:

“Far more important [than competition] is co-operation between operators. We can stand or fall on the extent to which the railway operates as a single, seamless product for the public... It’s imperative that operators work together... There’s far more scope for that than there is for competition.”

Instead of deploying rolling stock to compete with another company’s services, TOCs might seek to enhance their own levels of service provision on key routes; rather than omitting competitors’ trains from their timetables, TOCs might include them and so on.

Examples of co-operative working have already begun to develop around the network. First Great Western and Thames Trains have recently combined access rights to provide a new through service between Bristol and Oxford, and several TOCs now take part in joint marketing schemes, particularly those initiated by extra-industry groups such as the Devon and Cornwall Rail Partnership (Pinder, 1998). Some respondents felt that inter-TOC co-operation would increase as the industry’s outlook had matured after the initial uncertainty created by privatisation. Chapter six noted that whereas TOCs initially sought to attack each other in an attempt to satisfy the egos of newly-liberated management teams, operators had now begun to eschew the superficial attractions of short-term gain in favour of a long-term growth strategy. Evidence cited by respondents in early 1998 to support this thesis was the declining popularity of ORCATS raiding. A significant increase in co-operation between

TOCs would impact considerably on the amount of on-rail competition which develops around the network in the future. If co-operation is viewed by TOCs as a desirable substitute for competition, enabling them to effectively offset declining subsidies/increased premiums, then it would become a kind of self-regulation working in addition to CCICM and CI to restrict market liberalisation. The ORR (1997a) has acknowledged that extensive co-operation could negate the effects of relaxing CCICM, noting that whilst the Regulator will encourage operators to compete, he cannot force them to do so.

Despite these predictions of growing inter-TOC co-operation, other respondents felt instead that more on-rail competition would take place after September. There were two reasons for this point of view. First, in contrast to the opinions cited above, it was argued that existing co-operation around the network was exceptional and belied an immaturity which had persisted throughout much of the industry; indeed, it was predicted that rivalry between many TOCs would remain strong in the foreseeable future. One respondent implied that this was because although co-operation is easy to advocate, it is difficult to achieve when sharply reducing subsidies/increasing premiums “require desperate actions.” He argued that laudable long-term aims - and the logic of seeking market growth rather than maintaining market share which underpins them (see above) - might therefore fall victim to short-termism as some TOCs attempt to make a ‘quick buck’:

“There’s little in the way, unfortunately, of co-operation... I think that’s an element that’s been wasted in the rail industry. There’s far more options to co-operate with each other and compete against what is the real competitor, which is the car, [but] I don’t think there is a maturity in the industry... There’s really not been the co-operation, the maturity which one would expect, to fight the real competition which is the car.”

“For the last 6-9 months I’ve been working very closely with colleagues to say ‘we must co-operate,’ but I’m getting nowhere fast. People are concerned that I will grow my market share and have a vested interest in promoting co-operation. They think I’ll pinch some of [their] business... Yes, if my share goes up somebody has to decline in market share, but if the overall growth is so big why should any of us be concerned?”

Just as there is evidence of co-operation between TOCs, so there are examples of short-termist competition, all of which are ORCATS raids. One TOC, which has returned an operating loss in both trading years since privatisation, has identified and implemented a novel ORCATS raiding technique at another operator’s expense.¹⁰ In another instance, Wales and West, the former Regional Railways operator, has cut rural services to free up

¹⁰ This involved identifying a loophole in CI which enabled the creation of new dedicated flows on inter-available routes between alternative London termini. Whereas the previous flow specified only London BR as the final destination (in this case including two termini), the new flow referred to London Victoria only

rolling stock to run along the West of England main line (Wales and West has not ordered any new train sets). Although the company maintains that it is responding to patterns of demand - an ostensibly valid claim, given that its branch lines are patronised so thinly - industry insiders have suggested that Wales and West is engineering an elaborate ORCATS raid in an attempt to address its worsening financial performance. The ORR's decision to ensure that new services introduced under CCICM stage two are primarily generative rather than abstractive appears particularly prescient in light of this experience.

Second, other respondents were of the view that, far from being destructive or superfluous, an increased level of on-rail competition would contribute positively to the future success of the rail industry. Much as the Conservatives argued in *New Opportunities for the Railways*, it was suggested that on-rail competition would secure market growth rather than encourage fights over market share because it would provide a spur for TOCs to provide better services for customers. Respondents referred in particular to the competition between WAGN and GNER on the Peterborough to London route which, despite the arguments advanced in opposition to on-rail competition, was viewed as a success. WAGN's services have benefited not only customers - by providing a real choice of operator - but also both TOCs; whereas WAGN has increased its share of both the existing rail- and overall-markets between Peterborough and London (WAGN, 1999), GNER has been able to use its resultant increase in capacity to attract additional longer-distance customers and accommodate further growth from northern cities such as York and Newcastle. Although WAGN's actions were made possible through CI rather than CCICM, respondents were hopeful that similar conditions might be created on other routes with the introduction of new open access services.

Numerous operators have publicly expressed an interest in introducing new services from September 1999. GB Railways announced plans to run across London from Ipswich to Northampton and Romsey, as well as to introduce a 'Hampshire Pullman' service in direct competition with South West Trains between Southampton and Waterloo (Ford, 1999a); Virgin will significantly expand its network after 2002, but in the meantime is considering extending its *Dorset Scot* service from Perth to Inverness (Holley, 1999); and WAGN is planning to initiate services from London to Doncaster (*Modern Railways*, 1999b). Several respondents also implied that they would also be seeking to exploit the relaxation of

and resulted in the manipulative operator being able to introduce its own dedicated fares to undercut the interavailable ones.

CCICM. At least one non-franchised company is known to be seeking to introduce new services in the near future (*Local Transport Today*, 1999), and Railtrack is keen to encourage operators to take advantage of open access because it will enable the company to increase its revenue base (Morgan and Halstead, 1998).

It is apparent from this section that a number of new opportunities for on-rail competition will arise following the introduction of CCICM stage two. Whilst some operators argued that priority should be given to increased co-operation rather than competition, it is likely that several TOCs will begin to introduce new services over the next few years. Some of these services may not be competitive in that they will provide links between destinations without impacting upon other operators (as they had to under CCICM stage one). Most will have an element of abstraction, however, and the ORR's task will be to ensure that a new entrant's primary motivation is to generate additional revenue rather than plunder that which currently exists. It should be noted that the introduction of competitive new services does not mean that all TOCs will necessarily cease to co-operate. Whilst it may not be the case that operators will choose to collaborate with counterparts with whom they are in direct competition, many opportunities for co-operation will still exist and be exploited. Examples might be the pooling of rolling stock to create new services or the improvement of connectional arrangements to reduce overall journey times.

7.4.1 The sustainability of on-rail competition

Whether or not the services introduced under CCICM stage two will prove financially viable is far from assured. Although the Peterborough to London example cited earlier has clearly been a success, recent events indicate that it may also prove exceptional. First North Western has been forced to withdraw two long-distance services it introduced to compete with Virgin's Blackpool/Manchester-London Euston trains because of poor loading. The Manchester-London service was particularly under-patronised, attracting only 253 passengers per week despite an available capacity of 5,040 (Thornton, 1999b). Although it might be argued that First North Western's trains would have moved into profit in the future after becoming more established, this is unlikely owing to their relative infrequency. Particularly with regard to the Manchester-London services, customers travelling with First North Western had to choose from two services per day, whereas Virgin's could select from 21. Whilst presented in a different context, Wolmar's (1999d) argument that it is difficult to build patronage with an infrequent service is equally applicable here. Moreover, the lack of ticket interavailability on the route exacerbated the infrequency problem because,

unless they bought another ticket, customers were unable to take a Virgin train if they missed their First North Western service. Some open access services introduced under stage two of CCICM could also be heavily disadvantaged by these, or similar, factors. Even if they are required to adhere to CI, new entrants are almost certain to introduce - and encourage customers to use - their own dedicated tickets and, so long as they are allowed to compete for only 20 per cent of a flow's total revenue, their services will be infrequent relative to those of the incumbent.

Furthermore, any new on-rail competition which does take place will do so against the background of the impediments to growth outlined in section 7.3.1. Generative new services will need to attract a large amount of long-term, structural growth against the historic trend of short-term, economically-related growth if they are to survive. There will be some which accomplish this, particularly those designed to exploit potentially lucrative market niches (see chapter six). An example to date is Connex's Rugby to Gatwick service, which has built up a market from nothing to over 100,000 journeys per month (Knight, 1998) because it greatly simplifies the journey from the south Midlands to the airport and encourages modal switch for this reason. But such niches may be limited in number and, as a result, potential new entrants could be forced to increase the abstractive element of new service proposals in an attempt to guarantee their financial success. The Regulator will be aware of this and no doubt seek to discourage such a trend, but in reality he will be faced with a dilemma. Despite the ORR's policy being geared towards preventing abstraction, its over-riding objective remains the promotion of competition. These two goals will become increasingly incompatible once most lucrative niches have been filled and/or current growth levels stagnate. The Regulator might be forced to scale down his aversion to abstraction if he wants to continue encouraging new services, because few will materialise if he refuses applications with an abstractive element larger than he is currently prepared to accept. On the other hand, however, sanctioning overtly abstractive new services could, as outlined in chapter six, result in the financial viability of incumbents being seriously affected, particularly if they are already in difficulty because passenger numbers have failed to grow as predicted in their franchise bid. This will in turn affect the amount of competition for the market generated by the next franchising round. Although successful new entrants might increase the value of their own businesses - and thus attract a high level of interest from bidders - badly affected incumbents would have to be re-let at far higher levels of subsidy. The government has recently appointed a new Rail Regulator, Tom Winsor, who is understood to be significantly less pro-market than his predecessor (Shaw, 1999). If this

proves to be the case, the ORR may begin to lose its present enthusiasm for on-rail competition, and choose to resolve the above dilemma by simply refusing to sanction most applications for competitive new services.

Perhaps the most likely outcome of CCICM stage two is that, after niches have been filled, TOCs will adopt a 'defensive' rather than an 'attacking' attitude to introducing new services. In essence, this would involve incumbents identifying lines within their own networks which they think will be vulnerable to attack from new entrants, and then 'protecting' them by filling spare capacity with extra trains of their own. This scenario would in practice be consistent with that predicted by the theory of contestable markets (see chapter six). Although hit and run entry would still not be entirely feasible because of timetabling lead times, it would be the *threat* of competition, rather than competition itself, which forced incumbents to improve their quality and levels of service. Such an outcome has numerous advantages. It allows incumbent TOCs to expand in their own markets with which they are already familiar; it minimises the cost of expansion because access rights already exist (although an overall increase in train movements of more than six per cent will incur additional charges) and there is less need for extensive driver training; there will be none of the potential for ticketing and timetable confusion identified above because all new services will be provided by the same operator; and TOCs, in the absence of direct rivalry, could be more inclined to collaborate with each other. In combination, these factors could be more effective than direct competition in increasing the amount of structural growth TOCs are able to attract, thereby assisting many of them in their efforts to offset declining subsidies. Recent evidence indicates that TOCs are becoming aware of this as South West Trains has successfully fought off a threat by GB Rail to operate along the Southampton-London Waterloo corridor (see above) by introducing additional services of its own (*Modern Railways*, 1999c).

One final point to make with regard to the future prospects for on-rail competition is the likely impact of the above developments on the relationship between the passenger rail industry and the state. It will be recalled from chapter six that TOCs are currently subject to surrogate competition in the form of RPI minus 'x' and various quality of service regulations specified in the Passengers' Charters and elsewhere. Although in theory an increase in the amount of competition between operators should result in a decrease in the need for regulation, this is unlikely to happen in practice, at least over the coming five years. Apart from the fact that the regime originally proposed by the Conservatives - different

routes being subject to different degrees of regulation depending on the level of competition they supported - would be complicated in the extreme to implement successfully, the Labour administration elected in 1997 is less sympathetic than the Major administration to neoliberal ideals and has indicated accordingly its intention to strengthen, rather than relinquish, its control over the passenger railway industry (DETR, 1998b; Knight and Harris, 1999; Shaw *et al.*, 1998; see also Jenkins, 1999). It is therefore extremely improbable that, even if passenger growth exceeded all expectations, capacity constraints were all resolved and on-rail competition became viable across much of the network, the regulations currently governing the performance of the TOCs would be relaxed.

7.5 Promoting railway competition: an appropriate policy goal?

7.5.1 Competition for the market

Whilst the above analyses add a new perspective to the tentative conclusions outlined in section 7.2, they in fact do little to detract from the validity of the original statements. In terms of competition for the market, it was suggested that the success of the 1996/97 franchising round would not be repeated in 2003/04. High levels of passenger growth, upon which many of the TOCs depend, are probably not sustainable and it would appear that bidders generally overvalued the market in 1996/97. Such a mistake is unlikely to be repeated. That said, an increase in subsidy bills need not - and, indeed, should not - undermine the case for passenger rail franchising. Competitive tendering will still offer numerous advantages. First, franchising will continue to facilitate competition for a market which, despite the impact of CCICM stage two, will retain a significant element of monopoly. More importantly, however, franchising will provide the government with a mechanism for the continued protection of both passengers' and taxpayers' interests (Wadsworth, 1995). If one operator's performance is poor, another can be sought after a contractually-specified time period.

Thirdly, franchising will also enable the government to redraw the boundaries of TOCs should the need arise. It is possible that the 25 franchises designed in 1994/95 will not be appropriate in 2003/04 for a variety of reasons such as the completion of major infrastructural improvements or the identification of new opportunities to realise economies of scale. It was pointed out in chapter five that an optimal division of BR's operations would have involved the creation of fewer TOCs, and the recent round of takeovers and subsequent management rationalisations suggest that certain franchise boundaries might be re-drawn before the 2003/04 tendering round. The issue of redrawing franchise boundaries

has recently been discussed by Whitehouse (1998), although it is likely that the Franchising Director was aware there would be a need to reconsider the operating territories of some TOCs before letting them again in the future. As a respondent from OPRAF pointed out in 1997,

“One of the criticisms I’ve heard levelled against us [OPRAF] recently is ‘what on earth do we think we’re doing having lots of franchises finishing at the same time?’ It wasn’t an accident, we did it on purpose, and the reason we did it on purpose is that at the time we let these franchises we believed that the format of each of these businesses was right. In seven years’ time they may be different. We wanted to give ourselves the opportunity to reconfigure some of these franchises if we thought there was a better way of getting more benefits to the passengers. It might not happen, but then again it might... So we’ve given ourselves the option of making sure those franchises finish at the same time so we can take the benefits of any reconfiguring if we want to.”

Although reducing the number of franchises will obviously result in fewer competitive tenders, the amount of competition generated for each could be greater than if the current 25 are retained because potential bidders would be encouraged if improved business prospects were associated with each.

Fourthly, franchising will give ministers scope to alter rail policy in accordance with future changes to the government’s wider transport and/or environmental objectives. A key criticism of the Conservatives’ attitude towards rail privatisation is that, although some major investment was secured, emphasis was placed on securing a ‘cheap’ rather than a quality railway.¹¹ From an environmental perspective, the latter would have been more desirable because of its heightened potential to play a central role in effecting large and sustainable modal shift from road to rail. The sale of BR provided a real opportunity for the government to influence people’s travel habits because through franchising ministers could have secured ambitious output targets at a competitive price from the private sector. Of course, such a policy would probably have been unacceptable to the Conservatives because it would have meant significantly increasing the level of financial support to, and thus the influence of the state over, the railway industry. The new Labour administration is less preoccupied with neoliberal ideals than were the Conservatives (see section 7.3.2) and train operators could benefit from a public-private investment partnership in the future. However, although the government has recently announced a tentative move in this direction in the form of the £130 million Rail Passenger Partnership Fund (RPPF) (*Rail*, 1999d), it is beginning to look as though Labour will also prove as reluctant as the Conservatives to commit significant amounts of new public funding to improve railway services. Industry insiders have become aware that the Chancellor of the Exchequer, Gordon Brown, is

applying increasing pressure on transport ministers to justify the level of subsidy *currently* given to the rail operators.

Ironically, it could be that neoliberal policies hold the key to providing an environmentally sustainable transport policy. Numerous authors have argued that a key reason for rail's decline relative to the continued ascendancy of the private car is that the two transport modes do not compete on a level playing field (ASI, 1983; Campbell-Bannerman, 1993; Bradshaw, 1997; Hibbs, 1998; Martin and Michaelis, 1992). Although this has been the case for many decades (see, for example, Shaw *et al.*, 1998), the problem was exacerbated in the 1980s by an ideological paradox in Conservative transport policy. The Thatcher administrations sought to promote individual freedom by encouraging car use, but this was achieved and maintained through what amounted to huge subsidies - i.e. state intervention - for motorists. Whilst petrol and road taxes covered the cost of road building and maintenance, they failed to take adequate account of costs incurred by externalities such as congestion, pollution, threats to safety and so on (see, for example, Bradshaw, 1997; Department of Transport, 1996). Thus the *true* cost of motoring remained significantly higher than that which road users actually paid. At the same time the Conservatives sought to ensure that a progressively higher proportion of BR's costs were being met by its users rather than by state subsidy (see chapter six) and, in combination, these factors hugely distorted the transport market to the benefit of road and the detriment of rail.

Recent real-terms increases in fuel duty and rail fares regulation (both of which were initiated by the Conservatives) have begun to address this imbalance - the relative cost of motoring is now starting to rise (Leathley, 1999) - but the market distortion remains immense and is likely to do so for some time. Charging motorists the true cost of using the road would be inflationary and, to say the least, politically difficult and it is conceivable that the current policy on fuel duty will be modified should it begin to prove politically inconvenient. This would be unfortunate, because the long-term effect of 'levelling the playing field' between road and rail would almost certainly be significantly increased patronage for train operators. As Martin and Michaelis (quoted in Hughes, 1993: 76) point out, "if car users had to pay the full external cost, in a system which recovered the full costs of the congestion and nuisance effects of car use, they would be far more likely to take the train." The rail industry's increased revenue expectations would enable Railtrack to embark upon a far more ambitious investment programme, the train operators to order more new

¹¹ That is to say, 'cheap' in the context of the increased transaction costs associated with vertical separation.

trains and provide more frequent services and the government to diminish its influence over the rail industry at least in terms of subsidy payable. Competition both for and in the passenger rail market would then become much more viable.

7.5.2 *Competition in the market*

Whereas franchising was and remains advantageous despite anticipated setbacks, the case for competition in the market is less convincing. As things currently stand, on-rail competition is severely limited around the network, although section 7.3.2 predicts that more will arise following the implementation of CCICM stage two. Nevertheless, in judging whether or not it was an appropriate policy, the key question must be: will the amount of on-rail competition which develops in the future be sufficient to justify the Conservatives' method of rail privatisation and the restructuring costs/opportunity costs associated with it? Answers to this question will inevitably be speculative and also subjective, as much can depend upon differing interpretations of 'appropriateness'. One respondent pursued an ideologically dogmatic line, arguing that establishing an environment in which on-rail competition can take place was justifiable despite its cost and practical outcome. The respondent's views were based on the assumption that all competition is good and, therefore, that some competition is better than none. Another suggested that on-rail competition could only be judged appropriate if it benefited all passengers equally, but this is problematic in the sense that universal advantage is unlikely to be the result of *any* government policy. Perhaps most reasonably, it was suggested that appropriateness in this sense should be defined as a utilitarian concept to reflect the generalised circumstances in which government policies are frequently devised - will the promotion of on-rail competition result in service improvements for most passengers whilst at the same time produce a cheaper and more efficient railway for the majority of both passengers and taxpayers?¹²

Whilst it would seem that on-rail competition has led to service innovations on certain lines, most improvements since privatisation have had little to do with direct inter-TOC rivalry; Railtrack's station regeneration programme, rolling stock refurbishment schemes and increases in train frequencies were all enacted during stage one of CCICM. It is true that competition along shared route miles and competition by emulation will have stimulated

¹² There are of course problems with this concept, notably the fact that it ignores the circumstances of the disadvantaged minority. However, because all rail users are protected by PSRs and other regulations, it is assumed that no passengers will receive a level of service *significantly* worse than that in evidence before privatisation.

some innovations, but these kinds of competitive pressure are not exclusive to the track authority model and would have existed in a regional or sectoral rail industry too. Moreover, although CCICM stage two will result in the introduction of competitive new services around the network, they will in the main be off-peak and/or operate on less busy routes. Combined with the possibility that the new Regulator may refuse to sanction many applications to run them, the impact of competitive new services on the majority of customers may be limited. If, alternatively, the new services are defensive in nature, introduced in response to the *threat* of competition, they could bring major benefits to large numbers of rail users. Again, however, it is important to note that a similar outcome could have been achieved by any other method of rail privatisation, at a considerably reduced cost, through stipulating higher PSRs (or equivalent) at the time of divestiture. In neoliberal terms, although this would have meant more government involvement in terms of quality of service regulations, such intervention would have been offset by the relative reduction in restructuring costs and subsidy payments. Finally, and in relation to subsidy, potential taxpayer benefits are of course contingent upon the overall subsidy bill falling continuously until the state realises a net gain from rail privatisation. It has been argued here that this is unlikely to occur at least in the foreseeable future.

Despite these factors, it would be wrong to conclude that the promotion of on-rail competition *per se* is inappropriate. On a line by line basis, it has the potential to stimulate new demand and improve operational efficiency - the introduction of Connex's Rugby-Gatwick Airport service is a good example. On the other hand, it is not the case that the small amount of competition generated between TOCs is, or will be, sufficient to justify adopting a restructuring policy designed first and foremost to liberalise the entire network. The track authority model, despite the promotion of on-rail competition being its *raison d'être*, has resulted in minimal direct rivalry at a cost which significantly outweighs that of running BR as a vertically integrated whole. Perhaps a more sensible approach to rail privatisation would have been to pursue a more simplistic method of divestiture and then evaluate the prospects for on-rail competition on a line by line basis as and when applications arose. This would have been perfectly possible in any of the methods of rail privatisation outlined in this thesis (it had also, of course, been done in 1992 when Stagecoach introduced its Scotland to London services to compete against BR (see chapter five)) and still allowed the introduction of franchising.

Evidence presented in this thesis would support the argument that the Conservatives were mistaken to view BR's passenger services as monopolies. BR already faced competition from other transport modes, a point of course stressed repeatedly by critics of the track authority model before, during and after the time of privatisation (see section 7.3.2 and chapter four). Given the distortion which currently characterises the transport market (see above), it is crucial that a railway provides safe, fast, efficient, punctual and reliable trains in order to maximise its competitive position relative to road transport. Despite major productivity and efficiency gains in the 1980s and early 1990s, BR was arguably not achieving this at the time of its divestiture and it is becoming clear that the "management skills, flair and entrepreneurial spirit" (Department of Transport, 1992a) of the private sector has hardly improved the situation. As noted in section 7.3.1, standards of punctuality and reliability are on average no better than they were under BR; in addition, many trains remain dirty, overcrowding is increasingly commonplace and rural services, especially in the South West of England and South Wales, are being cut back to PSR levels (OPRAF, 1998c, 1998d, 1999a, 1999b; Ford, 1999b; Thornton, 1999b). On-rail competition was supposed to help prevent such problems, but in reality it could - and probably will - have the opposite effect. As TOCs spend time and effort devising new services to take advantage of CCICM stage two, they devote less energy to addressing the fundamental deficiencies which pervade their day-to-day operations. As Railtrack encourages more trains onto its network, punctuality and reliability suffer further as pinch points develop more quickly than the company can (or is prepared to) invest to alleviate them. Promoting competition on the current network is to encourage expansion at a time when the industry needs consolidation. So long as all TOCs are unable *routinely* to deliver fast, efficient, punctual and reliable trains, it could be suggested that on-rail competition is an unnecessary distraction to the rail industry and a largely inappropriate policy goal. If the money spent on trying to liberalise BR's market had instead been invested in improving the quality of its network, the train operators of today - nationalised or privatised - might have found themselves far better equipped to provide a high quality service capable of attracting high levels of long-term structural growth.

Chapter four showed that the track authority model of rail privatisation was pushed by the Treasury because it wanted competition and made the erroneous assumption that vertical separation would liberalise BR's market as effectively as it had the CEGB's. Little consideration had been given to how appropriate competition would be in the railway industry, but the circumstances in which the policy was adopted precluded detailed

discussion of the matter. Had the Conservatives not chosen to formulate rail privatisation policy in the context of drafting their 1992 election manifesto, their analysis might have led them to compare BR's market with those of companies other than the network industries, especially ones in which competition has been far less beneficial than free-marketeers would generally expect. Ministers might, for instance, have considered the experience of the bus industry - where the Conservatives also sought to introduce competition for and in the market (see chapter one) - since it was privatised in 1985. Although the markets of BR and the NBC were by no means identical, they shared key characteristics such as their relative insignificance in terms of the transport market as a whole and their dependence on public subsidy to support loss-making yet socially necessary services. The chief architect of bus privatisation, Nicholas Ridley, envisaged that, as a result of his policy, the NBC would be replaced by numerous small operators in each town competing with each other to grow the bus market and improve the overall level of service to passengers. The outcome was somewhat different to that which Joseph had in mind, however. As Wolmar (1998) makes clear, the bus market was not sufficiently robust to support competition from within. Far from increasing, patronage continued to decline (passenger numbers had been falling steadily for decades), services became unnecessarily bunched along busy corridors whereas rural routes were in contrast relatively neglected, small operators went bust or sold out to larger firms and the industry is now dominated by three major players, Stagecoach, FirstGroup and Arriva (see also Knowles and Hall, 1992; Lowndes, 1997; Simpson, 1996; White, 1995).

Wolmar (1998) suggests that bus privatisation policy (and especially the attempts made by the MMC to support it) was flawed because it under-emphasised the competitive threat posed by other modes of transport. Whereas in reality the bus companies' share of the overall transport market was generally too small to be contestable, the regulatory authorities "insisted that competition between the bus companies was the only yardstick against which to measure the competitiveness of the market... The only recognised form of competition against the bus were other buses" (Wolmar, 1998: 171-172). Despite Ridley's efforts, the bus industry is now characterised by very little intra-modal competition, as the NBC's successor companies recognise the futility of 'bus wars' and for the most part respect and avoid each other's territories (Wolmar, 1998). Attempting to introduce competition into the bus market was thus a largely superfluous exercise, often creating instability and uncertainty rather than service improvements and market growth. The fact that BR's share of the overall transport market was small, and in addition that it required an annual subsidy of

around £1 billion, should have alerted the Conservatives to the likelihood of on-track competition having a similar impact in the rail market. Had bus and rail privatisation been considered as part of a wider neoliberal transport strategy, creating a level playing field between road and rail, liberalising the NBC and BR's markets might have been a more feasible proposition. But such a radical policy approach was always unlikely. There are, of course, both practical and political limitations to the application of theories of political economy.

Whatever the inappropriateness of the track authority model of rail privatisation, the Blair administration has had to review its future policy options carefully. Renationalisation was not an option as it would have involved considerable wasted expenditure. Under European law, the businesses sold outright could only be bought back at their current market values and these are significantly higher than they were at privatisation. Furthermore, the level of investment needed in the rail industry outstrips that which any UK government would be prepared to undertake. It could be argued that successive administrations, both Labour and Conservative, have viewed the railways as a low priority and starved BR of investment capital, and there is no reason to suppose this would change. One benefit of privatisation is that it frees industry from public sector financial constraints, so the rail companies are able to raise their own investment capital from the financial markets. The government has also had to ensure that any changes it does implement will not significantly alter the structure of the railway. Despite the expense and complexity of the current regime, further restructuring will only create more uncertainty within the industry. As Chris Green, former InterCity director and now chief executive at Virgin Trains, has pointed out, various reorganisations over the past two decades have forced British railway managers to concentrate too much on implementing new industry structures - perhaps at the expense of actually running the railway (Shaw, 1999).

Labour's 'third way' approach, suggesting that the answer lies in tougher state guidance rather than either nationalisation or free-marketeering, seems sensible in theory and is being welcomed by many in the industry, including some respondents. A Strategic Rail Authority (SRA) has been established to assume all of the Franchising Director's and some of the Regulator's duties, as well as to provide decisive leadership for the myriad railway companies. The SRA is currently operating in shadow form as primary legislation is needed before it can formally begin its task, although policy details are currently being formulated in anticipation of a start in spring 2000. It is hoped that the strategic vision the government is

promising will contribute significantly to the future success of the railway, but it will only do so if ministers learn from the experience of the original privatisation and carefully think out their strategy first. In the short-term, the SRA needs to concentrate on developing tougher standards of performance. Passenger's charters currently allow TOCs to run trains up to 10 minutes late and claim they are on time. Moreover, operators can 'stretch' their timetables if they think that certain trains will be delayed, and this has resulted in advertised journey times between certain stations increasing beyond those of 100 years ago (Leake and Macaskill, 1998). The list of shortcomings in TOC regulation is considerable and will occupy the minds of SRA staff for some time to come. In the longer term, it is suggested that rail policy be formulated with reference to the wider context of the transport market as a whole. Although not addressed in this thesis, it would also seem sensible that environmental and social objectives play a key role in determining both the SRA's and the Regulator's agenda. The effective regulation of Railtrack, the only true monopoly left in the industry, will be crucial in ensuring sufficient investment in the infrastructure is forthcoming to support these wider objectives.

In terms of market liberalisation, the most appropriate course of action might be to continue with franchising, but to abandon CCICM stage two, at least for the time being. Competition in the market might, at some future stage, become viable in more areas across the network and could then be re-introduced on a case by case basis. What is certain, however, is that future research into railway competition will be essential in helping the regulatory authorities take decisions on the matter. It was noted in chapter one that this study did not set out to undertake an exhaustive analysis of railway competition in terms of its impact upon service output. Such research is now required with some urgency. Even if CCICM stage two is dropped, pockets of on-rail competition will remain around the network as described in chapter six. The effect of each or all of these can be measured to ascertain in detail their costs and benefits line by line. What are the implications of on-rail competition along different types of corridors? How does it affect the quality and frequency of services along those corridors, and does it impact detrimentally on services in other areas? What effect could on-rail competition have on local or regional socio-economic development? Finally, what is the perception of rail users towards on-rail competition? Do customers want a choice of trains between destinations or, as a respondent suggested (see section 7.3.2), will this give rise to unnecessary confusion and detract from rail's appeal to potential customers (see also Bradshaw, 1997a)? The method of rail privatisation adopted by the Conservatives to liberalise BR's market has been only partially successful. Whilst

franchising has much to commend it, on-rail competition is not an appropriate policy goal at present. Ministers wanted to introduce on-rail competition because they thought it would bring benefits to rail passengers and taxpayers alike, but they failed to research the potential implications of the track authority model in sufficient detail before its implementation. It is the responsibility of the new government to ensure a similar mistake is not repeated in the future.

This thesis has examined the policy adopted to promote competition in the British passenger railway industry. Its central aim was to assess the extent to which the promotion of competition between passenger train operators was an appropriate policy goal. In pursuit of this aim, the thesis critically evaluated the evolution, outcome and future prospects of rail liberalisation policy and closely examined the translation of neoliberal political philosophy into practical policy measures. The study's original investigation, which used qualitative methods of data collection and analysis to draw upon the experiences of key personnel involved in framing, executing and operating within the policy, augmented secondary data to provide an in-depth level of analysis not previously available within the literature. The main findings were that, despite the sale of BR having been considered by the government for more than a decade, the privatisation and liberalisation strategy advanced by the 1992 White Paper, *New Opportunities for the Railways*, was not the result of a coherent policy analysis. The opportunities for, and even appropriateness of, a neoliberal agenda to promote competition between train operators were not sufficiently well understood by government when the proposals were adopted. Competition for the market, nevertheless, would appear to be a workable and successful policy option, with the scope to offer long-term benefits to the rail industry should future governments choose to seek them. Competition in the market, on the other hand, is far less appropriate and continued emphasis on this aspect of rail policy could damage the industry's prospects in the coming years. The success of franchising seems to have occurred despite the muddled circumstances in which the Conservatives formulated rail privatisation policy, whereas the general failure of 'on-rail' competition seems to reflect them.

Appendix one

Schedule used to interview franchise bidders

Section A: Interviews with franchise bidders

The central aim of this research project is to evaluate whether or not the promotion of competition was a viable policy goal in the privatisation of British Rail. This series of interviews is designed to examine bidders' perceptions and attitudes towards the competitive tendering process used to award TOC franchises. I would like to record the interview for logistical reasons, although confidentiality is of course guaranteed.

Questions will focus on: the competitiveness of the bidding process; the openness or otherwise of the tendering process; clarity of OPRAF's criteria for awarding franchises; consistency with these criteria of winning franchise bids; the independence (from government) of the process; the speed at which franchising was conducted and whether this affected the outcome; overall benefits/shortcomings with the system, for both your company and the consumer; what you would like to see altered next time around.

The interview will comprise a limited number of open-ended questions, to which you will be invited to respond in as much depth as you feel necessary to make your points. It will last between 45 minutes and one hour.

Section B: Preparing to bid

I should first like to discuss your attitudes regarding the bid submission process in relation to your decision to tender for a franchise(s).

1. Was the bidding process logical and clearly explained by OPRAF? Why/why not?

- *Were sufficient instructions provided as to exactly what you should submit etc?*
- *Did these instructions change over time?*

2. How far do you feel sufficient information was available as to the nature of the business on offer?

- *Did (for example) the lack of PSRs until late in the bidding process, or the possibility of a change in government, affect your understanding of what you were bidding for?*

3. What are your thoughts about OPRAF preventing bids from BR for the first 14 franchises?

- *Why? Would you still have submitted bids had BR been involved in the process?*

4. Several Mebo teams submitted bids with some financial security provided by the BRB. Is there therefore a difference between a Mebo bid and one from the Board?

- *What and why?*

Section C: Awarding franchises

5. How well did OPRAF outline the criteria on which they would award franchises?

- *What did you perceive these criteria to be?*

6. In what order of preference do you think OPRAF held these criteria?

- *Did your interpretation of this order of preference remain constant or did it change with time?*
- *Presumably your interpretation, whether static or dynamic, influenced your bidding strategy? How?*

7. Is it feasible that other bidders would have interpreted OPRAF's preferences in a similar manner to you?

- *What, therefore, do you see as the consequences of these interpretations?*
Key issues to prod: levels of investment, franchise length (and the relationship between these two).

8. Do you believe the allocation of franchises was influenced by factors other than bid quality?

- *Government interference, opposition policy etc?*

Section D: Prospect and retrospect

Bearing in mind our discussion so far, I would like to ask you a few questions about your overall perceptions of the process

9. What comments do you have regarding the pace at which the franchising process was conducted?

- *How did this affect the outcome?*

10. How far do you think the franchising process was coherent? Why?

- *Was this related to the speed at which it was conducted?*

11. Roger Salmon, whilst giving evidence to the CPA in 1996, said that "most of our unsuccessful bidders come back again; they have a lot of confidence in the system." What is your reaction to that statement?

- *Prod for an answer relating to all bidders as well as their own company*

12. How effective was the franchising process as a mechanism of generating competition between bidders? Why?

13. Did the level of competitiveness between bidders change as the process evolved?

- *Is there an identifiable pattern in terms of the bids' competitiveness? Why?*
- *Are some successful bidders therefore going to have a harder task than others to operate profitably?*

14. When framing your bid, did you bear in mind the threat of on-rail competition?

- *Did you alter your bid because of it?*

15. Has the franchising process benefited the consumer?

- Both in terms of improvements over and above what BR were already going to do and than a different method of sale?

16. Has the franchising process benefited the industry?

- Is it a key component to the future success of the industry?
- Is it appropriate?

17. When the current generation of franchises expire, should they be re-tendered or dealt with in a different manner?

- Sold outright? Kept in public ownership?
- What is your long-term strategy? Will you be bidding again?

18. Keeping in mind all we have discussed, and presuming that TOCs will be re-franchised, what, if anything, would you like to see changed in the next round of franchising?

I have now finished my questions. Is there anything else you would like to add?

Appendix two

Schedule used to interview TOC managers

Section A: Interviews with key Train Operating Companies' personnel

The central aim of this research project is to evaluate whether or not the promotion of competition was a viable policy goal in the privatisation of British Rail. This interview is designed to examine the attitudes, perceptions and experiences of TOCs' management in this area. I would like to record the interview for logistical reasons, although confidentiality is of course guaranteed.

I should like to discuss competition *in* the market, where TOCs provide a number of competing on-rail services. Questions will focus on: the extent to which competition exists between TOCs; the future prospects for on-rail competition; the appropriateness of competition in the passenger train service industry; the extent to which competition influences your business and whether this has changed since privatisation.

The interview will comprise a limited number of open-ended questions, to which you will be invited to respond in as much depth as you feel necessary to make your points. It will last between 45 minutes and one hour.

Section B: General introduction

1. What would you say were the key objectives of the Conservative government in framing the 1993 Railways Act?

- Both in terms of what they wanted to achieve and the methods used?

2. The Rail Regulator believes that, because of the current territorial geography of TOCs, there are 'many opportunities for [TOCs] to compete, both on price and service quality'. What are your thoughts about that statement?

- What form does competition take?

- What factors limit/promote it? Only regulation, or operator (un)willingness too?

- Any more than under the BR sectors? Was it worth restructuring for competition, then?

3. What are the prospects for competition developing between operators in the future?

- What form will this take?

- What factors will limit/promote it?

Section C: TOC-specific questions

4. Who or what do you regard as your main competitor? Why?

- Has this changed since privatisation?

5. Do you compete with other TOCs?

- If so, which ones and how?

- ORCATS?

6. Have you introduced new train services which compete with other operators?

- *What about other initiatives?*
- *How many of these are 'carry-ons' from what BR was already planning?*
- *ORCATS?*

7. Do you work in co-operation with other TOCs you could in fact compete with?

- *How and why? Bear in mind size of market, fragility, what would happen if you did get into aggressive competition?*

8. To what extent does the prospect/threat of on-rail competition impact upon your business plan?

- *At the time of bidding? For the future?*
- *Positive/negative/no effect? Why?*

9. Bearing in mind our discussion so far, do you think (lack of) competition between operators has benefited the consumer?

- *Has privatisation enabled TOCs to become more competitive with other modes of transport than BR was?*
- *Has this benefited the rail user? Wales and West/Virgin example?*

10. What are your opinions regarding the regulatory framework within which you operate?

- *Controlled competition in contestable markets?*
- *Other regulation from OPRAF/ORR. Is it flexible? Is it effective? From whose point of view? Why?*

Section D: The future

11. Do you think the current restrictions to open access competition should be relaxed in 1999? Why/why not?

- *What about a further relaxation in 2002? Pace of change?*

12. How will you, as a company, react to this change?

13. Who do you see being the operators being most likely to benefit from a relaxation of CCICM? Why?

- *Who will open access operators be? TOCs or new entrants?*

13. How far do you think that competition between TOCs is a key component to the future success of the industry?

- *What other components? Co-operation?*
- *Is competition appropriate?*

14. Will competition between operators benefit the consumer?

- *Was it worth restructuring for competition, then?*

15. I contend that competition between operators is to all intents and purposes absent and is likely to remain so for the foreseeable future. How far do you agree with this statement?

I have now finished my questions. Is there anything you would like to add?

Appendix three

Example of schedule used to interview policy makers

Section A: Interviews with key policymakers/advisors

The central aim of this research project is to evaluate whether or not the promotion of competition was a viable policy goal in the privatisation of British Rail. This series of interviews is designed to broaden understanding of rail privatisation policy formulation by investigating the roles and recollections of key actors involved in the process. I would like to record the interview for logistical reasons, although confidentiality is of course guaranteed.

Questions will focus on: your/your Department's role in the policy making process; the relative balance of power between different groups of decision makers (e.g. Ministers, civil servants, advisors, different Departments) during policy formulation; the relative importance of market liberalisation as an influencing factor in policy evolution; the mechanisms used to promote, and the difficulties recognised with using, competition as an organising principle for the passenger train service industry.

The interview will comprise a limited number of open-ended questions, to which you will be invited to respond in as much depth as you feel necessary to make your points. It will last between 45 minutes and one hour.

1. When did you first become aware of the government's plans to sell BR?

2. When did the Treasury become involved, and in what capacity?

(Other respondents have hinted at a very influential role for the Treasury. Probe in particular the Freeman/Maude/Redwood Working Party.)

3. Would it be fair to say that a key objective in the White Paper was to promote competition in the passenger railway industry?

- Clarify where. Between TOCs and between bidders?

- How strenuously was this pursued within government, and by whom particularly?

(Note that others have said it came from the Treasury.)

4. Was competition between TOCs seen as viable?

- By who? What was the Treasury's opinion on this?

5. What was the Treasury's working relationship with other Departments like?

- Was the policy making exercise coherent?

(Point out accusations of 'dominance' and that the process was a shambles.)

6. When was it realised, and who realised, that competition in the market was not compatible with competition for the market?

- Was ideology being pushed at the expense of practicality?

7. What was the Treasury's influence on CCICM?

- Did you agree with it? Why/why not?

- *Did you suggest an alternative? Why did you agree to it?*
- *Isn't it the case that you could get more money (or pay out less in subsidy) for monopolies?*

8. What about the Treasury's involvement with the structure and sale of franchises?

- *How independent was the Franchising Director in deciding what criteria he would award them by? How did the Treasury interpret 'value for money' in this sense?*
- *How long did the Treasury want them to be?*
- *Did the Treasury support the long-term commitment to franchises? (Mention accusations of 'breathing down the neck of the FD'.)*

9. How would you like to see competition, both for and in the market, develop in the passenger railway industry?

10. In retrospect, was the method used the correct one from the Treasury's perspective?

Appendix four

BR Businesses franchised/sold/closed.

Sources: Curwen, 1997; Department of Transport, 1996; *Modern Railways* 1996, 1997, 1998a, 1998b.

Company and group (now trading as)	Date sold	Owner
TOC		
South West Trains	19/12/95	Stagecoach Holdings
Great Western (First Great Western)	20/12/95	FirstGroup
LTS Rail	08/05/96	Prism Rail
InterCity East Coast (GNER)	29/03/96	Sea Containers
Gatwick Express	03/04/96	National Express Group
Network SouthCentral (Connex South Central)	12/04/96	CGEA
Midland Main Line	22/04/96	National Express Group
Chiltern Railways	25/06/96	M40 Trains
South Eastern (Connex South Eastern)	21/08/96	CGEA
South Wales and West (Wales and West)	17/09/96	Prism Rail
Cardiff Railways	17/09/96	Prism Rail
Island Line	13/10/96	Stagecoach Holdings
Thames Trains	19/10/96	Go-Ahead
CrossCountry Trains (Virgin Trains)	28/11/96	Virgin Rail Group
Great Eastern	03/12/96	FirstGroup
West Anglia Great Northern	05/12/96	Prism Rail
Anglia Railways	05/12/96	GB Railways
Merseyrail Electrics	20/12/96	MTL Trustholdings
North West Regional Railways (First North Western)	04/02/97	FirstGroup
North London Railways (Silverlink)	07/02/97	National Express Group
Regional Railways North East (Northern Spirit)	10/02/97	MTL Trustholdings
Thameslink	11/02/97	GoVia
Central Trains	17/02/97	National Express Group
InterCity West Coast (Virgin Trains)	09/02/97	Virgin Rail Group
ScotRail Railways	25/02/97	National Express Group
Freight		
Red Star Parcels	05/09/95	Rald (MBO)
Rail Express Systems	09/12/95	EWS
Mainline Freight	24/02/96	EWS
Loadhaul	24/02/96	EWS
Transrail Freight	24/02/96	EWS
Freightliner	25/05/96	MCB (MBO) ¹
Railfreight Distribution ^u	13/03/97	EWS
Rosco		
Porterbrook Leasing ^{uu}	08/01/96	MEBO
Angel Train Contracts ^{uv}	16/01/96	Nomura/Babcock <i>et al</i>
Eversholt Leasing (Forward Trust Rail) ^y	02/02/96	Candover Partners/MBO
GoCo		
Railtrack	20/05/96	Stock market flotation
Union Railways ^u	31/05/96	London & Continental Railways
European Passenger Services	31/05/96	London & Continental Railways
BRIS		
DCU Birmingham (Owen Williams Railways)	25/07/95	Owen Williams
IDG Glasgow	18/08/95	Scott Wilson Kirkpatrick
Mainline Swindon (Scott Wilson Mainline)	18/08/95	Scott Wilson Kirkpatrick
Civil Engineering Design Group (CEDG York)	15/09/95	British Steel
BPE Mechanical & Electrical Engineering Consultancy (BPE Engineering)	15/09/95	James Scott (AMEC)
CEDAC (W S Atkins Rail (CEDAC))	15/12/95	W S Atkins Consultants
Powertrack Engineering (W S Atkins Power Track)	15/12/95	W S Atkins Consultants
Scotland Track Renewals	08/02/96	Relayfast (MBO)
Scotland Infrastructure Maintenance (First Engineering)	14/02/96	First Engineering (MBO)
Central Track Renewals (Centrac)	29/02/96	Tarmac
Eastern Track Renewals	15/03/96	Fastline Track Renewals (MBO)
Western Infrastructure Maintenance (Amey Railways)	25/03/96	Amey/MBO
South East Infrastructure Maintenance	02/04/96	Balfour Beatty/MBO
Eastern Infrastructure maintenance	02/04/96	Balfour Beatty
Southern Track Renewals	02/04/96	Balfour Beatty
South West Infrastructure Maintenance (SWIMCO)	18/04/96	AMEC
Central Infrastructure Maintenance (GT Railway Maintenance)	19/04/96	GEC Alsthom/Tarmac
Northern Track Renewals	23/05/96	Fastline Group (MEBO)
Northern Infrastructure Maintenance (Jarvis Facilities)	18/06/96	Jarvis
Western Track Renewals	23/07/96	Relayfast (MBO)
BRML		
Swindon Electronic Service Centre (ABB Daimler-Benz Transportation)	13/04/95	ABB Customer Support Services
Chart Leacon Level 5 Depot (ABB Daimler-Benz Transportation)	05/06/95	ABB Customer Support Services
Doncaster BRML Depot (ABB Daimler-Benz Transportation)	05/06/95	ABB Customer Support Services

IIFord Level 5 Depot (ABB Daimler-Benz Transportation)	05/06/95	ABB Customer Support Services
Springburn BRML Depot (Railcare)	06/06/95	Babcock/Siemens
Wolverton BRML Depot	06/06/95	Babcock/Siemens
Eastleigh BRML Depot	07/06/95	Wessex Traincare (MBO)
Central		
Meldon Quarry	04/03/94	ECC Construction Materials
Special Trains Unit	31/01/95	Flying Scotsman Railways
Baileyfield Switches and Crossings Works	07/07/95	VAE-Baileyfield
Ditton Timber Treatment Works	01/09/95	The Phoenix Timber Group
OBS Services Ltd	03/10/95	European Rail Catering (MBO)
Quality & Safety Services	10/11/95	Ingleby (805) Ltd (MBO)
Railway Occupational Health	30/11/95	Occupational Health Care
Signalling Control (UK)	01/12/95	BTR (Westinghouse Signals)
BR Telecommunications (Racal BRT)	21/12/95	Racal Electronics
Interlogic Control Engineering	04/01/96	ABB Daimler-Benz Transportation
Castleton Works (British Steel Track Products)	14/03/96	British Steel
The Engineering Link	18/03/96	Chief Policy Ltd
Interfleet Technology	22/03/96	Bromco 909 (MBO)
College of Railway Technology	29/03/96	Advicepart (MBO)
Network Train Engineering Services	01/04/96	W S Atkins (Consultants)
BR Projects	26/06/96	Addspice Ltd (MBO)
Scientifics	09/12/96	Atesta Group
British Rail Research	20/12/96	AEA Technology
Nationwide Fire Services	06/01/97	Serco
BR Business Systems	03/02/97	Sema
National Railway Supplies (including Collector's Corner)	03/02/97	MEBO/Unipart
Rail Operational Research	04/02/97	BR Projects Ltd (MBO)
Opal Engineering	13/02/97	W S Atkins (Consultants)
Railtest	14/02/97	Serco
Railpart UK	06/03/97	Unipart
BRIL	Not yet sold	
Businesses closed		
Crewe Timber Works	25/03/94	
Newton Heath Concrete Works	25/03/94	
Crofton Track Works, Wakefield	25/03/94	
Architecture & Design	31/03/94	
Haulmark	30/09/94	
Brighton Fabrication Works	25/11/94	
Shettleston Fabrication Works	23/12/94	
Taunton Concrete Works	02/02/95	
The Grove Management School	16/02/95	
Materials Technology, Derby	31/03/95	
Materials Engineering Group	31/12/95	
Railnews	30/10/96	
First Procurement	31/12/96	
British Railways Savings Co	31/03/97	

ⁱ Sale includes the promise of a subsidy totalling £75 million and a five year track access agreement with Railtrack

ⁱⁱ Ownership finally transferred to EWS on 22-11-97 after an EU enquiry.

ⁱⁱⁱ Sold on to Stagecoach for £825 million.

^{iv} Sold on to Royal Bank of Scotland for £395 million.

^v Sold on to Forward Trust for £726.5 million.

^{vi} Union Railways and European Passenger Services were both given to London and Continental Railways after their winning bid to build the CTRL.

Appendix five

Summary of mechanistic approaches to access charging assessed by the Rail Regulator in 1994. Source: ORR, 1994b

Negotiated Charges required Railtrack to estimate its total future revenue requirement, and then deduct anticipated income from (among other things) access charges expected to be paid from non-franchised operators. TOCs would, between them, meet the remaining 'control cost'. Meanwhile, Railtrack would have an incentive to encourage non-franchised operators onto the network - who would pay a negotiated charge - in order to increase its revenue above the control cost. This approach to charging was seen as a means "both of maximising the use of the network and of maximising financial contributions towards it - both highly desirable objectives" (ORR, 1994a: 11). However, aside from the fact that negotiations between Railtrack and non-franchised operators might fail to capture the full amount of their potential contribution, or even *discourage* open access entry to the network, a major shortcoming of the negotiated charges regime was that it made no attempt to moderate competition. If non-franchised operators did abound, then the problems of escalating subsidy bills and/or absence of bids for franchises would have occurred.

Equalised Access Charges envisaged that all operators, whether a TOC or non-franchised, would pay the same price per unit of operation for access to a particular route. The 'unit of operation' might comprise train miles, vehicle miles or passenger revenues. Analysis undertaken by the ORR for a typical InterCity TOC showed that using train miles as the unit of operation created an almost complete barrier to entry, whilst using vehicle miles created virtually no barrier at all and would have exposed the incumbent's income in a manner similar to the negotiated charges regime. The use of passenger revenues would have been equally problematic. Because Railtrack's costs represent at least 40 per cent of all passenger revenues, train operators would have had an incentive to cease operating services which earned, on average, a margin of less than 40 per cent over direct operating costs. Such a scenario would have required detailed timetable specifications (in considerable excess of those included in PSRs) to prevent this happening, thus, as the Regulator pointed out, entrenching inflexibility instead of removing it.

Access Deficit Charges represented a different approach to the above models. The charges would contain some of the risks a TOC might face from competition by requiring new entrants to compensate incumbents for their reduced capacity to cross-subsidise services. This type of charge was first considered in the railway industry in 1991, when the Virgin Group expressed a desire to run services from London to Edinburgh in competition with British Rail (House of Commons Papers, 1992d). However, the calculation of an access deficit charge would have raised problems of practicality because of the extreme difficulty in

Appendix six

**Duplicated route miles on the British passenger rail network.
Source: Railtrack, 1998**

Route	Competition ?	Operator(s)
Barking/Upminster - Benfleet/Southend	No	LTS Rail
Birmingham - Edinburgh	No	Virgin Trains
Birmingham - Leamington Spa	Yes	Central Trains, Virgin Trains, Wales and West
Birmingham - Stafford	Yes	Virgin Trains, Central Trains
Birmingham - Smethwick	No	Central Trains (Centro)
Birmingham - Worcester	Yes	Central Trains, Wales and West
Cardiff - Cheltenham/Birmingham	Yes	Wales and West, Virgin Trains
Cardiff - Radyr	No	Valley Lines
Clapham Junction - Staines	No	South West Trains
Didcot - Worcester	Yes	Thames Trains, Great Western
Edinburgh - Perth	Yes	Virgin Trains, ScotRail
Gatwick - Barnham	No	Connex South Central
Glasgow - Carlisle	Yes	Virgin Trains, ScotRail
Glasgow - Edinburgh	Yes	ScotRail/Virgin Trains
Glasgow - Motherwell	Yes	ScotRail (SPT)/Virgin Trains
Glasgow - Dalmuir	No	ScotRail (SPT)
Glasgow - Newton	No	ScotRail (SPT)
Glasgow - Springburn	No	ScotRail (SPT)
Leeds - Bradford	Yes	North Western Trains, Regional Railways North East
Liverpool - Chester/Ellesmere Port	Yes	Merseyrail Electrics, North Western Trains
Liverpool - Hunts Cross	Yes	Merseyrail Electrics, Central Trains
Liverpool - Manchester	Yes	North Western Trains, Regional Railways North East, Central Trains
Liverpool - Preston	No	North Western Trains
Liverpool - Wigan	No	North Western Trains
London - Beckenham Junction	No	Connex South Central/Eastern
London - Birmingham	Yes	Virgin Trains/Silverlink, Chiltern Railways
London - Clapham	Yes	Connex South Central/Eastern, South West Trains
London - Croydon	Yes	Thameslink, Connex South Central, Connex South Eastern
London - Epsom	Yes	South West Trains, Thameslink
London - Exeter	Yes	Great Western, South West Trains
London - Glasgow	Yes	Virgin Trains, GNER
London - Havant/Portsmouth	Yes	Connex South Central, South West Trains
London - Herne Hill	Yes	Thameslink, Connex South Eastern
London - Reading	Yes	Great Western, Thames Trains, Virgin Trains, South West Trains
London - Leeds/Wakefield	Yes	GNER, Midland Main Line
London - Southend	Yes	LTS Rail, Great Eastern
London - Stevenage	Yes	GNER, WAGN
London - Streatham	Yes	Thameslink, Connex South Central
London - Sutton	Yes	Thameslink, Connex South Central
London - Wimbledon	Yes	Connex South Central, South West Trains
London - Ashford	No	Connex South Central/Eastern
London - Aylesbury	No	Chiltern Railways
London - Bromley	No	Connex South Eastern

London - Broxbourne	No	WAGN
London - Cambridge	No	WAGN
London - Canterbury	No	Connex South Eastern
London - Catford	No	Connex South Eastern
London - Charlton	No	Connex South Eastern
London - Dartford	No	Connex South Eastern
London - Dover	No	Connex South Eastern
London - Finsbury Park	No	WAGN
London - Horsham	No	Connex South Central
London - Lewisham	No	Connex South Eastern
London - Maidstone	No	Connex South Eastern
London - Margate/Ramsgate	No	Connex South Eastern
London - Minster	No	Connex South Eastern
London - Orpington	No	Connex South Eastern
London - Peckham/Denmark Hill	No	Connex South Central/Eastern
London - Penge	No	Connex South Central/Eastern
London - Rochester/Chatham	No	Connex South Eastern
London - Sevenoaks	No	Connex South Eastern
London - Twickenham	No	South West Trains
Loughborough - Chesterfield	Yes	Central Trains, Midland Mainline
Manchester - Bristol	Yes	Wales and West, Virgin Trains
Manchester - Chester	No	North Western Trains
Manchester - Leeds	No	Regional Railways North East
Manchester - Sheffield	Yes	North Western Trains, Regional Railways North East, Central Trains
Manchester - Stafford/Birmingham	No	Virgin Trains
Manchester - Rochdale	No	Regional Railways North East
Manchester - Wigan	No	North Western Trains
Milton Keynes - Rugby	Yes	Virgin Trains, Silverlink
Norwich - Great Yarmouth	No	Anglia
Preston - Blackpool	Yes	North Western Trains, Regional Railways North East, Virgin Trains
Surbiton - Guildford	No	South West Trains
Wakefield - Castleford	No	Regional Railways North East
Wakefield - Sheffield	Yes	Midland Mainline, Regional Railways North East
Wimbledon - Effingham Junction	No	South West Trains
York - Leeds	Yes	Virgin Trains, Regional Railways North East
York - Sheffield	Yes	Virgin Trains, Regional Railways North East
York - Selby	No	Regional Railways North East

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Viewpoint

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Regulation and continuing monopoly on Britain's railways

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One of the key objectives of rail privatization was to dismantle British Rail's (BR's) monopoly and introduce a competitive spirit into the industry. In order to achieve this, BR was fragmented into 92 separate companies. This restructuring is now complete and, at the time of writing, slightly more than two-thirds of these new companies have been divested. Despite this, the government is taking regulatory steps to *prevent* the competition it wanted to promote and there are signs that a private monopoly has already begun to rise from the ashes of the public one. This paper explores the government's apparently paradoxical regulatory stance and questions the necessity of such a major restructuring exercise within the railway industry. © 1997 Elsevier Science Ltd

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Introduction

In 1992, the Government published its White Paper *New Opportunities for the Railways* (Department of Transport, 1992) with a view to radically restructuring British Rail (BR) in preparation for privatization. A principal objective of the White Paper was to improve the quality of railway services through the promotion of competition. In order to facilitate this, BR was fragmented to form a complex new industry structure comprising 92 separate companies (Department of Transport, 1996). However, despite having adopted a fiercely pro-competitive stance throughout the formulation of its rail privatization policy, the government is now taking regulatory steps to try and *prevent* competition. Through this policy of regulation, one of the principal objectives of the rail privatization exercise appears to have been lost, as most customers are still dealing with a monopoly service provider just as in the days of BR.

It is a central contention of the present paper that meaningful competition has not, and will not, materialize in the railway industry whilst the government continues to encourage an extensive regulatory regime. It is also suggested that, as such, the complex restructuring exercise undertaken to end BR's monopoly was probably unnecessary. This paper will therefore examine the initial thinking behind competition in the railway industry, the methodology used to

try and promote it, and the subsequent regulation imposed to ensure its prevention. Evidence presented in the last section of this paper suggests that BR's public monopoly, rather than being replaced by a myriad of competing companies, has begun to re-emerge both spatially and structurally in private hands.

Why competition?

Achieving the theoretical benefits of competition in a free market—increased efficiency, greater choice and so on—is a stated goal of the Conservative Party's privatization policy (Conservative Party, 1992). The government suggests it has returned much of Britain's formerly nationalized industry to the free market (Conservative Party, 1992), but this assertion would be contested by many in that utilities such as British Telecom, British Gas and the water industry were privatized as regulated monopolies. However, beginning with the divestiture of the electricity industry, the government began thinking more radically in order to secure a genuine movement towards market liberalization. Some freedom was introduced into the market by splitting up the generating business into a number of competing companies (Wharmby, 1993). Now the regional electricity supply companies can buy their electricity from a host of different generators in a truly

free market and, according to the government, benefits are passed on to all involved.

The same benefits were envisaged by the government for rail users. Customers travelling from, say, Exeter to London would be in a position to choose between Train Operating Companies (TOCs) and, by virtue of competition, receive a better service from either operator than available under the monopolized BR. Presumably, competition was also seen to offer PTEs and other such organizations a better deal. Take, for example, Centro, the operating arm of the West Midlands Passenger Transport Authority. Before rail privatization, Centro *had* to contract BR to operate its services. The Department of Transport (1992) observed:

'... at present ... there is no choice of operator for the rail customer ... [however] liberalising access to the network will complement structural changes by providing the opportunity for new operators to run services' (Department of Transport, 1992, p. 13).

Therefore, as a result of the privatization process, Centro should in theory be free to contract whichever train operator offers it the most appropriate service arrangements, thus passing the benefits of competition onto rail users and taxpayers alike.

In 1992, the government was enthusiastically endorsing the benefits to be derived from a competitive, privatized railway system. *New Opportunities for the Railways* promulgated that the new industry structure would 'improve the quality of railway services by creating many new opportunities for ... more competition' (Department of Transport, 1992, p. 13). The Rail Regulator, who was appointed by the government to oversee corporate interaction within the new structure, was in 'no doubt that the promotion of competition [will be] of fundamental importance to the future of the railway industry' (Office of the Rail Regulator, 1994a, p. ii). In order to create a competitive environment within the railway industry, however, the Government needed to find a way of ending BR's monopoly. In the event, it essentially experimented further with the methodology it employed whilst divesting the electricity industry and BR was fragmented into 92 separate companies (Department of Transport, 1996). The structure of the new railway, devised to facilitate competition, is examined below.

The structure of the new railway

The methodology used by the Government to break BR's monopoly revolves around a *common carrier* (CC). The advantage of this methodology in BR's case was that it allowed the monopoly to be broken without the need for an entirely new infrastructure. This was achieved by separating ownership of infrastructure from service provision. The infrastructure owner is the CC because it provides customers with access to its assets (i.e. it 'carries' them). The CC's customers are

companies who in turn compete to offer their services to the public.

In order to maintain its infrastructure, the common carrier must contract work out to suppliers through a system of competitive tendering. Although the CC is clearly still a monopoly, its significance is diminutive compared to its vertically-integrated predecessor. Furthermore, given that access provision is its dominant source of revenue, the CC is usually subject to market pressures via a financial incentive scheme which encourages the reliability of the network. In essence, then, the CC is a monopolistic fulcrum around which the competitive remainder of the industry can organize itself.

In the British railway industry the CC is Railtrack. Railtrack has charge of the infrastructure (track, signalling, bridges, stations and so on), train-timetabling and the overall safety of the network. It is also obligated to both maintain and invest in the infrastructure, and its operations are divided regionally into seven zones (Gibb *et al*, 1996). The remainder of the industry consists of a multitude of companies whose collective functions are to operate train services and fulfil any 'support' duties required by the industry as a whole. To assist clarity, we have divided these companies into groups based upon the functions they would have performed under the BR regime (see Table 1). Within each group, individual companies are theoretically free to compete with each other to provide services to other groups on a commercial, contractual basis (Department of Transport, 1994). The interaction between these groups is represented in Figure 1.

Whereas under BR all aspects of running the railway were dealt with by one company, it is apparent from Figure 1 that, in order to function within the new railway structure, a company must contract with many, if not all, of the other company-groups. The average TOC is used as an example: in the first instance, it

Table 1 Company groups as defined by their functions within British Rail. After Department of Transport (1996)

Central	e.g. consultancies, research and telecommunications services
TOC	Train Operating Companies running passenger services
BRIS	British Rail Infrastructure Services; e.g. track renewal/maintenance
BRML	British Rail Maintenance Limited; e.g. rolling stock maintenance/construction
Freight	Goods haulage companies
RoSCO	Rolling stock leasing companies
GoCo	Railtrack, Union Railways and European Passenger Services. Ownership was transferred from BR directly to central government before privatization (the latter two have now been combined as part of the Channel Tunnel Rail Link deal).

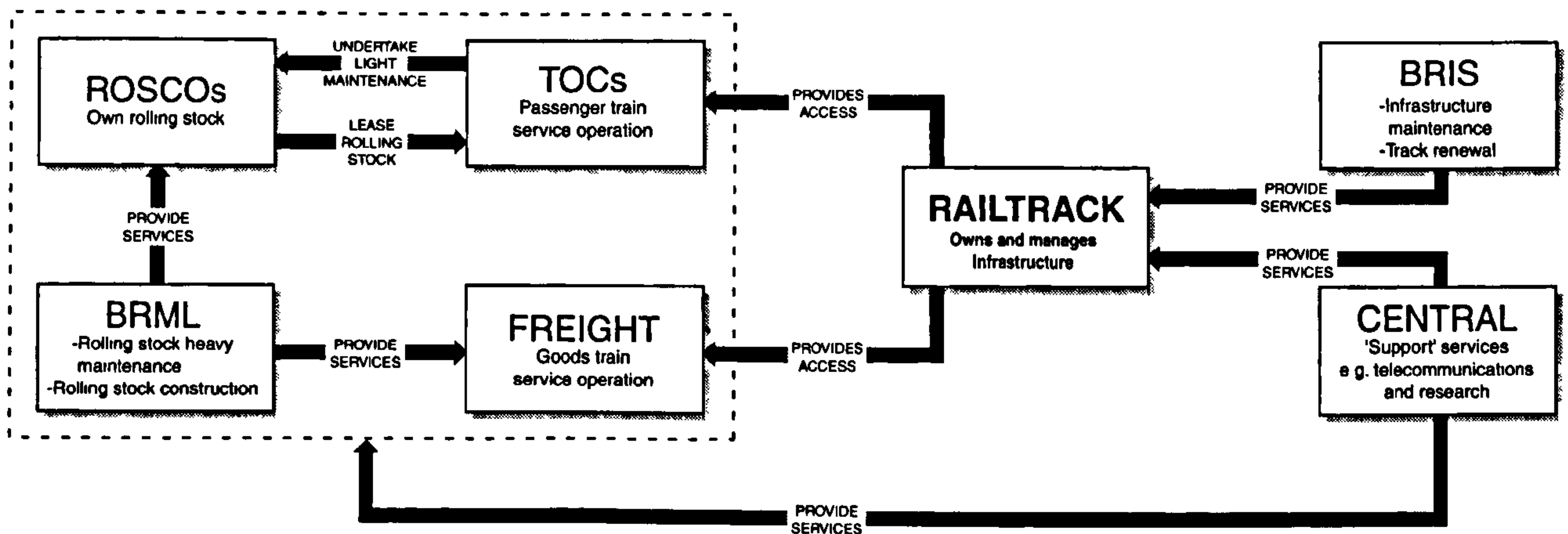


Figure 1 The interaction between company-groups in the new railway structure.

must procure rolling stock. This it can do from a RoSCO. The TOC must then negotiate access to the infrastructure with Railtrack. Whilst doing this, it will normally also make arrangements to lease the majority of stations and depots situated upon its route network. The TOC is then in a position to offer the use of its stations to other TOCs with whom it shares route miles, and its depots to RoSCOs to undertake light rolling stock maintenance. Finally, the TOC will have to enter into various contractual agreements with Central group companies in order to secure support services such as telecommunications. As well as liaising with other ex-BR businesses, the average TOC will also involve itself with non-railway actors, such as local authorities. The latter will be the case in major conurbations, through the funding of rail services operated by PTEs, and also in rural areas, in terms of station

construction or rail-oriented tourism partnerships (see, for example, Charlton *et al*, 1995).

The government's desire to maximize the potential for competition within the new railway has led not only to a complex operational structure, but also a circuitous privatization. Each of the 92 businesses created by the break-up of BR has had to be prepared separately for divestiture. Furthermore, only 67 of these companies have been offered for outright sale. The 25 TOCs were all offered to the private sector as regionally-based franchises, to be won through a competitive tendering process (Department of Transport, 1994). The route-plan of the Great Western franchise is shown as an example in Figure 2. According to the Department of Transport (1996), 55 businesses were sold outright, and 13 TOC franchises let, between February 1994 and October 1996. Figure 3 provides a

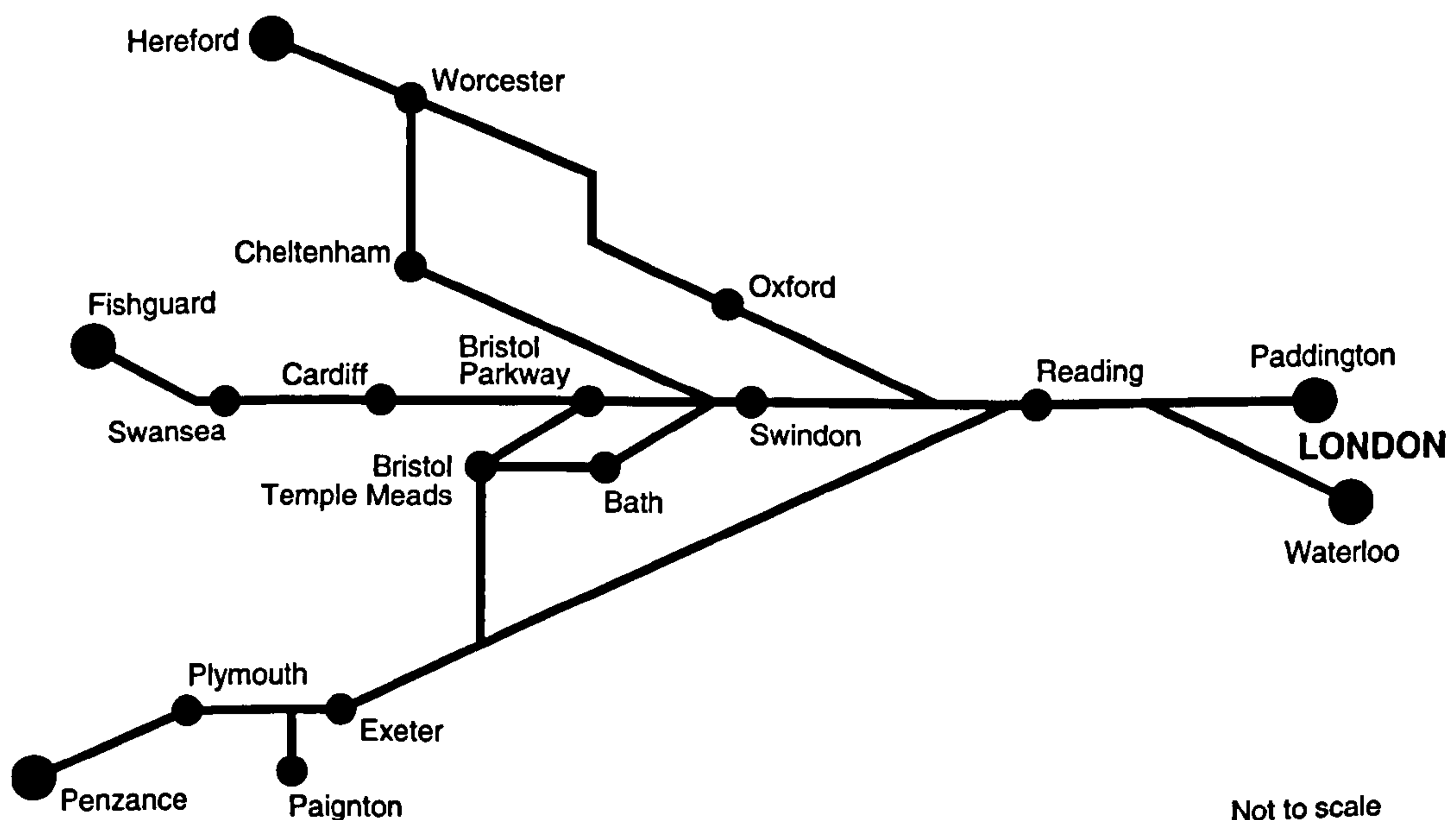


Figure 2 Route-network of the Great Western Trains Company Ltd.

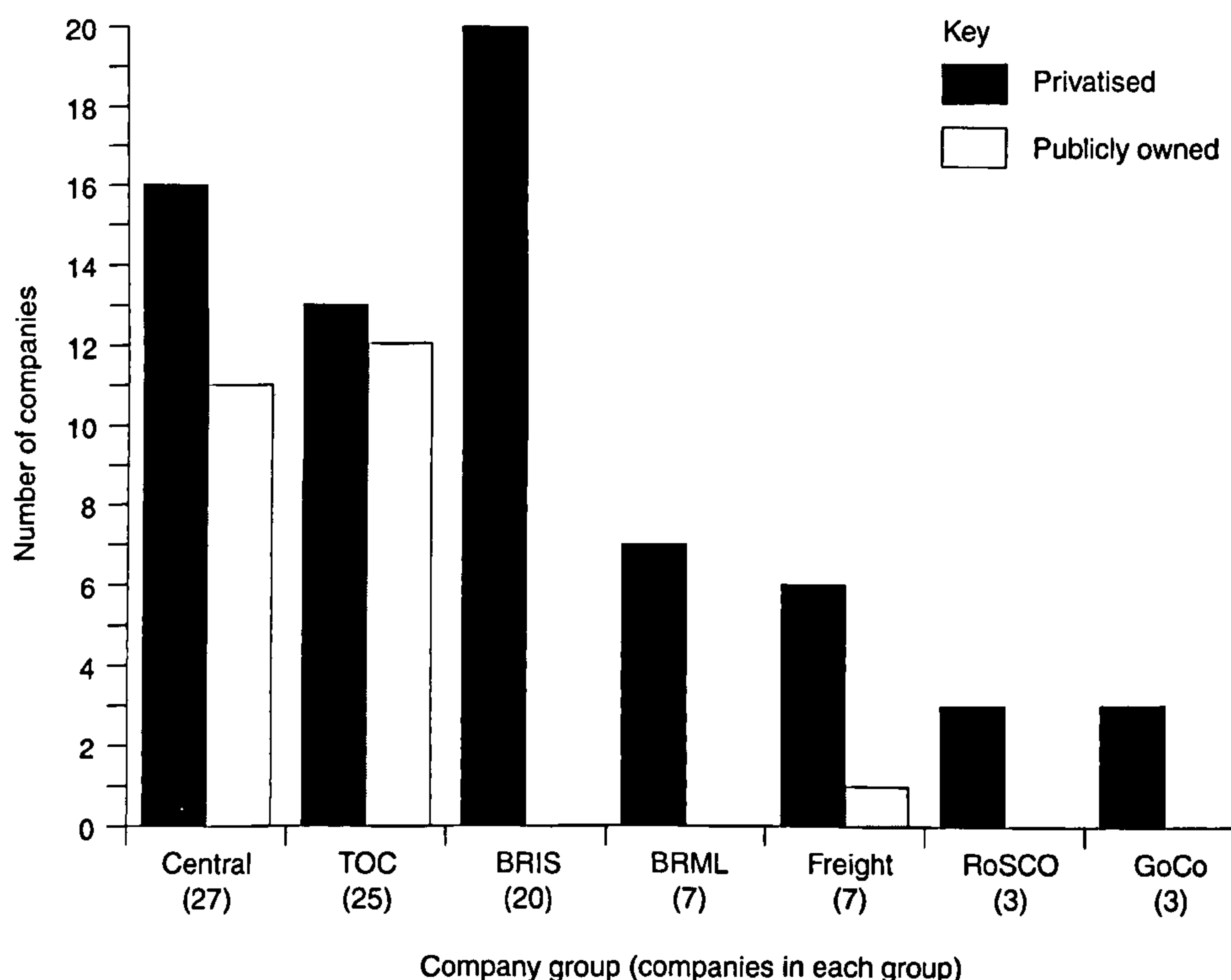


Figure 3 Companies sold in the rail privatization process, February 1994–October 1996.

breakdown of the number of businesses divested in each company-group.

With Railtrack and a multitude of individual businesses designed to promote competition within the industry in place, the government's new railway structure has created the theoretical potential for market liberalization. But the central contention of the present paper is that, despite this progress, the market is unlikely to be freed because the government is now taking regulatory measures to *prevent* the very competitive environment it initially set out to achieve. The key aspects of this apparent paradox are examined below.

Modifying competition

Although the Rail Regulator noted the fundamental importance of competition to the future of the new railway, he was already expressing doubts as to its viability as an organizing principle by July 1994, just 4 months after the privatization process had officially begun (Office of the Rail Regulator, 1994a). However, the Regulator's concerns had already been foreseen by the government itself at this stage. Evidence to support this view can be found in regulatory mechanisms the government began to impose upon the industry. These mechanisms were implemented principally by two means: first, the nature of the contracts drawn up to formalize the working arrangements between individual companies within the industry; and second, guidance issued to the Rail Regulator.

Contracts were drawn up on behalf of the individual companies by the government before privatization. Many of them are still current and effectively dismiss any realistic competitive opportunities. For example, TOCs were theoretically given freedom to negotiate advantageous rolling stock leasing deals because they could choose between three, competing RoSCOs. In practice, however, this has not been possible because government-imposed contracts have been designed, according to the Office of Passenger Rail Franchising (1996a), to match the length of the first franchise period. Most rolling stock is therefore leased to TOCs on 8- or 10-year periods from 1 April 1994. Although a limited proportion of rolling stock is leased to the TOCs on a 'short-term' basis (i.e. 4 or 6 years), the government has essentially removed any possibility of meaningful competition between the RoSCOs. TOCs are therefore held to ransom by *de facto* monopolists. The same is true among BRIS units theoretically competing for Railtrack's custom. Instead of creating a liberalized maintenance and renewal market, the government awarded fixed-term contracts to the BRIS companies on behalf of Railtrack before its divestiture (SBC Warburg, 1996). The net result is a collection of regional monopolies from whom Railtrack can extract none of the theoretical benefits of competition.

As far as the provision of passenger train services is concerned, competition of any significance also appears unlikely to evolve. Indeed, if anything, the prospects are worse because whereas the companies in the above

examples are profitable, almost all TOCs are supported by considerable government subsidy (Modern Railways, 1995). TOCs use this subsidy in order to help finance rolling stock procurement, to gain access to the track and so on. In this sense, although only the TOCs receive financial support directly from government, the profitability of all 92 companies in the new railway structure depends upon public money in one way or another. In return for a predetermined level of state support, a TOC franchisee is legally obliged to provide a minimum service pattern, or Passenger Service Requirement (PSR), over all its routes (Department of Transport, 1994). This pattern is published prior to franchising in keeping with the government's commitment to protect the interests of railway users (House of Commons, 1993).

In line with its desire to break up BR's monopoly, the government also requires the Rail Regulator and Franchising Director—whose key duty is to oversee the transfer of franchises from the public to the private sector—to promote competition in the provision of railway services (Office of the Rail Regulator, 1996; Office of Passenger Rail Franchising, 1996b). However, so long as TOCs are not financially viable, the goals of protecting passengers' interests and promoting competition are largely incompatible. In fact, the introduction of competition into the provision of railway services could threaten the viability of franchises. A franchisee operating lucrative services between, say, Bristol and London, will be obligated not only to run those services, but also the host of other routes contained in its franchise region at the specified PSR. On the other hand, the structure envisaged by the 1992 White Paper means that a new entrant wishing to provide additional railway services will be able to 'cherry-pick'—i.e. operate trains at the most profitable times on the most profitable routes—without the statutory obligations of a franchisee. This could result in a

substantial decline in revenue for the incumbent franchisee whilst its subsidy remained static. Thus the franchisee's ability to cross-subsidize its network would be reduced dramatically, possibly resulting in bankruptcy. Despite provisions made by the Franchising Director to assume responsibility for the operation of train services should this scenario arise (Office of Passenger Rail Franchising, 1996a), it remains likely that the potential for franchise-wide service disruption would be considerable. Therefore, despite its initial enthusiasm for market liberalization, the government now supports the view that 'competition between passenger train operators [should be] substantially restricted' (Office of the Rail Regulator, 1994b, p. 2) to ensure the successful launch of the first generation of franchises.

This restriction is effected principally through guidance from the government to the Rail Regulator. The Regulator's policy for moderating competition faced by franchisees is essentially to restrict new entry into the service provision market (Office of the Rail Regulator, 1994b). No significant new competition will be permitted on any route before 31 March 1999, and substantial restrictions will remain until 2002, by which time a review of the situation will have been conducted. However, even after 2002 the Regulator does not currently intend to permit any new competition where it would discourage improvements to passenger rail services (Office of Passenger Rail Franchising, 1996a).

The few exceptions where competition is practicable in the new railway structure are found either where separate routes exist between destination pairs and are worked by different TOCs, or where two or more TOCs work the same route. In the case of the former, notable examples are services between London–Birmingham, London–Glasgow and London–Southend (see *Figure 4*). In general, however, incidences of this

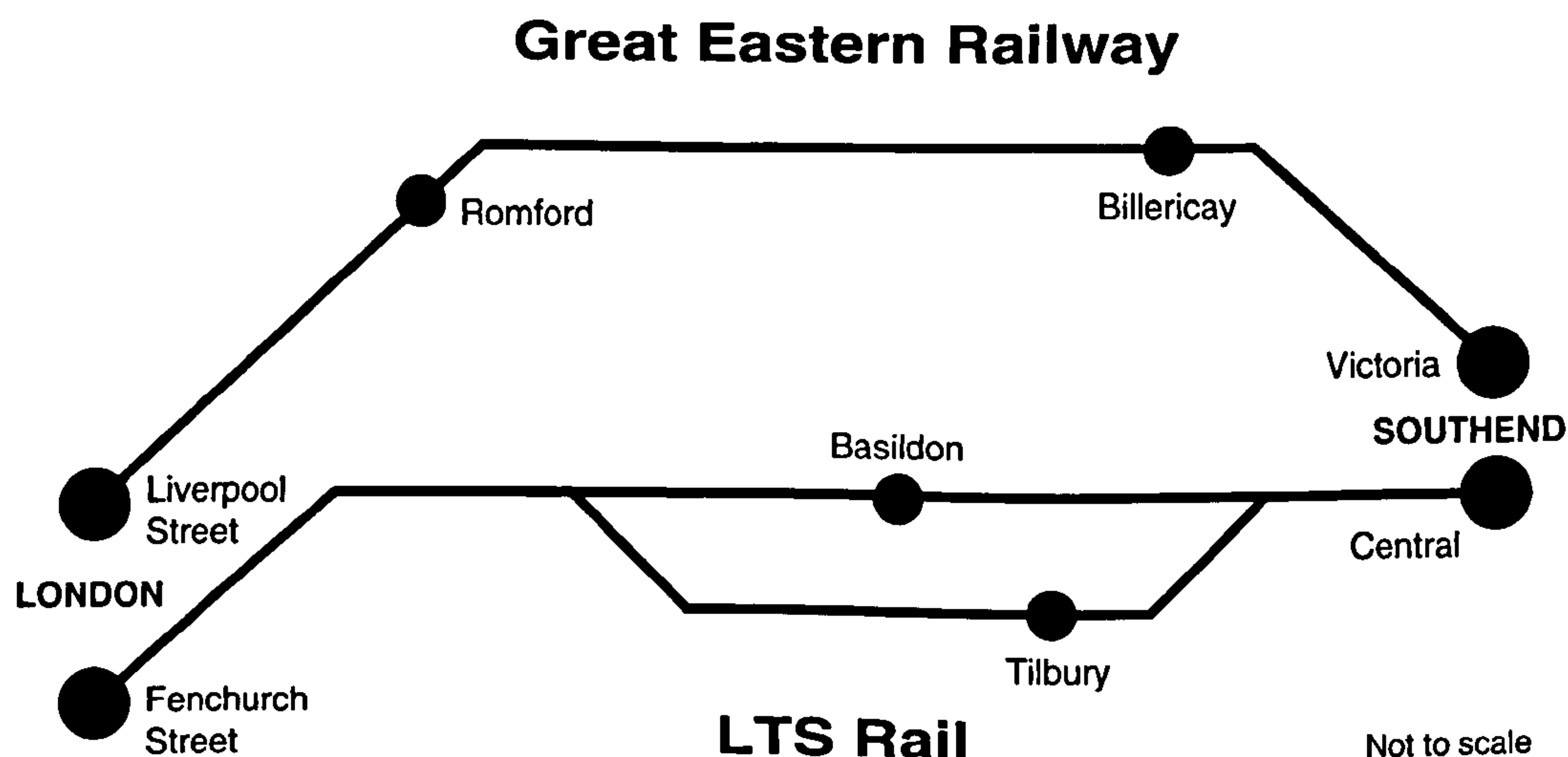


Figure 4 The routes of competing TOCs, London–Southend.

kind of competition are limited due to rationalization trends which have occurred from time to time in the recent history of Britain's railways (see, for example, British Railways Board, 1962). Furthermore, TOCs working between destination pairs on the same route (e.g. Plymouth–Exeter St David's) appear disinclined to compete with rivals. Representatives of TOCs have recently indicated at conferences the intention of their companies to work together, rather than compete, for the benefit of the railway industry as a whole (Save Our Railways, 1996). In this sense, together with the lack of new entry into the industry, most TOCs will retain effective regional exclusivity until 2002 (Office of Passenger Rail Franchising, 1996a); in other words, 25 regional monopolies have, with only a few minor exceptions, replaced BR's national one. The majority of rail customers will therefore still be unable to choose their service provider for many years.

Finally, the industry is also finding ways of returning itself to monopoly, or at least oligopoly, status without regulatory assistance. A marked trend of horizontal and vertical integration is becoming apparent as a handful of large corporate concerns acquire an increasing number of railway companies and franchises. National Express (the coach operator) integrated horizontally when it obtained the Midland Main Line and Gatwick Express franchises (Simonian, 1996). This raises monopoly issues outside of the railway industry as National Express now operates both road and rail services to the East Midlands from London. Stagecoach, the acquisitive bus company, has integrated vertically by purchasing the RoSCO from which the franchise it already owned, South West Trains, leases its rolling stock (Office of Passenger Rail Franchising, 1996c). The French-based refuse disposal group, CGEA, has secured the neighbouring Network SouthCentral and South Eastern franchises (Department of Transport, 1996; Office of Passenger Rail Franchising, 1996d) and will in all likelihood bid for more. With regard to freight services, four of the seven freight operators created by the privatization process (Loadhaul, Mainline, Transrail and Rail Express Systems) have been sold to English, Welsh and Scottish Railways (E, W and S), a new company formed by a consortium led by Wisconsin Central Transportation (Department of Transport, 1996). Furthermore, E, W and S is believed to be considering the acquisition of a fifth freight company, Railfreight Distribution (Modern Railways, 1996).

Prospects for the future

The restructuring of the British railway industry was designed to break up BR's monopoly and create opportunities for competition. Evidence presented here, however, would seem to suggest that although a structure theoretically capable of achieving this aim is now in place, competition is largely being prevented by

the imposition of a regulatory regime. In fact, the publicly-owned, national monopoly has begun simply to transmogrify into privately-owned, regional ones. Admittedly, the opportunity for competition to emerge in some areas of the industry could well present itself in the future—monopolistic contracts, for example, will certainly expire and be re-negotiable. However, it would seem unlikely that meaningful competition will ever emerge in service provision—the key area in which the government wished to encourage it—whilst the rail industry continues to run at a loss. Restrictions to new entry into the market are currently envisaged to last well into the first decade of the next century, and there is every certainty they will be extended if there is a chance that the financial solvency of a TOC could be jeopardized. What is more, if the present trend towards integration within the railway continues, the likelihood of meaningful competition arising anywhere in the industry—even after the re-negotiation of contracts—may quickly disappear.

The CC methodology used by the government to privatize British Rail is therefore failing to meet one of its key objectives, namely to introduce a competitive spirit into the industry. Although intent on pursuing its ideology, the government appears to have failed in this case to acknowledge some of the difficulties involved in translating theory into policy. The CC methodology was efficacious when the electricity companies were divested because the industry was profitable. Competition in the railway industry could threaten the viability of many services. Ministers realized this too late and despite spending considerable sums to implement the CC methodology—the industry's annual subsidy now stands at over £2 billion (British Railways Board, 1995)—the government now finds itself regulating to prevent the very competition it wanted to create. Perhaps the government's most fundamental mistake was in fact viewing BR as a monopoly at all. BR should never have had to worry about competing with itself because it already had to rival other modes of transport. The restructuring of the railway industry designed to foster competition is therefore probably best viewed, in the light of evidence presented here, as unnecessarily complex.

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Competition, regulation, and the privatisation of British Rail

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Abstract. The privatisation programme pursued by successive Conservative administrations in the 1979–97 period was based on neoliberal values, and was aimed at the reduction of public sector involvement in industry by the promotion of a competitive ‘free’ market. However, despite this ideological objective, several large utility companies were privatised as regulated monopolies. Against this background, in a notable reorientation of privatisation policy, the Major administration attempted to secure a genuine movement towards market liberalisation when it divested British Rail (BR). An elaborate methodology was used to break BR’s monopoly and establish a competitive market for the provision of passenger rail services. The authors argue that, notwithstanding the complexity of the rail sell-off, competition has not materialised and BR’s monopoly has to all intents and purposes been reconstituted in the private sector.

Introduction

The dominant political ideology in Britain during the 1980s and early 1990s was that of the New Right, whose economic beliefs, based upon neoliberalism, prioritised reducing public sector involvement in society and the economy by promoting a ‘free’ market driven by competition (Barry, 1987; Farnham and Horton, 1993; Green, 1987; Hayes, 1994; King, 1987). For this and other reasons, the privatisation of public sector industries was of central importance to successive Conservative governments (Foster, 1992; Heald, 1983), the most recent divestiture being that of British Rail (BR). A key objective of the Major administration was to end BR’s monopoly and introduce a competitive structure into the provision of passenger train services (DoT, 1992). In pursuit of this aim, the railway industry was restructured and provisions were made to allow a “significant number of new companies” (Conservative Party, 1992, page 35) to operate train services on the network.

The methodology employed to divest BR was one of the most complex in the British privatisation programme to date (Charlton et al, 1997). However, a primary assertion in the present paper is that, despite the complexity of the rail sell-off, meaningful competition has not materialised. Indeed we suggest that, somewhat paradoxically, the new railway structure is based on a comprehensive array of regulatory mechanisms designed to promote a form of surrogate competition. In this sense it would appear that, despite the Conservative government’s commitment to a neoliberal agenda, the goal of market liberalisation was marginalised. Our aim in this paper is to evaluate the nature and potential impacts of the policy used to privatise BR. We examine the methodology used to promote competition in the provision of passenger railway services, reasons why competition has not materialised, and the regulatory mechanisms which have imposed surrogate competition on the industry.

Statutory regulation and surrogate competition

Privatisation has been variously defined and has many objectives (for example, see Kay and Thompson, 1986; Wiltshire, 1987). In essence, it is the transfer of *at least part* of the operations of a state-owned enterprise to private control (Heald, 1983). However, for

our purposes in the present paper, some further clarification is necessary. According to the basic tenets of neoliberal thinking (Hayes, 1994) and Conservative Party statements (see below), privatisation must not only achieve asset transfer, but must also ensure: (a) that the respective markets of divested companies are characterised by competition rather than by monopoly (to allow voluntary exchange between individuals); in order (b) that a genuine reduction takes place in the powers of the state to manage an industry (to diminish government control over the production of goods and services).

Speaking before the sale of British Telecom (BT), the minister in charge of privatisation, John Moore, noted that the long-term success of the privatisation programme "will stand or fall by the extent to which it maximises competition. If competition cannot be achieved, an historic opportunity will have been lost" (Moore, 1983, page 92). Nonetheless, the Conservatives ultimately sold the utilities as virtual monopolies guaranteed by statute (Moore, 1985) and were forced to adopt a form of regulation to govern the market. On divestiture BT, British Gas, the water industry, and electricity-supply industry became subject to 'economic' regulation in the form of 'RPI minus x '⁽¹⁾ (Littlechild, 1983), and 'social' regulation designed to achieve specified qualities in service objectives (Foster, 1992; Rovizzi and Thompson, 1992; Thompson, 1990). The regulation of each privatised utility industry is administered by a dedicated 'independent' institution.⁽²⁾ In combination, these regulatory mechanisms and institutions provide a form of 'surrogate' competition to the regulated industries; that is to say, they are designed to replicate the effects of actual competition by forcing prices down and efficiency up (*The Economist* 1995).

By creating a set of regulated monopolies, "privatisation in the United Kingdom ... [came] to emphasise the virtues of denationalisation over, and even at the expense of, competition" (Kay and Thompson, 1986, page 31) and the state did not withdraw in any simple sense from the privatised sectors. Rather, policy substituted a previously 'close' form of intervention—nationalisation—for 'intervention at a distance'—regulation. Even the 'distance' of regulation might, in certain cases, be somewhat illusory. Although the utility regulators are technically independent in their day-to-day operations, their brief was very much moulded by objectives and guidance that was issued by central government at the time of privatisation (Thompson, 1990). In addition, political interest in the economic affairs of the utilities has often resurfaced to the occasional dismay and humiliation of regulators (Jenkins, 1995; *The Times* 1996).

At stake is, therefore, the *form* of intervention rather than its existence (Kay and Vickers, 1988; Thompson, 1990). Certainly, as suggested by Hancher and Moran (1989, page 131), much of what began as an intent to withdraw from the intervention arena resulted in "not so much a change in the content of rules, or a departure from regulatory objectives, [as] an adjustment to the means of enforcement". The privatisation of the utilities throughout the 1980s was as much—if not more—of an exercise in the formulation of regulatory mechanisms and institutions as it was an attempt to promote competition and reduce state influence over the utility industries.

By the late 1980s, however, there was evidence to suggest that senior Conservatives had become dissatisfied with the lack of competition in the utilities markets, and structural reform resurfaced as a serious option when decisions were being taken over the sale of the Central Electricity Generating Board (CEGB) (Nash, 1994; Shaw, 1997).

(1) 'RPI minus x ' regulation requires that a firm keeps its price increases for specific products at a fixed level below the rate of inflation (retail price index—RPI) for a given number of years.

(2) BT is regulated by the Office of Telecommunications (OfTel); British Gas by the Office of Gas Supply (Ofgas); the water industry by the Office of Water Services (Ofwat); and the electricity suppliers by the Office of Electricity Regulation (Offer).

In a notable reorientation of policy, the CEGB was fragmented into a number of competing companies, and new entrants were permitted to compete with former-CEGB companies (Wharmby, 1993). Despite initial concerns within the industry regarding the practicality of such a policy, the restructuring successfully assembled a competitive market and, by 1993, fourteen licences had been issued to new generating companies (Littlechild, 1993). As a result, the need for surrogate competition was eliminated and the industry is now free from statutory economic and social regulation. The privatisation of the CEGB therefore achieved not only transfer of ownership, but also liberalised the market and permitted a withdrawal of state power over the industry. The privatisation of BR—our central focus in this paper—essentially represents further experimentation with the methods which had been used to divest the electricity-generating industry, and the nature and potential impacts of this divestiture are examined below.

Competition, regulation, and the new railway

In 1992, the Major administration published its White Paper *New Opportunities for the Railways* (DoT, 1992). The document contained proposals to restructure radically British Rail in preparation for privatisation. As with the electricity industry, explicit attention was paid to the need to end BR's monopoly and liberalise the passenger rail market. Despite claims by such pressure groups as Transport 2000 (1989) as well as railway-industry chairmen (BBC, 1996) that BR already faced vigorous competition from other transport modes, the Conservative government was determined to end what it saw as a monopoly in the operation of rail services in Britain (DoT, 1992). Demonstrating a commitment to market liberalisation, the Conservative Party's 1992 election manifesto noted:

"... we believe that the best way to produce profound and lasting improvements on the railways is to end BR's state monopoly A significant number of companies have already said that they want to introduce new railway services as soon as the monopoly is ended. We will give them that chance" (Conservative Party, 1992, page 35).

This was reiterated in the 1992 White Paper:

"... the Government proposes to provide a right of access to the rail network for private sector operators of passenger services ... [and because of this] new operators will be allowed to provide services giving customers a choice stimulating improved services and value" (DoT, 1992, page 4).

In a parliamentary debate on the future of the railway industry, the then Secretary of State for Transport, John MacGregor, stressed that the BR sell-off championed "the market and competition as the best way of showing what the travelling public ... want" (*Hansard* 1992, volume 213, column 1162).

The 1993 Railways Act established the basis for the cessation of BR's monopoly and its vertical separation and division into as many as ninety-two separate businesses (DoT, 1996). The organisation was divided into two basic elements from 1 April 1994. Control of the whole rail infrastructure passed to Railtrack, which was thereby granted the status of a monopoly. Although this appears to be in contradiction of the aim of market liberalisation, it was in fact a step necessary to secure competition in the operations side of the rail industry (Charlton et al, 1997). The operations business was divided into ninety-one discrete companies which, before their transfer into the private sector, were placed into groups that reflected the nature of their activities (DoT, 1994). The groups were:

- (a) train-operating companies (TOCs)—to provide passenger rail services. TOCs are considered in more detail below;
- (b) freight—to operate freight trains;

- (c) rolling-stock companies (RoSCos)—three businesses established to lease rolling stock and locomotives to the TOCs;
- (d) central—to provide general support services to the industry such as telecommunications, consultancy, and research;
- (e) British Rail Infrastructure Services (BRIS)—companies concerned with the maintenance of track and signalling;
- (f) British Rail Maintenance Limited (BRML)—to undertake the overhaul of rolling stock and locomotives.

In theory, the creation of a number of companies within each group provided the possibility of competition in attracting custom from Railtrack and rail businesses in other groups or, in the case of train operators, passengers and freight shippers (Charlton et al, 1997).

The complex new industry structure required the creation of two new statutory bodies: the Office of the Rail Regulator and the Franchising Director. At the simplest level, the Rail Regulator is responsible for granting and monitoring licences to TOCs; the approval of agreements between Railtrack and train operators; the protection of consumers; and the promotion of competition (ORR, 1995). The Franchising Director was given the roles of transferring the TOCs from the public sector to the private sector through the award of franchises; paying subsidies to TOCs; and, subsequently, of undertaking consumer-protection measures which complement those of the Regulator (OPRAF, 1994; 1996a).

In the remainder of this paper we are primarily concerned with the competition and regulation issues surrounding the provision of passenger rail services. Whereas the roles of the Rail Regulator and Franchising Director in this regard are discussed in more detail below, fuller analyses of the interaction between the various actors in the new railway industry can be found elsewhere in the literature (see, for example, Charlton et al, 1997; DoT, 1994).

Promoting competition between train operators

Railtrack permits different passenger train operators to use its infrastructure after the negotiation of access contracts. Operators contracting with Railtrack can fall into two categories: franchised and nonfranchised. The passenger rail services previously operated by BR have now passed to the twenty-five franchised TOCs, each let to the private sector for a finite period of between 7 and 15 years (OPRAF, 1997). Each TOC operates passenger train services on a specified route network; figure 1 shows the route plan of the Great Eastern TOC franchise as an example.

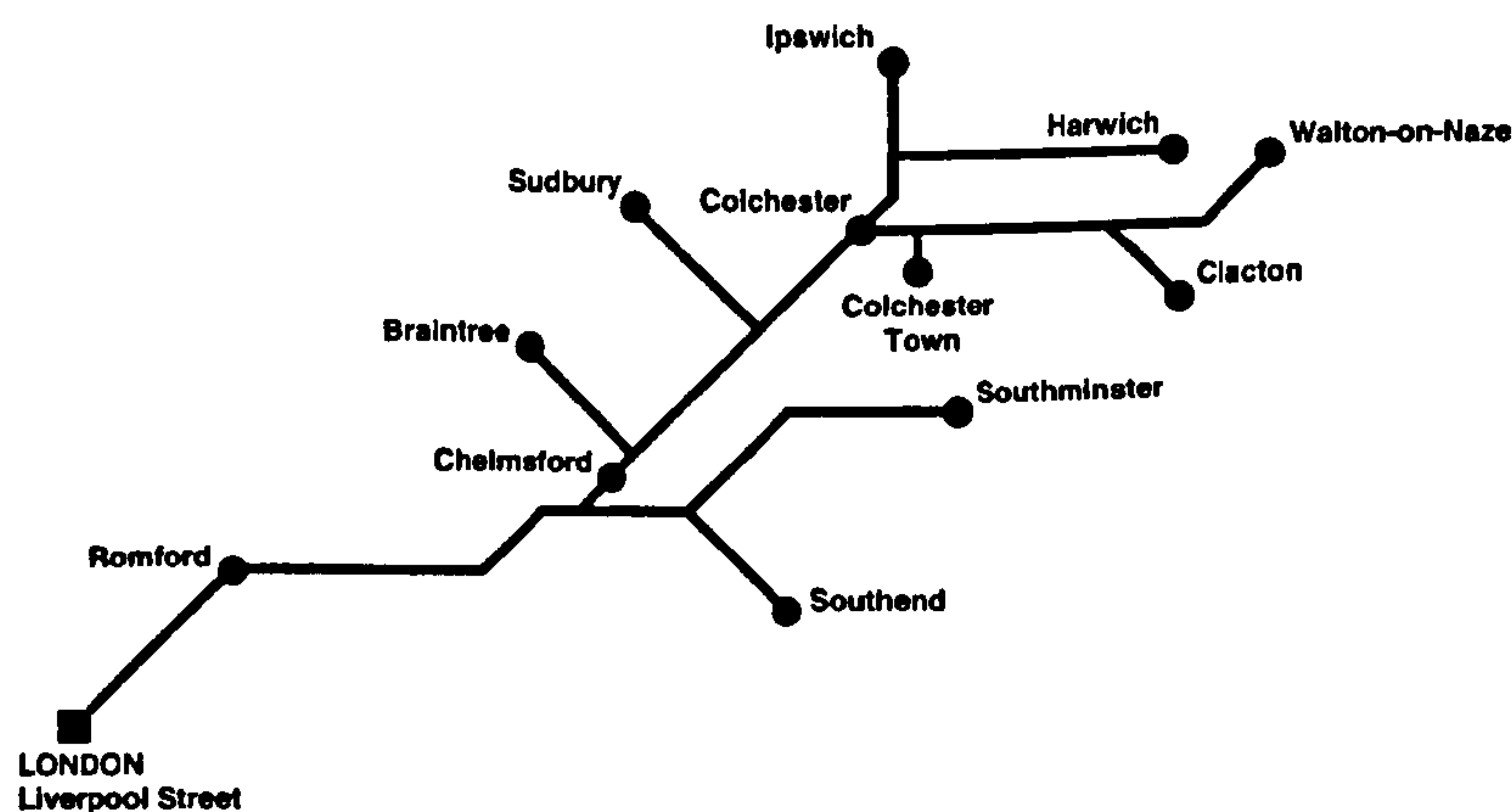


Figure 1. Route plan of the Great Eastern train-operating company (TOC) (not to scale).

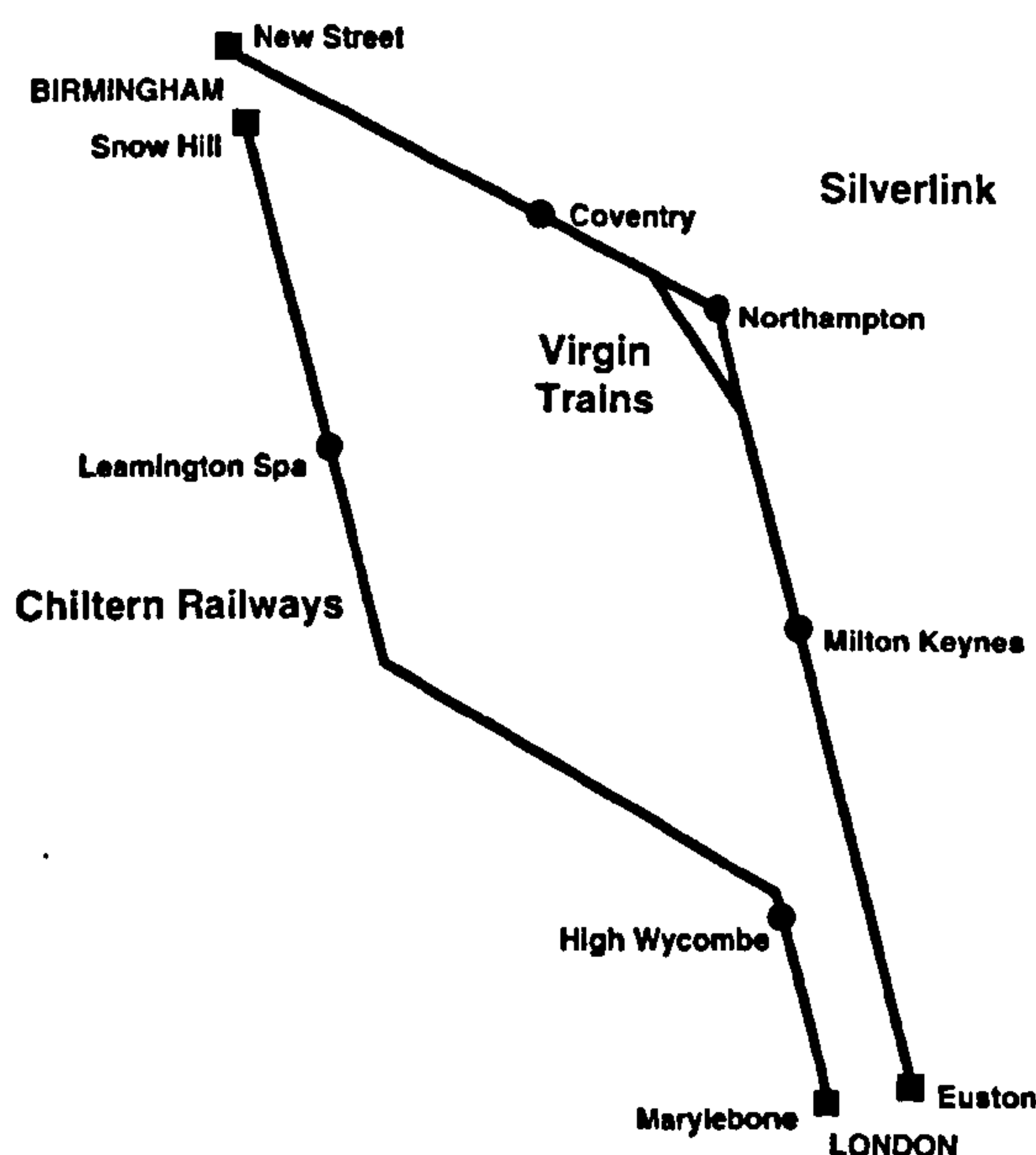


Figure 2. Route plan showing routes of competing services provided by Chiltern Railways, Virgin Trains, and Silverlink between London and Birmingham (not to scale).

Franchising represents a means of generating competition for the right to provide services or, in other words, competition *for* the market (Bradshaw, 1997). However, the Conservatives' desire to provide travellers with a choice of train operators also required the promotion of competition *in* the market. Many TOCs now share some track miles with at least one of their counterparts and competition between them is theoretically possible along such routes. An example is found in the London–Gatwick Airport line, which is worked by Gatwick Express, Connex South Central, and Thameslink. Alternatively, certain destination pairs are served by separate lines which are worked by different TOCs and this also facilitates potential competition. Notable examples are London–Exeter, London–Southend, and London–Birmingham (see figure 2).

The second category of passenger train operator, the nonfranchised, represents the "significant number of companies" (Conservative Party, 1992, page 35) to whom the Major administration sought to offer the chance of running railway services over and above those offered by TOCs. By negotiating an access contract with Railtrack, non-franchised operators can, in theory, compete with TOCs between any or all destination pairs on an 'open access' basis. These nonfranchised passenger train operators are not constrained to operate on all routes within a specific franchise: instead, they may choose to operate on only one route if they consider this to be the most profitable option.

The establishment of Railtrack, the fragmentation of BR's passenger train service operations, and the provision for competition from nonfranchised operators confirms that the Conservatives "restructured the railways in a manner which encourages competition between train operators in providing passenger services" (ORR, 1994a, page iii). Experimenting further with the methods which had been used to privatise the CEBG, the Conservatives reinforced their commitment to securing a genuine movement towards market liberalisation in the monopoly-privatisation programme. The new railway structure underlined the *potential* for surrogate competition to be replaced by actual competition, and for a reduction in the influence of the state over the industry. However, we argue below that, despite the restructuring of BR, competition has not materialised in practice.

Restricting competition between train operators

Although the fundamental importance of a liberalised passenger rail market was emphasised strongly at the outset, ministers had begun to express doubts regarding the viability of competition as an organising principle by early 1993 (DoT, 1993; House of Commons Papers, 1993). Concern appears to have arisen when policymakers were faced with a potential conflict between promoting competition on the one hand, and maintaining the quality and quantity of rail services, many of which were loss making but considered socially necessary, on the other. Public and political concern regarding possible service cuts and fare increases after privatisation resulted in calls for reassurance that the level and extent of services would not be detrimentally affected by the plans (for example, see *The Economist* 1996; *The Guardian* 1995). For this reason, it was acknowledged as far back as 1992 that some degree of social regulation would be necessary in order to maintain the network. The Conservatives conceded that "subsidy will continue to be paid where necessary" in order to "sustain the current national network of services" (Conservative Party, 1992, page 35). The network now remains intact because all TOCs are required to operate the amount of trains specified in a Public Service Requirement (PSR) as a minimum. Although it does not function explicitly as a timetable, the PSR does set parameters, based largely on the service levels of 1992, within which the TOCs must design their timetables (OPRAF, 1996a).

Competition between operators is impractical so long as franchises are legally obliged to maintain loss-making services specified in their PSRs. As Foster (1994) points out, because each TOC operates a set of train services—some highly lucrative, others less so—it needs to earn enough profit on its remunerative lines, given its level of subsidy, to ensure an adequate return on its whole operation. Meanwhile, open-access operators running services on lucrative trainpaths would not have the same obligation to maintain uneconomic services and would thus be able to undercut franchisees. The prospect of revenue dilution on high-earning routes would have prevented potential franchisees from planning their businesses with any reasonable degree of certainty. Indeed, they indicated that, at very best, they would require extremely high subsidies (not an option favoured by the Conservatives), and at worst they would refrain from bidding altogether (HC, 1992a). Faced with the prospect of rail privatisation either not proceeding or being extraordinarily expensive, the Major administration was forced to concede "that competition on routes to be franchised should be moderated to the extent necessary to ensure the successful launch of the first generation of franchises" (ORR, 1994a, page iii). In practice, this has essentially resulted in the abandonment of attempts to promote on-rail competition between operators.

Competition in the railway industry is restricted by regulatory frameworks established both by the Rail Regulator and by the Franchising Director. In addition, of course, operational factors such as the availability of trainpaths also inhibit competition on many routes at certain times of the day. However, technical improvements in the future may render this factor less restrictive as has been the case in the past—for example, many new trainpaths were identified for Eurostar trains along the congested suburban routes in southeast England (HC, 1992b)—and it remains the case that the bulk of potential competition is currently subject to administrative, rather than operational, restriction.

Despite the initial vision of nonfranchised train operators competing with TOCs, the Rail Regulator currently restricts the entry of such 'open-access' train operators to the market. No new entry will be permitted on any route nominated by TOCs before 31 March 1999. After a review of the situation—being conducted at the time of writing (ORR, 1997a)—it is anticipated that "significant restrictions" (ORR, 1994b, page 19)

will permit only limited entry on certain nominated flows until 2002. However, even after 2002, the Regulator acknowledges that any further change to the existing regime will be incremental in nature, and that restrictions will continue where the presence of competition would discourage major improvements to passenger rail services (ORR, 1994b). In cases where TOCs continue to run at a loss, or otherwise appear vulnerable to open-access newcomers, competition from nonfranchised operators will therefore remain largely absent.

In addition to open-access restrictions, franchisees are afforded a large measure of protection from potential competition between themselves. The Franchising Director effects this on routes where TOCs share route miles through a policy of 'compulsory interavailability' of tickets (OPRAF, 1996a). This policy enables the lead operator—usually the TOC with the greatest commercial interest in a particular route—to create fares and to require other TOCs running trains on the route to honour these fares in most instances. The compulsory-interavailability requirement can be lifted where it is considered "that the benefits of inter-availability will be outweighed by the potential benefits of price competition" (OPRAF, 1996a, page 186). Currently this is only true of the London–Gatwick Airport lines, and there are no plans to lift the requirement more widely (OPRAF, 1996a).

Such regulatory intervention from the Franchising Director may in fact have been unnecessary given the apparent determination by many TOCs to work together, rather than compete, because of the mutual commercial advantages which can arise from cooperation which fosters harmony and stability in the provision of services (for example, see *Save Our Railways*, 1996). Certainly, evidence is emerging to suggest that the prospect of a higher total revenue from joint initiatives is more appealing to TOCs than is plundering each other's largely incontestable markets (ATOC, 1997; OPRAF, 1996a; Shaw, 1997).

Against this background, there remains only one situation where effective liberalisation of the passenger rail market might reasonably be claimed. This is in cases where destination pairs are served by separate lines operated by different TOCs (such as the London–Birmingham example shown in figure 2). Although some key passenger flows fall into this category, past rationalisation of the network has reduced the potential for competition between routes (for example, see BRB, 1962). Therefore, despite the Conservatives' original intention to produce a competitive passenger-train-service market, it is in fact the case that "the new railway structure is built on ... monopoly ... The supply of passenger services is based on 25 territorial franchises with full protection from competition from new services" (Swift, 1997a, page 8). In other words, twenty-five regional monopolies have, with only a few minor exceptions, replaced BR's national one.

TOCs and surrogate competition

The creation of a new generation of privatised monopolies has obvious regulatory implications. Economic regulation in the passenger railway industry is needed in order to ensure 'reasonable' fares for those using franchised services (OPRAF, 1996a). Details of this regulation are to be found in literature released jointly by the Department of Transport and the Office of Passenger Rail Franchising (OPRAF, 1996b). As in previous divestitures, TOCs' fares are regulated by the 'RPI minus x ' formula. At present x stands at zero, but will increase to one in January 1999, where it will remain for four years. Currently, only certain fares are regulated, namely: unrestricted standard-class return fares (which permit outward and return travel on any train), some single fares for short journeys, 'saver' fares (which, subject to certain conditions, offer a discounted rate for most journeys over 50 miles), and certain standard-class season-ticket fares

Table 1. A comparison of key commitments in the Passengers' Charters of British Rail (BR) and South Wales and West Railway (source: BRB, 1992; Wales and West Passenger Trains Ltd, 1997).

	BR (Regional)	South Wales and West Railway	Improve-ment?
Punctuality	90% of long-distance trains to arrive within 10 minutes of schedule.	90% of long-distance trains to arrive within 10 minutes of schedule. To improve to 92% by 1998.	yes
Reliability	99% of services to run.	99% of services to run. To improve to 99.5% by 1998.	yes
Compensation (one-off journeys)	20% of price paid for journey refunded if delayed for >1 hour.	20% of price paid for journey refunded if delayed for >1 hour. Increases to 50% refund for delays >2 hours.	yes
Compensation (season tickets)	5% discount on monthly or longer season tickets if punctuality <87% or reliability <98% for preceding year. 10% discount if punctuality and reliability both below those thresholds.	5% discount for monthly season tickets if punctuality <87% or reliability <98% for preceding year. 10% discount if punctuality and reliability both below these thresholds. For annual season tickets, discounts rise to 7% and 14%, respectively.	yes
Ticket office queueing	Maximum five minutes peak. Maximum three minutes off-peak.	Maximum five minutes peak. Maximum three minutes off-peak.	no
Information	Timetables at all stations. Notice of engineering work at affected stations. Notice in advance if advertised on-board catering is cancelled.	Timetables at all stations. Public address or freephone, or information boards at all stations by 1999. 7 days notice of engineering work at affected stations. Advanced notice of cancellation of advertised on-board catering service.	yes
Disabled Travellers	48 hours notice for assistance at staffed stations.	24 hours notice for assistance at staffed stations.	yes
Train capacities (journeys less than 20 minutes)	Slam door: 10 standing for every 100 seated. Sliding door: 35 standing for every 100 seated.	Slam door: 0 standing. Sliding door: standing at a density of 1 passenger per 0.55 m ² .	yes

including all weekly season tickets. Some PTEs are entitled to set fares in their commuter markets and, as such, these will remain unregulated by the Franchising Director. However, in London, Cardiff, Edinburgh, and Greater Manchester, the Franchising Director himself takes a comprehensive approach to regulating commuter fares. A performance incentive applies whereby a TOC's failure to meet agreed punctuality

and reliability standards can result in the price cap being adjusted to RPI minus 3 for certain tickets. Although the RPI-minus-1 formula is not as stringent as it is in other utility industries [for example, the formula used to regulate BT is RPI minus 7.5 (Office of Telecommunications, 1997)], it is still regarded by the Rail Regulator as “radical, almost socialist, planning by a Conservative ‘free market’ government” (Swift, 1997b, page 7).

Details of social regulation in the form of quality-of-service obligations are found in the *Passenger Rail Industry Overview* (OPRAF, 1996a). TOCs are expected to maintain an operational environment at or above standards prescribed by the National Conditions of Carriage (NCC) (BRB, 1996). The NCC outlines the contractual obligations which train operators have towards their customers, and TOCs must produce a ‘user-friendly’ summary of the NCC in the form of a passengers’ charter. Charters set out TOCs’ commitments to operating punctual and reliable trains, as well as: ensuring acceptable train capacities; providing information on services, fares, and facilities; meeting the needs of disabled travellers; and disseminating information in advance of delays and nonemergency engineering works. In all cases, TOCs’ passengers’ charters must contain provisions at least as favourable as those which were offered by British Rail. Some TOCs have elected to offer certain improvements over the standards aspired to by BR. A comparison, in table 1, of BR and Wales and West Passenger Railway’s charters demonstrates this. In addition, TOCs are obliged to participate in ticketing and other schemes organised by the Association of Train Operating Companies (ATOC) in order to secure the provision of network-wide products. Examples of such products are the National Rail Enquiries Service and discount-railcard schemes. The fines imposed in 1997 on TOCs for their failure to meet performance targets for the National Rail Enquiries Service (ORR, 1997b) confirmed the regulator’s willingness to enforce service standards.

In conclusion: regulation and continuing monopoly

The privatisation of Britain’s passenger railway services, as measured by the criteria proposed in this paper—and, indeed, Conservative Party policy statements (Conservative Party, 1983; 1992; 1997; *Hansard* 1992; Moore, 1983)—has not been an overwhelming success. Although assets have been transferred, what began with an intention to promote competition and reduce government involvement has resulted in the reconstitution of BR’s monopoly in the private sector and the creation of a host of new regulatory mechanisms and institutions.

It was noted above that the privatisation of the utilities was as much, if not more, of an exercise in the formulation of regulation as it was an attempt to promote competition and reduce the role of government in industry. This trend has indubitably continued in the rail sell-off, for a complex method of divestiture has spawned complex regulatory mechanisms and institutions designed to reconcile the apparently incompatible objectives of liberalising the passenger rail market and maintaining the integrity of the network. A regulatory ‘domino effect’ developed in four stages. First, the consequences of mass service withdrawals dictated the imposition of social regulation in the form of subsidy and PSRs. Second, the threat posed to the completion of the franchising process by market liberalisation prompted regulation to *prevent* the very competition which ministers had originally wanted to promote. Third, economic regulation was necessitated by the reemergence of monopoly and, fourth, this was complemented by additional social regulation in the form of quality-of-service stipulations designed to provide a ‘surrogate’ competition regime with comparable objectives to those imposed on the utility industries in the 1980s.

Recent evidence indicates that other utility divestitures could, technology permitting, also have employed a degree of vertical separation at the time of divestiture

(Shaw, 1997). Genuine competition has recently been introduced into the gas market, some 10 years after privatisation, and the electricity-distribution industry is also set to be liberalised from 1998 (*The Guardian* 1997a; 1997b). However, in contrast to the utilities, much of the passenger railway industry operated and continues to operate at a loss. The Serpell Report (Serpell, 1983) concluded that almost 85% of the network would have to be shut down in order to run a commercially viable industry but, given public concern about its future, mass closure was always unlikely. As a result, difficulties were almost certain to be encountered in vertical separation because private sector companies would simply not compete with each other over the right to lose money. Moreover, despite the current review being undertaken by the Rail Regulator (ORR, 1997a), it is doubtful whether it will be possible to liberalise the passenger rail industry significantly in the medium to long term owing to a continued dependence on subsidy.

The extensive powers of the regulators to control the rail industry raise a number of important research agendas. Most importantly, more investigation is required into the nature, operations, and accountability of the industry regulators and their links with government and the private sector. With the regulators' ability to affect the profitability, service standards, and structure of the privatised railway industry, it is necessary for future research to build on work already undertaken to broaden understanding of the decisionmaking processes and the political economy of the regulatory environment.

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Communicating academic geography—the continuing challenge

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Introduction

There is a strong sense in which ‘everybody knows’ what geography is about. After all, it is studied in school compulsorily to the age of 14, and both the increasing incidence of overseas travel and the prevalence of maps and place descriptions in media reporting give geography an apparently uncomplicated role as a descriptive support to the understanding of everyday life. However, such a view is at variance with the core concerns of academics in geography—even those for whom ‘place’ is a major focus of interest. Numerous academic commentators continue to highlight concerns that what we actually do bears little resemblance to ‘popular’ conceptions of the discipline (Unwin 1987; Crang 1996). Such concerns have focused not only on the fact that the analytical and interpretive aspects of academic work are overlooked, but also that significant developments within the discipline have been neglected or misunderstood (Rawling 1996).

Of course, these concerns about a divergence between academic and popular geographies are not new. It has long been argued that non-academic practitioners have been slow to catch up with developments in academic geography, and divergences within the discipline have to some extent been amplified following each of the so-called paradigm shifts since the quantitative revolution (Strachan 1984). The relationship between academic geography and school syllabuses is a helpful example: it is difficult and costly to review school syllabuses, and when changes do occur, they are often in response to wider educational and social developments,

which do not necessarily give priority to the pre-occupations of university geographers (Rawling 1996). One of the problems lies in the difficulty of identifying precisely which changes to school syllabuses might produce an improved understanding of the academic contribution in geography. The approaches of conventional science, while very much under interrogation in some areas of the discipline (see, for example, Demeritt 1996), need to be taught not only as a foundation for appreciating the debates raging over its weaknesses, but also as the premise for responding to many of the most pressing dilemmas in environmental and technological spheres. At the same time, school students need to be introduced to the ‘social’ scientific approaches that are essential for understanding human environment interactions, and to appreciate the scope that lies within the humanities for yielding insights into the ways in which processes such as language can construct our understanding of the world (see, for example, Barnes and Gregory 1997; Doherty 1997). School geography curricula have battled with such issues for generations, and yet the problem is still only partially resolved, as any lecturer faced with classes of fresh undergraduates will, we suspect, only too readily confirm.

The Royal Geographical Society (with The Institute of British Geographers) (RGS-IBG) (1997, 2) has acknowledged that ‘public understanding of what geography is and what it has to offer often falls far short of reality’. As the issues of the ‘new regionalism’ and the ‘cultural turn’ in human geography have begun to establish another new landscape for geographical work, perhaps it is time once more to

revisit the debate about the links between academic preoccupations and conceptions of geography in the wider world. Again, then, we ask: if penetrating, insightful and prospectively useful geographical work is produced within academia, why does it often have little in common with what passes for people's perceptions of the subject outside of university geography departments? We propose that the answer may lie in a failure among academic geographers to communicate the value of our work effectively to a wider audience. Over the years, some commentators have attributed the blame for such poor communications to the fragmentation of the discipline. Jenkins (1987) points out that any institutional response to challenges facing geographers is bound to be hampered by the disparate interests and responsibilities of various geographical communities. However, whilst Jenkins' observation is obviously important, any likelihood that geography will—or should—consolidate its fragments is at best minimal. We argue that the central issue, perhaps the key to understanding the divergent conceptions of popular and academic geography, relates more to the fact that we frequently fail to make our work visible and accessible.

Invisibility and inaccessibility

Communicating cutting-edge geographical research to wide audiences has, of course, always been problematic. Moreover, there are indications that matters are worsening, owing to pressures of change in the funding and culture of universities, and to increasing demands to publish within a narrowly prescribed range of titles determined by 'readings' of the RAE criteria. This often means that what we write is not especially visible beyond the confines of a specialized academic audience.¹ The RAE (see, for a humorous account, Sugden 1997) gives academics little motivation to communicate their professional undertakings through a wider range of public forums. Lecturers are contracted to publish a consistent flow of research articles in learned journals, and this is the principal means through which promotion—in the widest sense—is obtained. The specialized nature of most journals means that they are usually known to only a handful of interested individuals and, as a result, even some of the most respected titles attract only a 'tiny' readership (Lee 1998, 3). This is ironic, when one considers that one of the original purposes of the RAE was to enhance the communication of academic work.

The problem, however, does not relate only to the visibility of our work; also at issue is its accessibility. The perceived demands of publication in learned journals have a tendency to encourage a style of language that all too easily lays itself open to challenge for its impenetrability. Billinge (1983), for example, launched a scathing attack on writing within the 'humanist' geographical tradition. The terms of his critique are often directly applicable—indeed, probably more so—to some of the contemporary writing that constitutes the 'cultural turn'. While geographical writing has not yet been exposed to the kind of ridicule meted out to postmodernism by Sokal's parody of 'cultural' writing (Sokal and Bricmont 1997; Swain 1998), the possibility is not altogether remote. Recent exchanges over the 'geography of sleep' (Smith 1996; Hamnett 1997; Pile 1997; Smith N 1997) held both echoes of, and references to, the Sokal article. It sometimes seems that some of the 'Mandarins' of Billinge's attack have produced a generation of followers for whom such writing is *de rigueur*, particularly where the inspiration derives from postmodernist sources.

Having said this, it must of course be allowed that the task of analysis in which many of these writers are engaged is one that may not, in fact, be amenable to a kind of everyday simplicity. There is, indeed, an urgent task to be pursued in achieving a better understanding of the processes from which our knowledge derives, and through which it is put into practice. This requires a careful, and probably specialist, language. Moreover, as academics, there is a reasonable case to be made for our undertaking the intellectual effort required to engage with thoughts expressed in such language. Academic theorizing has turned in upon itself for reasons more honourable than self-aggrandizement. Equally, however, there is an obligation for us all to contribute to the task of rendering complex thoughts accessible—not only for those beyond the academy, but also, as is becoming increasingly apparent, to colleagues within. The urgent preoccupations of many with their own research preclude their learning a new style of discourse, although they nevertheless need to be made aware of the serious challenges to their practice that new analyses may present. We return to this issue later.

Academy and impotency

If, as Bassett (1996) has argued, there is a real 'crisis of the intellectual', whereby processes—such as expanded access to higher education, the universal-

izing tendencies of ready access to the internet, and the breakdown of an automatic expectation that research and intellectual expertise is located within the universities—lead to a tendency to undervalue scholarly activity, then the need for accessible communication becomes all the more imperative. A decade ago, Lee (1988, 207) argued that academic geography had

seemed to rediscover its self-confidence ... [by] demonstrating its relevance to the world of everyday reality and by showing how it is central to the development of the social and natural world.

This was manifest, he argued, in the successful engagement of the (then) IBG with the media at its annual conferences, and by the formation of the Council of British Geography (COBRIG). Can we still assert such self-confidence in 1998?

Referring to the influence of the journal he then edited, Lee (1998, 3) now seems less convinced of his earlier argument. He notes that the effect of academic geographies on 'processes of power/knowledge—with all their devastating social, material and environmental consequences—[are] infinitesimally small'. Blomley (1994, 383), discussing those academic geographers who often refer to themselves as 'oppositional, critical, progressive and even emancipatory', maintains that their work (he includes his own) is often presented 'in a language [which makes] sense only to the *cognoscenti*'. He continues to note that there is rarely any talk amongst the same *cognoscenti* of the purchase of critical ideas beyond the pages of academic journals, and suggests that although we often assume that 'what academics do will make a difference ... how and where are left unclear'. The apparent daily manifestations of our failure to do anything effective about reasonably well-understood and devastating threats to human life, ranging from the problems of indebtedness to climatic change, environmental risk and ethnic cleansing, provide ample evidence that Blomley is right to challenge the nature of our contribution.

This challenge relates directly to the long-standing ethical criticism that people who are frequently the focus of our work—such as those whose lives are subject to devastating challenges—may be unable to benefit from their participation in research projects if the potentially useful academic responses to their problems are communicated ineffectively (Kimmel 1988). Nevertheless, as the new debate about ethics in geography has revealed, there are complex issues still to be resolved. Where do our responsibilities lie

in a world where postmodernism challenges the certainties of Enlightenment thinking, with its claims to grand theory and an ethical stance to match (Smith D 1997)? For some, the response lies in establishing the basis of a new 'normative turn' in social theory (Sayer and Storper 1997); for others, in asserting the primacy of an 'ethics of care', deriving from the work of Gilligan (1982). This debate notwithstanding, what is quite clear is that issues of ethical responsibility regarding the implications of our work are very much a defining characteristic of the challenge we face in communicating academic geography. However, ethical issues within the discipline, as in much of academia generally, have a tendency to be the concern of a relatively small group of interested individuals.

If the claim stands up that we have an ethical responsibility to communicate our work visibly and accessibly, then the development of a credible code of ethics, which includes such responsibility, is an important step for the discipline. However, the process of designing and implementing this kind of code might run counter to entrenched professional values, which do not prioritize such communication as a means of career advancement. For example, disseminating current issues and concerns in geography via outlets such as the *Geographical* magazine is confined, we would suggest, to those who already have some sympathy with the issues raised here. But academics who write for these outlets must frequently do so without—or even at the expense of—acknowledgement in the formal evaluative systems of their own departments. Despite the modest circulation and impact of learned geography journals, most academics continue to publish their research findings solely through these outlets, because efforts to make work visible and accessible by, for example, publishing press articles or works of scholarly synthesis (eg textbooks) are sometimes regarded pejoratively by peers. So long as visibility and accessibility are not viewed universally as meritorious, a kind of elitist culture prevails, which effectively maintains an ivory tower around academic undertakings, and hinders attempts made by those beyond its walls to understand them. It has to be recognized that the capacity to engage with lay approaches to the understanding of space and place, and the ability to link issues of physical environmental change to the impacts of management strategies, stand alongside cutting edge research at the very heart of the geographical endeavour. Unless, as a community, we are able to disengage

from this tendency towards communicating ineffectively, we may well forfeit any credible claim to a role in contributing to the solution of contemporary problems. In addition, we may lay ourselves open to attack, based on the failure of others—wilful or otherwise—to understand the intentions of our work.

In the past, influential people who misunderstood the potential contribution of a great deal of academic work identified various 'problems' with academia, and sought to 'fix' them on the profession's behalf. In the 1980s, Lady Thatcher regarded many academic pursuits as irrelevant (usually 'social' ones—she was a research chemist by training) and a waste of taxpayers' money. She spoke 'of universities "pushing out poison" . . . and [she] resented giving them a penny for doing so' (Jenkins 1995, 142). Her 'fix' was to reduce government support—both financially and in a wider, cultural sense—for academia through a series contentious policy decisions. Indeed, only through a Lords' amendment did the 1988 *Education Reform Act* guarantee academic staff

freedom within the law to question and test received wisdom and to put forward new ideas and controversial or unpopular opinions, without placing themselves in jeopardy of losing their jobs or privileges. (Griffith 1989, 59)

As Jenkins (1995, 147) understates, 'it is remarkable that a modern liberal government should have found this so unpalatable a clause'. A similar interpretation of this issue by the Blair government (which, it now seems, is not altogether impossible) could result in further such undesirable policy decisions. Academic ivory towers do not sit well with the rhetoric of transparency, public accountability and difficult choices, which has seemingly been carried over into the new administration from the old. Realizing a wider understanding of academic geography could even, in an extreme scenario, be central to the long-term *survival* of our profession.

Towards a convergence

How can academic geographers make their work more visible and accessible to those beyond university geography departments? Before outlining some tentative suggestions, it is necessary to raise two important points. First, we do not seek to advance a simplistic (and elitist) Enlightenment conception of academic 'knowledge-production' for lay 'knowledge-consumption'. On the contrary,

improved academic communication, capable of engaging the widest possible audience, is equally consistent with Irwin's (1993) conception of a citizen-orientated science. Second, we recognize the perhaps limited value of proposing quasi-Utopian strategies, whose adoption and implementation would be beyond the immediate influence of the majority of academic geographers (a recasting of the RAE to include 'visible and accessible communication' as a ranking criterion might be an example). Having said this, however, the RGS-IBG has recently announced a renewed commitment to raising the profile of academic geography (RGS-IBG 1998) and, with this in mind, we offer three suggestions concerning ways in which those of us within the organization might help to facilitate such action.

Firstly, there is a need to review the values we attribute to different forms of published communication within, and beyond, academia. There needs to be a change in culture within universities to recognize the importance of the task of synthesis, and in particular the production of textbooks for both school and undergraduate study. Davey *et al* (1995, 25) concur with others (see, for example, Johnston 1992) when they note that:

Within geography, most significant advances in knowledge—empirical, theoretical, methodological—will continue to be published first in the professional journals. But the wide dissemination and explanation of new ideas, including to an extent their evaluation and their creative linking with other ideas, will continue to be the function of upper-level and elementary text books. It is these too that will first inspire the scholars of the future, as well as contributing to the quality of education that students receive.

Publishers are well aware of the pressures on academic geographers to produce journal articles rather than textbooks (see the comments of Vanessa Lawrence, quoted in Davey *et al* 1995, 16), and are also inclined to the belief that textbooks are not likely to be written by people whose work is at the research frontier. Of course, that is not to deny that many geography 'classics' have been written from the cutting edge, albeit not in the first place explicitly as textbooks (David Harvey's *The condition of post-modernity* is an obvious example). Nevertheless, the publishers represented in Davey *et al* (1995) argue that, in future, students themselves rather than their lecturers must increasingly be seen as the principal target of the academic textbook writer; in view of increasing university class sizes, diminishing

opportunities exist for direct interaction between undergraduates and academic staff. This in itself will demand a clearer and more direct form of communication, and enhance the potential of academic geography to access an audience beyond the student body.

Encouraging increased textbook production will not just benefit students—it should also improve the level of communication amongst academics. We have already noted that the demands of our profession place many constraints upon our ability to recognize and respond to challenges levelled at some branches of academic inquiry. If, for example, the postmodern questioning of 'scientific' practice is genuinely important, and requires a redirection of scientific endeavours, then it is essential that the questions are couched in language that can be accessed by those to whom they are addressed. When scientific practitioners can dismiss a 'Mandarin' challenge as 'typical postmodern nonsense that nobody can understand', they perhaps feel safe in concluding that nothing serious is being said.

Second, there can be an increase in the emphasis that academic geographers place on their interaction with professional audiences beyond universities.² A number of the research groups within the RGS-IBG (such as the Higher Education Study Group and the Planning and Environment Research Group)—and, indeed the RGS-IBG itself—already see this as an explicit dimension of their purpose, and seek to forge and enhance connections between different geographical communities. Such interaction is achieved in various ways, from conferences and forums, which can lead to joint publication and research output, to encouraging consultancy work and job exchanges (Chalkley 1995). Other organizations use similar methods to inform professionals of their work. Groups such as Eurofem have emerged in an attempt to realize the implications of findings in the field of planning that have demonstrated the exclusion of women and gender from analyses of urban development (Vaious 1994, cited in Booth and Gilroy 1996). Eurofem seeks to bring the insights of academics concerned with analysing women's perspectives to bear upon the development of an urban environment that meets the needs of its users, of both sexes and all ages, more effectively (Booth and Gilroy 1996).

Third, the above strategies can be complemented by enhancing direct communication with the wider public. As well as helping to refocus 'popular' conceptions of the nature of geography, this would also ensure a comprehensive response to the ethical

criticism that research participants are unable to benefit from project results. Large public audiences can obviously be reached through outlets such as *National Geographic* or the *Geographical* magazine, and through an increased engagement with the popular media. In addition, however, a limited range of reciprocal schemes exist that encourage interaction between academics and those who participate in their research projects. Public participation in planning continues to benefit from the contributions of geographers in both urban and rural settings, and charitable bodies such as the National Asthma Campaign, commission work by geographers, which results in publication that communicates directly with sufferers (Taylor 1995).

It will be apparent that none of the above suggestions is particularly pioneering. This is because, just as the problem of 'divergent geographies' has existed for a long time, so too have the potential solutions. It is perhaps unnecessary to advance 'new' strategies until already-existing ones have been tried out properly; rather, our challenge as academic geographers is to revisit the debate and devote more resources to turning perennially *potential* solutions into *actual* ones. Endeavours of this kind can be difficult, and many will no doubt question the validity and value of time spent on them when the pressures are on to demonstrate the need for continuing support for academic research through conventional channels such as the RAE. However, we believe that such questions will be missing the point. By ignoring the challenge to make our work more visible and accessible—in effect, to maintain the popular conception of geography as a descriptive aid rather than as a penetrating, insightful and potentially useful contribution to human development—academic geography could, in fact, as we noted above, jeopardize its future claim to external support.

Geography has much to offer in understanding the contemporary world, as global processes of change alter the nature of space in social and economic relationships, and as physical and environmental processes present outcomes with spatial patterns, which must be managed if they cannot be reversed. Visible and accessible communication of academic geography would not only begin to address the divergence between 'popular' and academic branches of the discipline, but could also help resolve how and where the work of academics makes a difference. Of course, a question remains as to whether this is what the majority of academic geographers actually want.

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Notes

- 1 The consequences of this, even within the academic community, have been revealingly discussed by Sidaway (1997), whose survey also suggests that the *quality* of what we communicate in the specialized journals may be under threat. Such a likelihood adds a further twist to the already complex demands of the call presented here for wider communication and dissemination of the results of our academic work.
- 2 In particular, we refer to policy-makers, business leaders, politicians, educators and other such groups.

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What about the competition?

Privatisation, we were told, would open up the railways to the free market. **Jon Shaw** thinks we need more government intervention to make it work

John Major's government, in its anxiety to promote service competition, created an elaborate structure for the post-privatisation railway. British Rail was split into 92 companies which were either franchised (25 train operating companies, or TOCs) or sold outright (all the remaining businesses), and the idea was that competition between them would limit the need for regulation and thereby remove the "dead hand of the state" from the industry.

BR's successor companies were sold between two and three years ago. But where are the "management skills, flair and entrepreneurial spirit of the private sector" which ministers predicted would "provide better services for the public"? The punctuality and reliability of trains, the key indicators by which TOCs' performance is monitored, are no better now than they were under BR. Branch-line services are being cut back. Customer complaints are at their highest levels ever. The government has been forced to convene rail "summits" to warn the industry that its performance is not good enough.

Free marketeers may argue that the main reason for the railways' underperformance is that competition between train operators – the linchpin of rail privatisation policy – has largely failed to materialise. The Tories were forced to constrain the market because they realised that there would be fewer bidders for franchises if there was unfettered competition. Franchises usually give the winning bidder exclusive access to a revenue stream – they represent competition *for* the market rather than *in* it – so the prospect of further competition after the tendering process was not popular among potential bidders. Why should they buy a TOC if someone else could take all of their fare revenue away? The rules that prevent "on-rail" competition are so strict that John Swift QC, until recently the rail regulator, observed that "the supply of passenger services is based on 25 territorial franchises with full protection from competition from new services". But then, before he was replaced last November, Swift had a change of heart. He argued that the time was right to alter the competition rules and, as of this September, they will be relaxed to allow direct rivalry between operators.

No doubt the right-wing ideologues are delighted, but will things improve for rail users? Probably not. There are two main problems with on-rail competition. The first is economic. Because each TOC is contracted to run a host of services – some lucrative, others not – it needs to earn enough profit on its remunerative lines, which it then combines with a predetermined subsidy from the government, to ensure an adequate return on its whole operation. Only two TOCs, Gatwick Express and

Thameslink, currently operate subsidy-free. If other operators were to "cherry-pick" by running trains along a TOC's most profitable lines at the busiest times, then the TOC's ability to cross-subsidise would be reduced and its financial performance would be weakened. As it is, the subsidy declines (or, in Gatwick Express and Thameslink's cases, the premium payable to the government increases) year on year, and many TOCs will have major problems averting financial catastrophe even without the introduction of on-rail competition. A declining subsidy profile is tantamount to on-rail competition in this sense.

The second problem is more philosophical. What is the point of on-rail competition? Despite the Tories' fixation with the concept, it obviously misses the real point that train operators are already in competition with other modes of transport, notably the private car. As long as train operators are forced to keep tabs on what their counterparts are up to, it makes it more difficult for them to concentrate on the key issue of improving their services

to entice travellers off the road and on to the rails. While TOCs continue to require subsidy – and for the foreseeable future many will – the case for on-rail competition simply doesn't stack up; passenger rail services cannot yet be provided within the framework of a free market. Efforts to "get the government out", far from being redoubled by the regulator, need to be abandoned. Ministers have to work out how they can best get the government back in again.

That said, the minister responsible, John Prescott, has had to review his options carefully. Renationalisation, for instance, is not on. Apart from new Labour's ideological objections, returning the railways to the public sector makes no sense for practical reasons. By European law, the rail businesses sold outright (all of them except the TOCs) can only be bought back by the government at their true market value, and this is significantly more than it was when BR was sold (for example, Railtrack's share value has increased more than threefold since privatisation).

Furthermore, the level of investment needed in the rail industry outstrips what any government would be prepared to commit to. In the past, successive administrations, both Labour and Conservative, viewed the railways as a low priority and starved BR of sufficient investment capital. There is no reason to suppose this would change. One benefit of privatisation per se is that it frees industry from public-sector financial constraints, so the rail companies are able to raise their own investment capital from the financial markets. Prescott's recent talk about taking poorly performing franchisees back into the public sector is misguided.

Prescott has also had to ensure that any changes he does implement do not significantly alter the structure of the railway: what-

Companies will struggle to avoid disaster even without competition

ever the inadequacies of the Tories' organisational legacy, further meddling will only create more uncertainty in the industry. As Chris Green, former InterCity director and now chief executive at Virgin Trains, has pointed out, various ambitious schemes over the past two decades have made British railway managers world-beaters at restructuring. It's a pity they couldn't have concentrated on running the trains.

New Labour's approach equates more to the now-familiar Third Way. The answer is neither state ownership nor free-marketeering, but tougher state guidance. To forgo renationalisation does not mean that the government cannot significantly strengthen its hand. Prescott has just appointed a new rail regulator, Tom Winsor, who is known to be critical of the pro-market approach adopted by Swift. Winsor will almost certainly make things tougher for the industry when he takes up his post in July. Moreover, the new Strategic Rail Authority (SRA), now running in shadow form and chaired by Sir Alastair Morton, can address other problems in the current regulatory regime. This is a hotch-potch of ill-defined responsibility (despite the free-market orientation of rail privatisation, there are nine regulators covering different aspects of the industry), too complex and famously ineffective. Players in the new rail industry simply pass the buck when things go wrong, and no one is in a position to take a strategic, long-term view of the railways' future.

Some changes are needed straight-away, and the regulation of Railtrack is an obvious starting point. Railtrack is the only true monopoly left in the industry as it owns all the infrastructure (track, signalling, stations and so on). The company is legendarily risk averse – its commercial strategy has been said to resemble that of a public-sector utility – and Swift did little to persuade it to behave more entrepreneurially. For example, the growth in passenger numbers has prompted TOCs to run more trains, and “pinch points” – bottlenecks – are developing all around the network. These are beginning to cause delays to existing services and will prevent the addition of new ones. Railtrack forecast minimal growth at the time of flotation and has done little to alleviate them. However, it is likely that Railtrack foresaw a strengthening of its regulation following the appointment of Swift's successor and has recently announced a considerably expanded investment programme (£27 billion over the next ten years) which the company hopes will satisfy him. And it is important that it does: a common industry expression is that “a railway is only as good as its permanent way”, but with the infrastructure under Railtrack's stewardship this has not been very good at all.

The TOCs' trading environment, a matter for the SRA, also

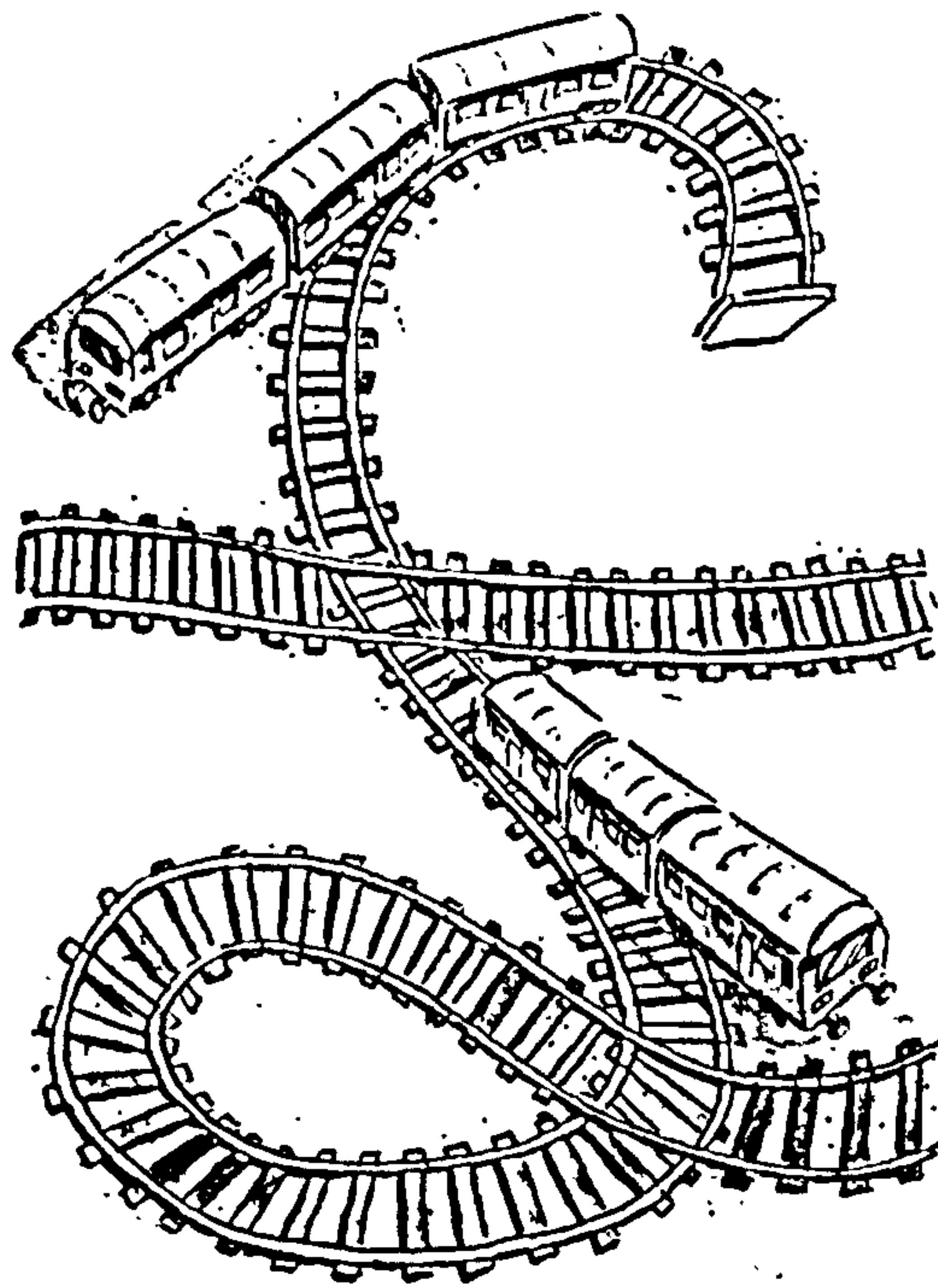
needs reviewing urgently. The introduction of on-rail competition should be abandoned for the time being. In return for the additional financial security this would accord many TOCs, the government could then start to demand better standards of performance. Passengers' charters, which allow TOCs to run trains up to 10 minutes late and claim they are on time, are a nonsense and clearly need rewriting. Moreover, TOCs can “stretch” their timetables if they think that certain trains will be delayed, and this has resulted in advertised journey times between certain stations increasing beyond those of 100 years ago. The list of shortcomings in TOC regulation is virtually endless.

In the longer term the SRA will have to consider more sweeping redefinitions of the franchise terms. Prescott has recently announced that he will accept applications from TOCs to lengthen their franchises (currently between five and 15 years) provided they “make it worth his while”. Great North Eastern Railway has invested heavily in its business and has witnessed huge organic growth since privatisation. As a result, it is running out of capacity and wants to invest in a fleet of new tilting trains in return for a franchise extension. The Deputy Prime Minister's willingness to consider such applications is generally to be welcomed, although he will have to be confident that any deals he negotiates are at least as good as those he could get from hopeful bidders in future competitive franchising rounds (an exceptionally difficult task – you can reasonably ask, “how will he know?”). In addition, by granting franchise extensions he may preclude the SRA from redefining some franchise boundaries in the future, should it deem this necessary (and it probably will: 25 franchises is

too many to permit significant economies of scale).

A safe, fast, punctual, reliable railway is essential if more and more people are to be lured out of their cars, and tougher regulation will play a crucial part in securing one. Private enterprise is notoriously sceptical of red tape and government interference, but in the passenger rail industry it may well be seen as a blessing in disguise. As subsidies continue to fall, the train operators will need to attract much higher patronage levels; it is now more or less certain that some operators will fail over the coming years unless they are able to maintain substantial revenue growth throughout their franchise periods. The strategic vision the government is promising can help them do that, but only if ministers learn from the mess of the original privatisation and carefully think out their strategy first.

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The competitive spirit re-awakens the ghost of railway monopoly

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Abstract

The 1921 and 1993 Railways Acts were both designed to increase the quality and efficiency of railway services through major industry restructuring. Aside from the fact that the 1921 legislation did not concern itself with privatisation (the rail industry already operated in private hands in the early 1920s), the two Acts appear strikingly dissimilar at first glance because of the very different policies, and their associated ideologies, adopted by each to accomplish its aims. Whilst the 1921 Act sought to eliminate competition from the passenger railway industry and promote monopoly, its 1993 counterpart was formulated to achieve precisely the opposite. However, this paper challenges the existence of a gulf between the two pieces of legislation. We argue that the 1993 Railways Act, far from liberalising the passenger rail market, has created a trading environment which shares key characteristics with that established in the 1920s. This paper therefore explores the conflicting methods and the policy outcomes of the 1921 and 1993 Railways Acts. © 1998 Elsevier Science Ltd. All rights reserved.

1. Introduction

The 1993 Railways Act (House of Commons, 1993) provided for the divestiture of British Rail (BR), one of the most complex 'natural monopoly' sell-offs in the privatisation programme of the 1979–97 Conservative government. Rather than simply divesting BR as one unit (like, for example, British Telecom), the Conservatives' intention was to improve the quality and efficiency of passenger train services by restructuring the railway industry in order to end BR's monopoly and promote competition (Department of Transport, 1992). In its attempt to facilitate market liberalisation, the Major administration fragmented BR into 92 separate companies, many of which were designed to compete with each other (Department of Transport, 1996).

Despite the intense public and political interest generated by the 1993 Railways Act (see, for example, *The Guardian*, 1995; *The Economist*, 1996), governmental reorganisation of the railways on this scale is not without precedent in Britain. The Railways Act (1921) also aimed to improve the quality and efficiency of railway services through major industry restructuring. Aside from the fact that the 1921 legislation did not concern itself with privatisation (the rail industry already operated in private hands in the early 1920s), the two Acts appear strikingly dissimilar at first glance because of the different methodological approaches used by each to restructure the railway industry. Far from being a manifestation of a neoliberal policy agenda, the

1921 Act was derived in a period of increasing political interventionism following World War One (Gray, 1995). Accordingly, the Act sought to eliminate competition from the railways and instigate a territorially based, monopolistic trading environment heavily regulated by government. However, this paper challenges the existence of a gulf between the two pieces of legislation.

More than three years after the rail privatisation process officially began in 1994, competition in the provision of passenger train services has generally not materialised and regionally based, regulated monopolies are beginning to emerge (Charlton et al., 1997). It is therefore the central contention of the present paper that, somewhat paradoxically, the 1993 Act achieved a broadly similar organisational outcome to that intended by its 1921 counterpart. Despite their contradictory ideological frameworks, both Acts created a passenger rail industry predominantly characterised by monopoly and associated governmental regulatory mechanisms. The paper begins to explore this unlikely association of policy outcomes through an examination of the background to, and methods contained in, the 1921 Railways Act. The contrary objectives of the 1993 Act are then considered, before discussion turns to highlight how the two pieces of legislation share similarities in key areas.

2. Background to the 1921 Railways Act

The railway industry in Britain has been subject to the play of political ideologies throughout its history. Indeed,

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the formulation of railway policy in the decades preceding the 1921 Railways Act owed much to the philosophies of governance espoused by influential parliamentarians. The opening of the first significant passenger line, the Liverpool to Manchester, occurred in 1830, a time described as ‘exemplifying the historical paradigm of a liberal civilisation’ (Gray, 1995, p. 26). Accordingly, politicians believed at first that competition in a free market would sufficiently encourage railway companies to operate efficiently and continually improve their customer service (Perkin, 1971). However, regional monopolies, such as the Great Western, quickly began to emerge as railway companies amalgamated in an attempt to secure economies of scale from larger operations (Simnett, 1923).

Simply put, monopolies exclude competition and thus are able to maximise profits by abusing their market position. Although monopolistic practices on the railways were recognised by Parliament in the 1830s (see, for example, Parliamentary Papers, 1839), contemporary governments demonstrated a commitment to *laissez-faire* principles through their reluctance to intervene in the affairs of the industry. By 1840, however, railway policy had moved towards curbing the abuse of monopoly power through the establishment of a regulatory regime. The Regulation of Railways Act (1840) and the Construction of Future Railways Act (1844) represented early governmental attempts to introduce to the railway industry what might be conceptualised as ‘surrogate competition’, so-called because it was designed to replicate the effect of actual competition by forcing prices down and efficiency up (The Economist, 1995). Mechanisms used to achieve this can be categorised as economic regulation, where attempts were made to control companies’ tariffs, and quality of service regulation. The latter was designed to complement economic regulation by guarding against a deterioration in output quality as rail firms strove to operate within tariff controls. Such measures in the 1844 Act dictated *inter alia* acceptable train frequencies and speeds. These categories of economic and quality of service regulation will be referred to throughout the paper.

From 1840 onwards, governmental influence over the railway industry gradually increased as a result of a confused and contradictory regulatory policy. On the one hand, successive governments maintained an ideological desire to encourage competitiveness, and this manifested itself in efforts to promote ‘anti-trust’ style regulation. On the other hand, increasingly stringent economic and quality of service regulation was necessitated to combat expanding regional monopolies which materialised precisely owing to the *failure* of anti-trust measures (see, for example, Parliamentary Papers, 1840, 1845, 1852, 1872). Towards the end of the nineteenth century, parliamentarians had begun to despair at the inefficacy of railway policy:

... committees and commissions carefully chosen have, for the last thirty years, clung to one form of

competition or another . . . [however] no means have yet been devised by which competition can be permanently maintained (Parliamentary Papers, 1872, p. xviii).

Increasingly, reflecting the New liberal (or ‘interventionist’) political tide sweeping late-nineteenth century Britain (Gray, 1995), pressure mounted upon governments to abandon altogether what remained of their commitment to a competitive railway industry. A notably more interventionist stance was advocated, involving either the amalgamation and comprehensive regulation of regional monopolies or outright nationalisation (Robbins, 1962; Parris, 1965). In the event, however, the railway industry was first taken under full governmental control as a result of the outbreak of World War One, rather than the influence of political ideology.

By the War’s conclusion, many railway companies were in a parlous financial state as industry-wide losses had, according to official estimates, reached an annual figure of anything between £45 and £100 million by 1920 (The Times, 1920). (The accuracy of these estimates was subject to contemporary debate, however: see, for example, The Times, 1919a, b.) Although a high proportion of the losses were attributable to the war effort, railway finances had been worsening for some time before 1914 (Waghorn, 1905). Despite the trend towards amalgamation, the competition which remained had resulted in much wasteful investment and a continuous fall in the value of railway stocks and dividends (The Times, 1921a; Waghorn, 1905). The economies of scale produced through unified working practices during the War were seen by government officials and railway managers to have been beneficial to both railway companies and consumers. For example, the acting chairman of the Railway Executive Committee commented:

... I cannot think that our railways will ever again revert to the independent and foolish competitive system which obtained before this war broke out. The old system possessed manifold evils, not the least being the wastefulness of competition . . . If we are to get the really useful and tangible result of what has been done in the war . . . there must be vastly more co-ordination between the various companies (Railway Gazette, 1917, p. 726).

Parliamentarians and railway interest groups began to focus their attention on finding a long-term solution to the political and economic dilemma posed by the railway industry. For a brief period following the armistice ‘nationalisation [was] in the air’ (Sheridan-Jones, 1919, p. 471) and state-ownership of the railways was the favoured option for certain groups, such as the Labour Party and the National Union of Railwaymen (NUR) (The Times, 1921b). Nationalisation was also publicly discussed as a possibility by government ministers (Aldcroft, 1975). However, the

prospect of such increased government involvement in society was less acceptable to others:

... having won a great war for liberty, during which only the nation's strength and endurance saved us from government, we seem to be in danger of surrendering our liberty and putting our heads under a yoke imposed by bureaucratic bunglers (The Economist, 1919, p. 172).

Ultimately, a combination of factors resulted in nationalisation as an option being left unexplored in the 1920s. Chief among these was public opinion, which largely concurred with the sentiments of *The Economist* (Sherrington, 1928; The Times, 1919c), and the fact that the performance of state-run railways overseas had frequently proved disappointing (Dyos and Aldcroft, 1971). However, solutions to the 'railway problem' were still perceived by government to be most appropriately sought by itself rather than the railway industry. The debate shifted towards the further amalgamation and comprehensive regulation of the railways, a course of action which, although stopping short of nationalisation, did guarantee a sizeable and active role for the state in the industry's future.

Neither the majority of railway companies nor their shareholders objected in principle to further amalgamation (see, for example, The Economist, 1920, 1921) because it was viewed as a logical extension of the process promoted by themselves throughout much of the 1900s. The government's document *Outline of proposals as to the future organisation of transport undertakings in Great Britain and their relation to the State* (Parliamentary Papers, 1920) proposed that the 100 or so railway companies still in existence (Simmons, 1978) should be formed into five or six groups. All direct competition between the groups was, as far as possible, to be eliminated and, in the absence of any market forces, economic and quality of service regulation was proposed in order to act as surrogate competition to prevent the abuse of monopoly power.

The Railways Bill appeared before Parliament in May 1921 and represented a decisive shift away from the *laissez-faire* principles which had influenced railway policy so heavily in the previous century. By eliminating market forces and elevating the role of statutory supervision to maximise the public good, the Bill can be seen to hold much in common with the prevailing mood of increasing political interventionism. Following some amendments, the Bill received Royal assent in August 1921. Attention is now turned to the specific methods employed by the Act to translate political ideology into policy.

3. Provisions of the 1921 Railways Act

Removing competition from the railway industry required a major restructuring exercise and, to this end,

the opening paragraph of the 1921 Act noted:

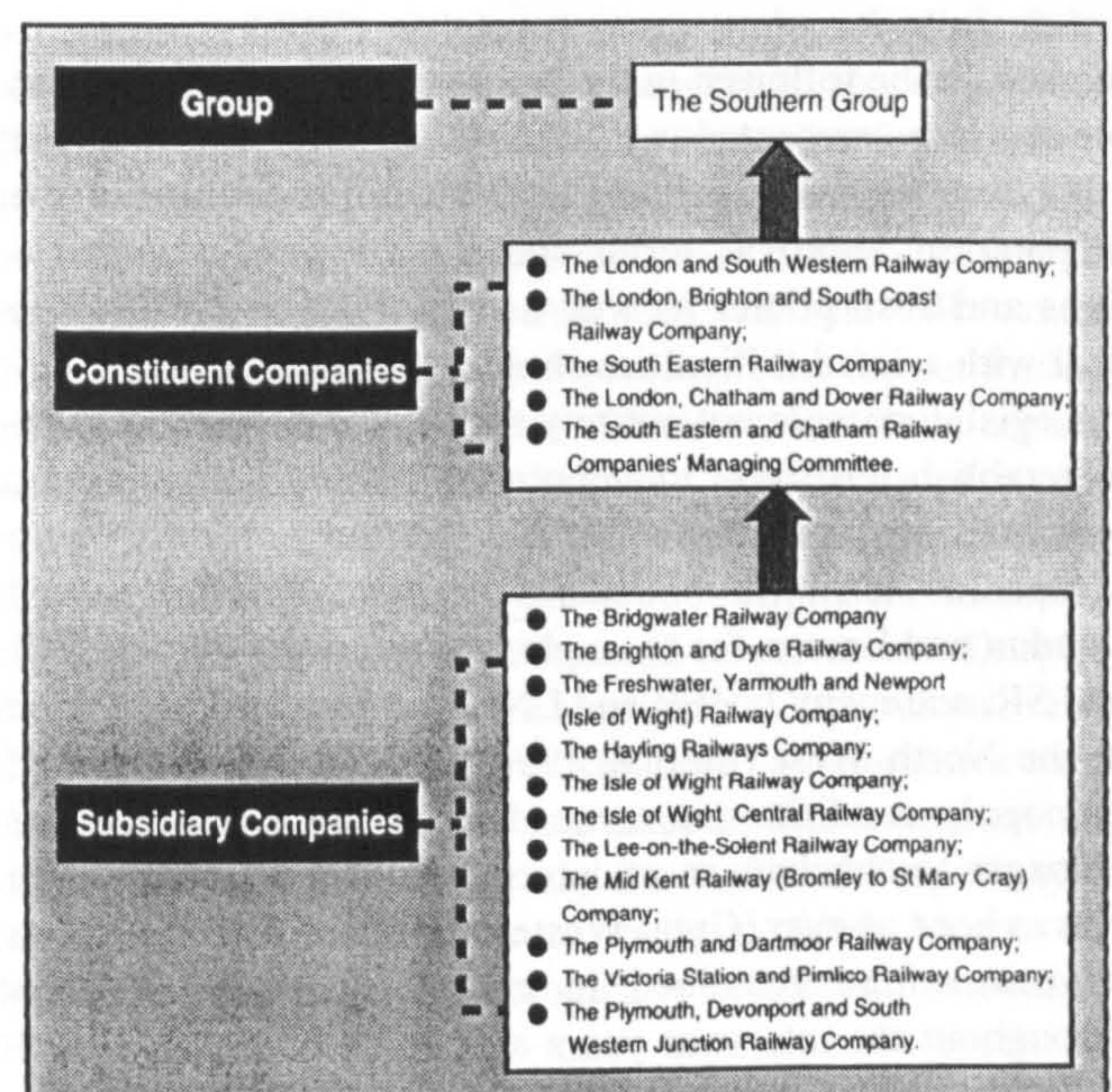
With a view to the reorganisation and more efficient and economical working of the railway system of Great Britain railways shall be formed into groups (Railways Act, 1921, 11 and 12 Geo., 5: 1(1)).

Considerable debate regarding the nature of the groups had ensued following the publication of the 1920 White Paper. The search for economies of scale played a key role in reducing the overall number of groupings from five or six, as envisaged in the White Paper, to four. Care was taken not only to keep together in one group those lines which had previously operated close working agreements, but also to saddle financially strong lines with their weaker neighbours in order to facilitate a degree of cross-subsidisation (Sherrington, 1928). Thus, concerns regarding the financial viability of a single Scottish grouping resulted in the East and West Scottish groups being attached longitudinally to their English counterparts.

Each of the four groups was designed as a territorial monopoly in order to avoid the duplication of services which had existed before the war. The 'big four'—the London, Midland and Scottish (LMS), the London and North Eastern (LNER), the Great Western (GWR) and the Southern (SR) railway companies (see Fig. 1)—were vertically integrated entities created by processes of amalgamation and absorption. Each group comprised a number of 'amalgamated companies' which in turn absorbed a number of 'constituent companies'. Table 1 shows how this process worked for the Southern Railway. The exact

Table 1

Formation of the Southern Railway Group. Source: Railways Act (1921) 11 and 12 Geo., 5



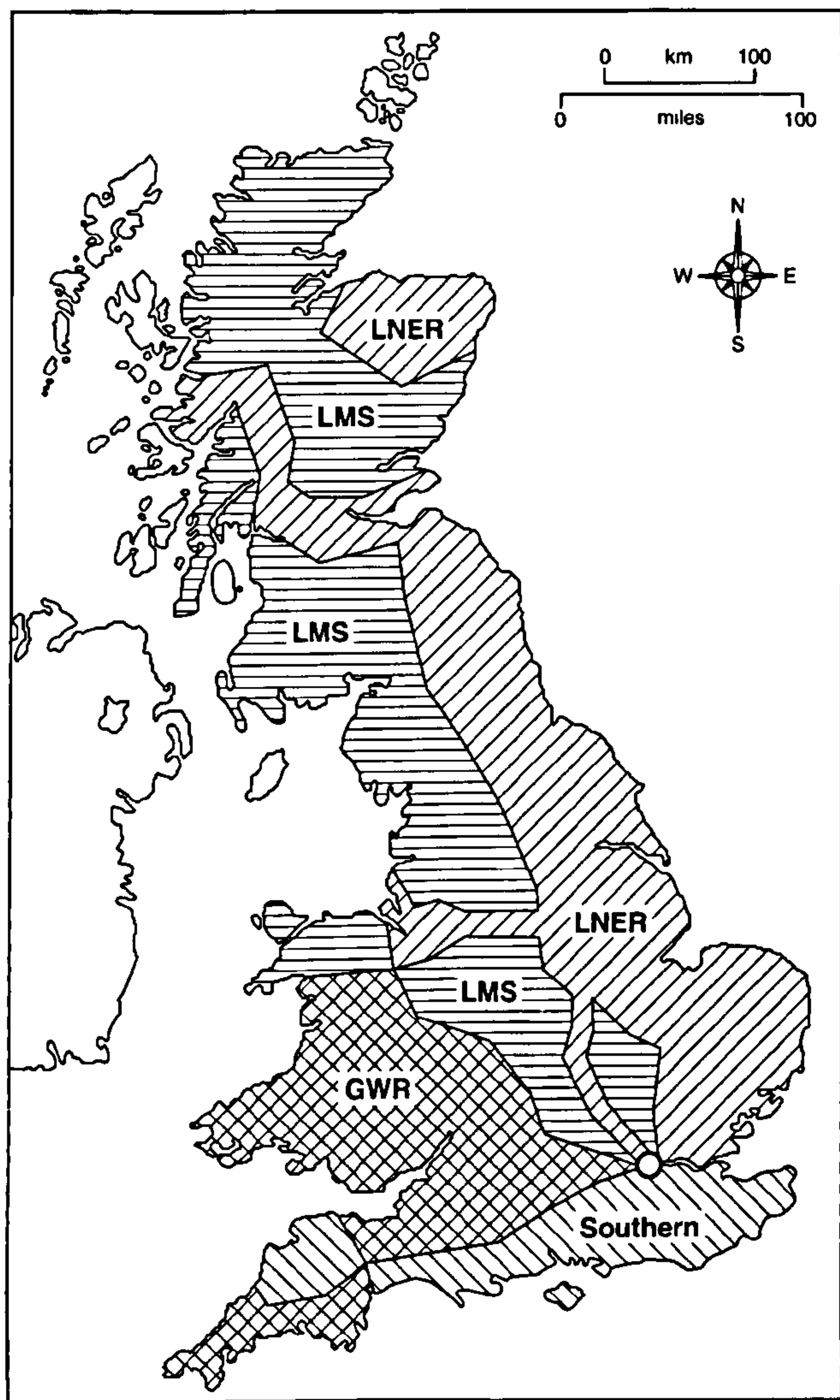


Fig. 1. Operating territories of the 'big four'. After Freeman and Aldcroft (1985).

methods to be followed in the amalgamation and absorption process were presented in a brief but specific manner by the 1921 Act. Sections 4 through 10 made provisions for the preparation, approval, terms and conditions of amalgamations and absorptions, as well as establishing a tribunal to deal with related difficulties should they have arisen.

Legislators were not entirely successful in their attempts to establish territorial monopolies. Competition for traffic remained, particularly around the 'frontier' regions where companies' territorial boundaries collided. Traffic between London and Exeter, for example, was carried by both GWR and SR, and many LMSR and LNER routes were duplicated in the North West (Mellor, 1994). Indeed, the absence of monopoly conditions in some districts led a GWR senior manager to conclude in an internal report that competition was as keen as ever (Great Western Railway, 1924). Pockets of competition remained in existence on the railways throughout the inter-war years and, in this sense, it is perhaps more exact to regard the big four as *virtual*, rather than actual, territorial monopolies. Nevertheless, the Act

formulated a regulatory regime very much contrived for keeping a monopoly industry in check. Economic and quality of service regulation was designed to act as surrogate competition, 'with a view to securing and promoting the . . . interests of the public, or of trade, or of any particular locality (Railways Act, 1921, 11 and 12 Geo., 5: 16(1)).

The 1921 Act established the Railway Rates Tribunal (RRT) to administer and enforce the economic regulation of the big four. The RRT was given wide powers and functions in all matters related to charges levied by the railway companies. Whilst primary consideration was given to the regulation of freight tariffs, passenger rates were also subject to statutory control. The initial function of the RRT was to approve new tariffs proposed by the railway companies. Each of the big four was obliged to submit a schedule of the standard charges it desired to levy. Following deliberation and consultation with interested parties, the RRT set the standard charges at levels it deemed acceptable (which may or may not have corresponded with those submitted by the railway companies). With but a few exceptions, no variation either upwards or downwards from the standard charges was permitted without the permission of the RRT. Although the general intention of regulating fares was to prevent the abuse of monopoly power, the Act acknowledged the need to ensure the financial viability of the railways. To this end, the new rates were set at a level which would provide for an annual net revenue equivalent to that of 1913, a year in which the railways had operated at a reasonable profit.

In the longer term, the RRT was empowered by sections 28 through 61 of the Act to function as a fares' watchdog designed to resolve queries relating to (for example) the variation or cancellation of existing charges or the introduction of new charges. Railway companies were also subject to periodical reviews of their charges by the RRT to ensure that revenue did not exceed the 1913 equivalent value. If, on any such review, the RRT found the average annual net revenue to be in excess of this value, the tribunal would modify the offending company's standard charges so as to effect a revenue reduction in subsequent years.

The 1921 Act was less specific with reference to quality of service regulation. Responsibility for upholding this regulation mostly rested with the Railway and Canal Commission. The Act noted that in order to:

. . . [secure] the interests of the public . . . the Commission may . . . by order require . . . the company or companies to afford such reasonable railway services, facilities and conveniences upon and in connection with its undertaking or their undertakings (Railways Act, 1921, 11 and 12 Geo., 5: 16(1)).

The Commission and the Minister for Transport were also empowered to request companies to make alterations, extensions and improvements to existing works, so long as such projects did not prejudicially affect the interests of existing

stockholders. Importantly, the ‘big four’ were ordered to adopt schemes for co-operative—rather than competitive—working. A key problem of creating railway territories, particularly from the passengers’ point of view, was that cross-country travel remained inconvenient because of the need to negotiate territorial boundaries. In an attempt to rectify this, the Act required each amalgamated company to provide proper points of exchange to maximise the convenient forwarding of passengers and freight between itself and another amalgamated company. Further, the companies were obliged by the Act to operate their trains at times which expedited this, and to provide through rates and fares to destinations beyond their own jurisdiction.

Although nationalisation as an option was not pursued in the 1920s, the government nevertheless ensured a sizeable and active role for itself in the future of the railway industry. The state’s decision to safeguard the public interest by seeking amalgamations to promote economies of scale resulted in the formation of regional ‘monopolies’, each subject to considerable economic and quality of service regulation. This organisational arrangement lasted until the railways were finally nationalised in 1948 (Ellis, 1959). It is not the intention of the current paper to discuss the process of railway nationalisation in detail; however, an authoritative account can be found in Gourvish (1986). The perpetuation of an interventionist political mood, through the decades of welfare state consensus (Sked and Cook, 1990), precluded serious discussion regarding a future role for the industry outside of the public sector. However, the election to power of the Conservative Party in 1979 once again brought the societal role of the free market sharply into focus, and attention turned towards the divestiture of nationalised industries. Although the railways were not privatised until the early 1990s, debates regarding private sector involvement in the industry began shortly after the Conservatives assumed power (Zahariadis, 1995, 1996; Gibb et al., 1996). The text now turns to explore the background to, and methods used in, the privatisation of British Rail.

4. Privatising British Rail

Following the nationalisation of the big four, the British Railways Board (BRB) was established. Although it was assumed that BRB would break even after a short time this target was not met and, by 1979, BR’s financial situation was considered disastrous—subsidy requirements had exceeded £600 million every year since 1975 (Redwood, 1984). The loss-making performance of nationalised industries in general was an irritation to many Conservatives throughout the 1970s. Indeed BR, according to one minister, was no more than one of the ‘lame duck’ state-owned companies, ‘part of the soft morass of subsidised incompetence’ (quoted in Blackaby, 1978, p. 55). The reaction against the performance of nationalised industries was part of a more general shift within the Conservative Party away from the interventionist principles of the welfare state consensus.

Increasingly embraced was the neoliberal ideology which, in short, looks to reduce public sector involvement in society and the economy by promoting a ‘free’ market driven by competition (Friedman, 1962, 1980). Free marketeers within the Conservative Party published various documents whilst in opposition (see, for example, *The Right Approach*, Conservative Party, 1976; *The Right Approach to the Economy*, Conservative Party, 1977) concerning measures which could be taken to achieve these goals, and key among them was the privatisation of state-owned industries such as BR.

Following the 1979 general election, the Queen’s speech of that year outlined ‘proposals [which] will reduce the extent of nationalised and state ownership and increase competition by providing offers of sale’ (McLachlan, 1983, p. 21). Progress in these areas with regard to BR initially revolved around rationalising the industry’s activities in an attempt to prepare it for privatisation at a future stage (Gibb et al., 1996). Particularly radical was the proposal of the ‘rail conversionists’, who argued that railway lines should be concreted over in order that cars might instead make use of the premium city-centre to city-centre route paths (Redwood, 1984). The Serpell Report (Serpell, 1983) investigated ways of improving the railways’ short-term financial prospects. In order to turn BR into a profitable entity, the Report concluded that 84% of the rail network needed closing, a move which would have reduced BR’s route miles from around 11,000 to just 1,630. Although less dramatic options were also proposed by Serpell, the Report’s suggestions encountered hostility and the Transport Secretary assured Parliament that although the report constituted a ‘basis for decisions and for action . . . the extreme options were not acceptable’ (Hansard, 1983, Cols 489, 499).

It is argued by Gibb et al. (1996) that a coherent policy for privatising BR started to crystallise in the early 1980s. To begin, some of BR’s peripheral assets, such as Sealink, British Transport Hotels and non-operational property, were divested. Selling BR’s subsidiaries had a profound effect on the subsequent debate regarding privatisation by establishing a precedent. Whereas some years before commentators and the public alike had believed that BR would ‘remain for all time in public ownership’, the former Parliamentary Secretary to the Prime Minister, Ian Gow, argued that ‘the climate of opinion and the experience of recent years has [sic] transformed that belief’ (Lynch, 1988, p. 12). Rightist think-tanks began to focus upon the formulation of a method by which BR could be privatised. Despite attempts to streamline the industry’s operations, BR remained a loss-making industry and a straightforward divestiture was far from guaranteed. The retention of some state subsidy was clearly inevitable if Serpell-style cuts in service provision were to be avoided. Moreover, the Conservatives were ideologically committed to ending BR’s monopoly. Of course, many contested the assertion that BR constituted a monopoly given that it already faced fierce inter-modal competition. Certainly this was (and

remains) the view of pressure groups such as Transport 2000 (1989) and railway industry chairmen (British Broadcasting Corporation, 1996). However, the Conservatives' position originated from the view that BR constituted a monopoly as it was the only provider of train services (Department of Transport, 1992). In this sense, therefore, the BR sell-off became doubly complex. Not only did it trade unprofitably, but there was also the perceived need to introduce a competitive spirit into the railway industry.

Proposals put forward in the mid-1980s partially addressed the industry's finances, promoting the idea of cross-subsidisation, but largely disregarded direct on-rail competition as an option (Beesley and Littlechild, 1983). More concerned with market liberalisation, Gritten (1988) espoused the regional division of BR into vertically integrated independent companies, each based upon a major route corridor. The proposal involved the introduction of a host of competitive companies operating trains on track owned by the independent regional companies. However, such plans were seen as unworkable by groups such as Transport 2000 (1989), principally because of two potential operational difficulties: first, the negotiation of through traffic across the territories of several different railway companies; and second, the ability of track owners to prioritise their own train services to the detriment of competitors. In the view of BR itself the least damaging privatisation option was to sell off the railway industry as a whole (Financial Times, 1989), although the Conservatives remained hostile to this approach because it made no provision for on-rail competition (Gibb et al., 1996). Ministerial attention turned to proposals initially proffered by the Adam Smith Institute (ASI) in 1987 (Irvine, 1987). The ASI's report rested on the claim that industry ownership could be divided between tracks and trains. A national track authority would lease track time to private companies running competing rail services between destination pairs. Such a proposal was denounced by BR chairman Sir Robert Reid, who viewed a fragmented railway 'with lots of little companies which are not properly coordinated as a great disadvantage to [his] customers because there will be constant friction' (Financial Times, 1989, p. 10). Nevertheless, the model upon which the privatisation was ultimately based can be viewed in many ways as similar to the proposals of the ASI.

In 1992, the Conservative Party formally announced its intention to pursue the privatisation of BR within the lifetime of the 1992–97 parliament (Conservative Party, 1992). The pursuit of competition in the provision of passenger train services was afforded the highest priority, being viewed as a mechanism capable of improving quality and efficiency on the railways:

... we believe the best way to produce profound and lasting improvements on the railways is to end BR's state monopoly ... We want to give the private sector the opportunity to operate existing rail services and introduce new ones (Conservative Party, 1992, p. 35).

The 1992 White Paper *New Opportunities for the Railways* (Department of Transport, 1992), used by the Major administration to formally present its vision of how BR's denationalisation would take place, stated that:

... one part of BR will become a track authority, Railtrack ... [and] new operators will be allowed to provide services, giving customers a choice and stimulating improved services and value (Department of Transport, 1992, p. 4).

The proposals were implemented by the 1993 Railways Act (House of Commons, 1993). The Act provided for the privatisation of the railway industry and, of specific importance in terms of the present paper, the creation of a framework through which BR's monopoly could be ended to liberalise the passenger train service market. The text now turns to examine this framework.

5. The 1993 Railways Act

Unlike in the 1921 Act, the exact methodology to be used in order to achieve the Conservatives' objectives was not outlined by the 1993 legislation. In fact, the imprecise wording of the Act—it is little more than enabling legislation in many respects—is one of its most striking features. It is likely that a degree of flexibility was required in the legislation because policy makers were 'still thinking through the details of how [they proposed] to carry through privatisation' (Nash, 1993, p. 317). The enormity of the restructuring, combined with the lack of an international parallel, rendered the plans somewhat experimental in nature (House of Commons Papers, 1992). Accordingly, the retention of some leeway to 'fine tune' the policy, in order to surmount difficulties as and when they arose, was advantageous. With reference to the physical restructuring of BR, the Act noted:

... The Secretary of State may, after consultation with the [BR] Board ... give the Board directions with respect to: (a) the nature and objects of the company which is to be formed; (b) the manner in which, and the time within which, it is to be formed (House of Commons, 1993: 84 (2) (a) (b)).

By virtue of this clause, Ministers were effectively given licence to create whatever they wished from the BR monolith. In the event, however, BR was fragmented into 92 separate companies (Department of Transport, 1996). The creation of so many new businesses was a result of the *common carrier* (CC) methodology used to restructure the railway industry. The advantage of forming a CC was that it allowed BR's monopoly to be broken without the need for an entirely new infrastructure. This was accomplished by separating ownership of the infrastructure (track, signalling, bridges and so on) from maintenance and train service provision.

The infrastructure owner, Railtrack, is the CC because it provides train operators with access to its assets (it ‘carries’ them). The operators in turn compete to offer their services to the public. In order to maintain its infrastructure, Railtrack must contract work out to competing suppliers. Focus in the present paper is on the provision of passenger train services; a review of the functions of, and interaction between, other actors in the industry can be found elsewhere in the literature (see, for example, Charlton et al., 1997). Of course, Railtrack is still a monopoly and, although the formation of such a company appears to oppose the objective of market liberalisation, it is in fact a necessary paradox—the CC is a kind of monopolistic fulcrum around which the competitive remainder of the industry can organise itself.

Railtrack is legally entitled to function as the sole ‘network licensee’. As such, and in keeping with its role as the CC, Railtrack must allow train operators to use its infrastructure through access contracts. Section 17 of the 1993 Act notes how this procedure facilitates the competitive provision of train services:

... directions [may be given] to a facility owner [Railtrack] requiring him to enter into an access contract . . . The purpose for which directions may be given is that of enabling the beneficiary to obtain . . . from a facility owner whose railway facility is track, permission to use that track for the purpose of the operation of trains on that track by the beneficiary (House of Commons, 1993:17 (1) (2) (a)).

Those train operators negotiating access contracts

with Railtrack fall into two categories—franchised and non-franchised—and these contracts are overseen by a government-appointed Rail Regulator. Franchised Train Operating Companies (TOCs) are let to the private sector for a finite period. The 25 TOCs lease almost all of their physical assets, having been established essentially as people businesses in order to assuage the inevitable transfer of franchise ownership. Each TOC operates passenger train services along specified routes within a specified region and, together, the TOCs assume responsibility for those services previously worked by BR (OPRAF, 1996). The creation of 25 TOCs has led to a complex geographical arrangement of their operating territories (see Figs 2–4). Because of this complex geography, many TOCs share at least some track miles with one, or maybe more, of their counterparts, and competition along these routes is theoretically possible. A good example of this is the Chester to Holyhead line, where customers are served by both North Western Trains and Virgin Trains. Moreover, ‘frontier’ regions, similar to those created by the 1921 Railways Act, have also been created. In this way, Londoners travelling to (for example) Exeter are still in a position to choose their preferred train operator (see Fig. 5).

Non-franchised passenger operators represent the ‘significant number of companies’ (Conservative Party, 1992, p. 35) to whom the Major administration sought to offer the chance of running new railway services. By negotiating an access agreement with Railtrack, these companies can theoretically compete with franchised TOCs between destination pairs on an ‘open access’ basis. In this way, non-franchised passenger operators do not operate within

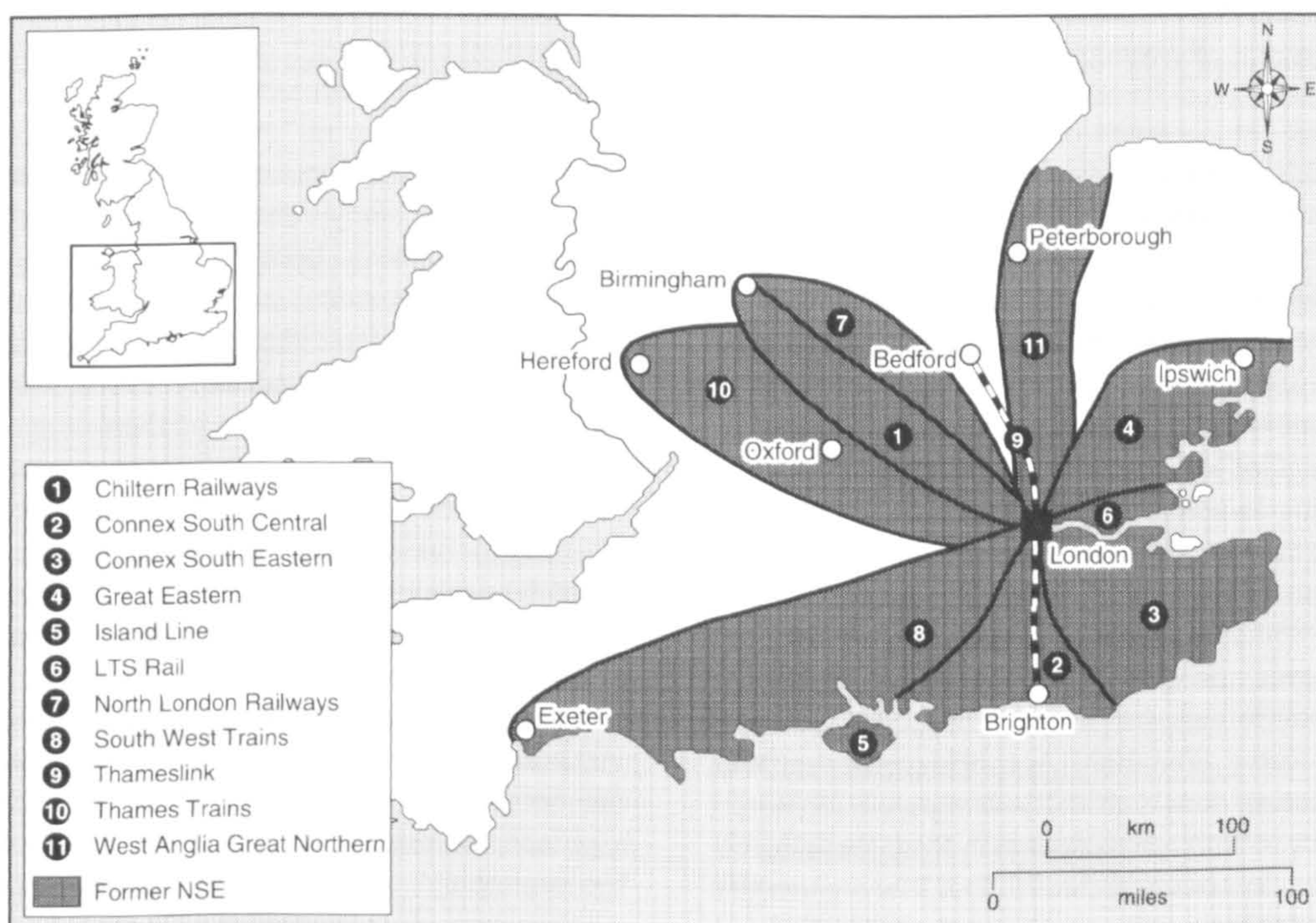


Fig. 2. Operating territories of the former Network SouthEast TOCs.

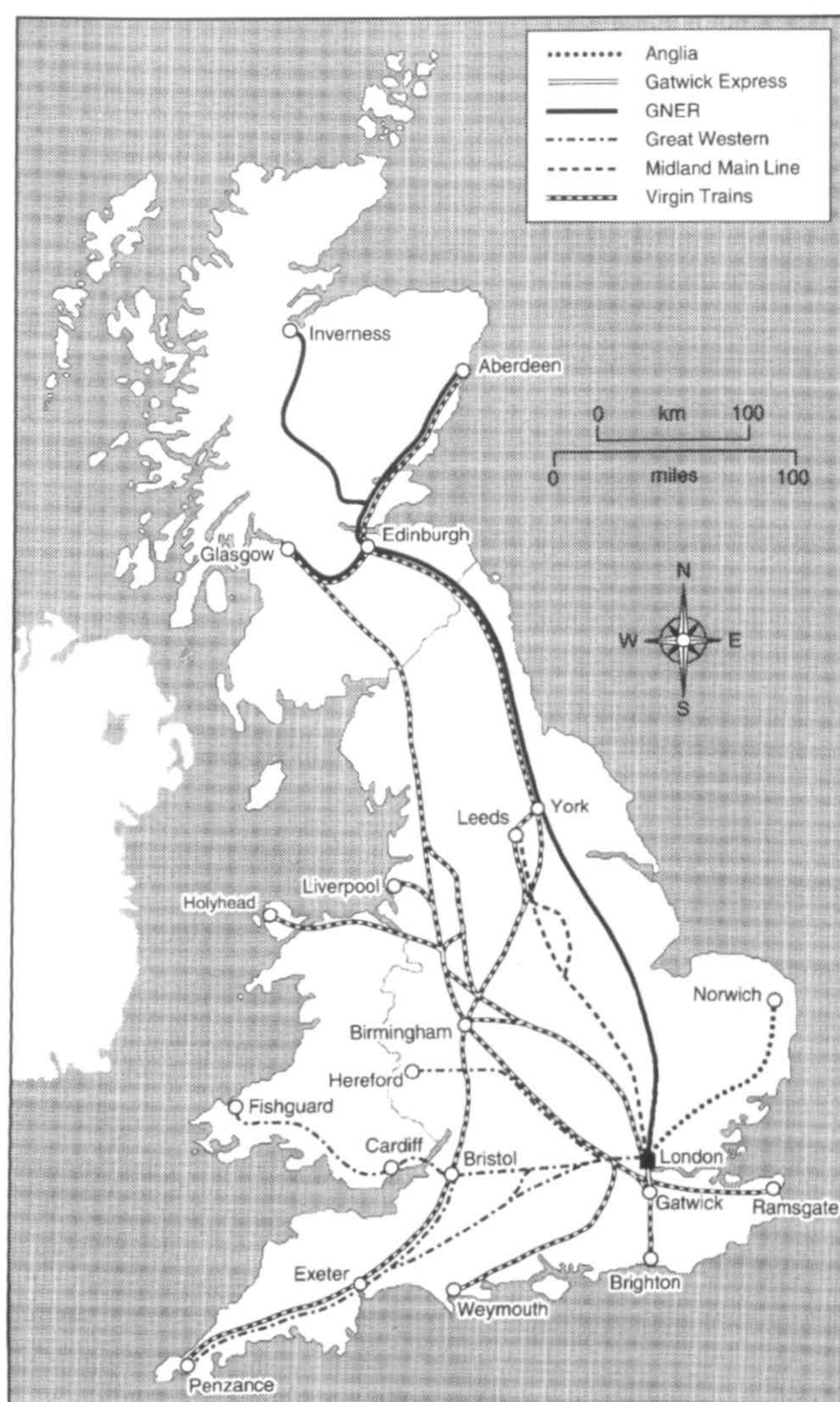


Fig. 3. Route plans of the former InterCity TOCs.

a specific territory; instead they may choose to operate solely on one route should this be deemed the most profitable option.

By fragmenting BR's passenger operations and devolving the responsibility for their operation to territorially based companies, the 1993 Act can immediately be seen to share some organisational purpose with its 1921 counterpart. Indeed, the Conservative Party declared this as its intention by noting 'we want to restore the pride and local commitment that died with nationalisation . . . and recapture the spirit of the old regional companies' (Conservative Party, 1992, pp. 35–36). Beyond the existence of regional companies, however, the conflicting ideological objectives of the two Acts are reflected in the differing organisational structures they created. The 1921 Act tackled the 'railway problem' by creating four vertically integrated territorial groups, designed to eliminate competition from the industry as far as possible. In contrast, the 25 TOCs are generally asset-less franchises who gain access to the infrastructure from Railtrack on a contractual basis. This is in order to

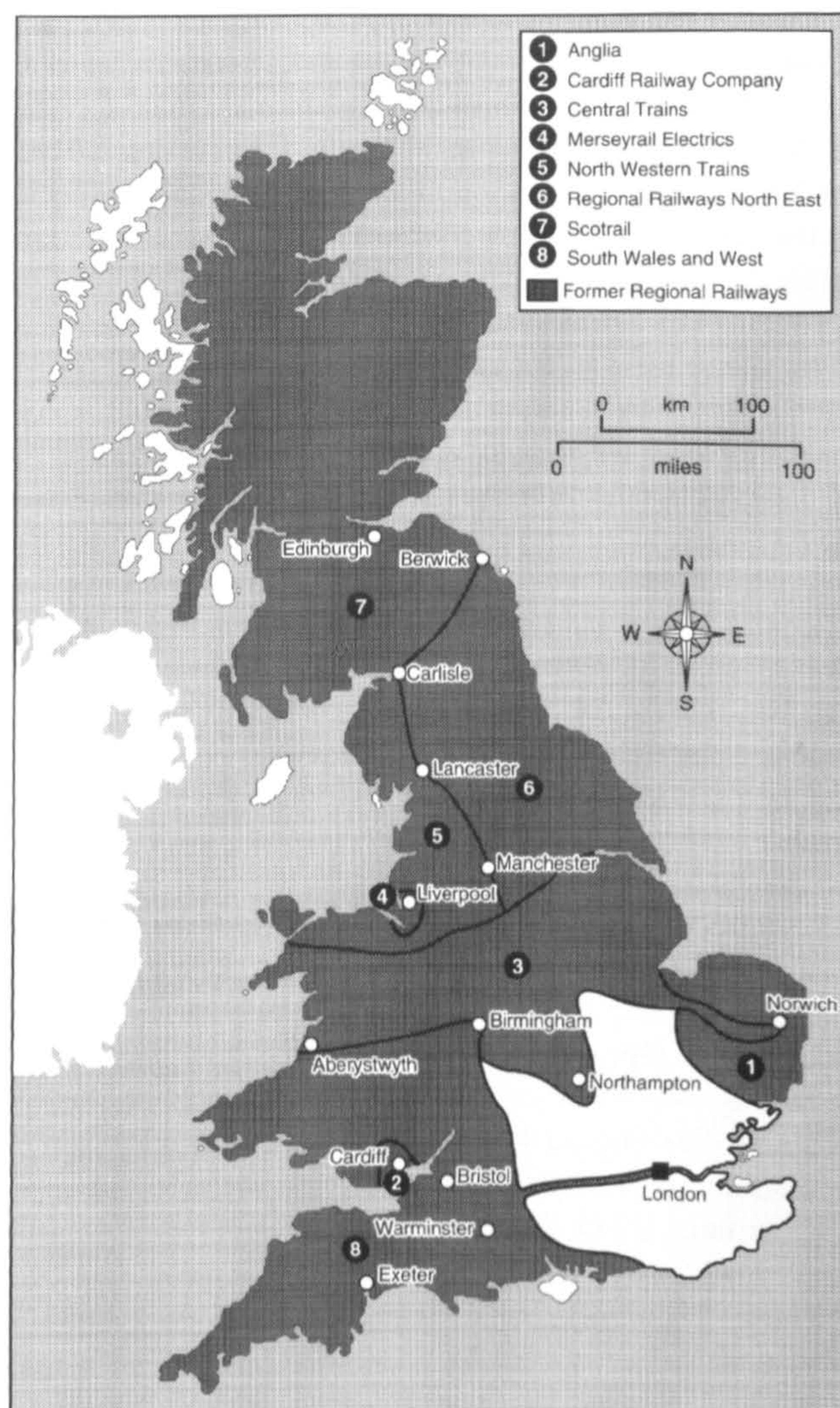


Fig. 4. Operating territories of the former Regional Railways TOCs.

facilitate competition, not only between incumbent TOCs—where they share route miles or 'frontier' regions—but also between TOCs and open access newcomers.

To briefly recap, the dominant economic ideology throughout the 1980s and early 1990s was neoliberalism, seeking to maximise the role of the free market in society. A key policy objective of the Conservative government was to improve the performance of the railway industry by liberalising the passenger train service market. This is in some contrast to the 1921 Railways Act, which was formulated in a period of increasing political interventionism and sought to eliminate competition from the railway industry. However, it is the central contention of the present paper that the 1993 Act has, in fact, achieved a broadly similar policy outcome to that intended by the 1921 legislation, namely a passenger railway industry predominantly characterised by monopoly and associated governmental regulatory mechanisms. Attention is now turned to why this is the case.

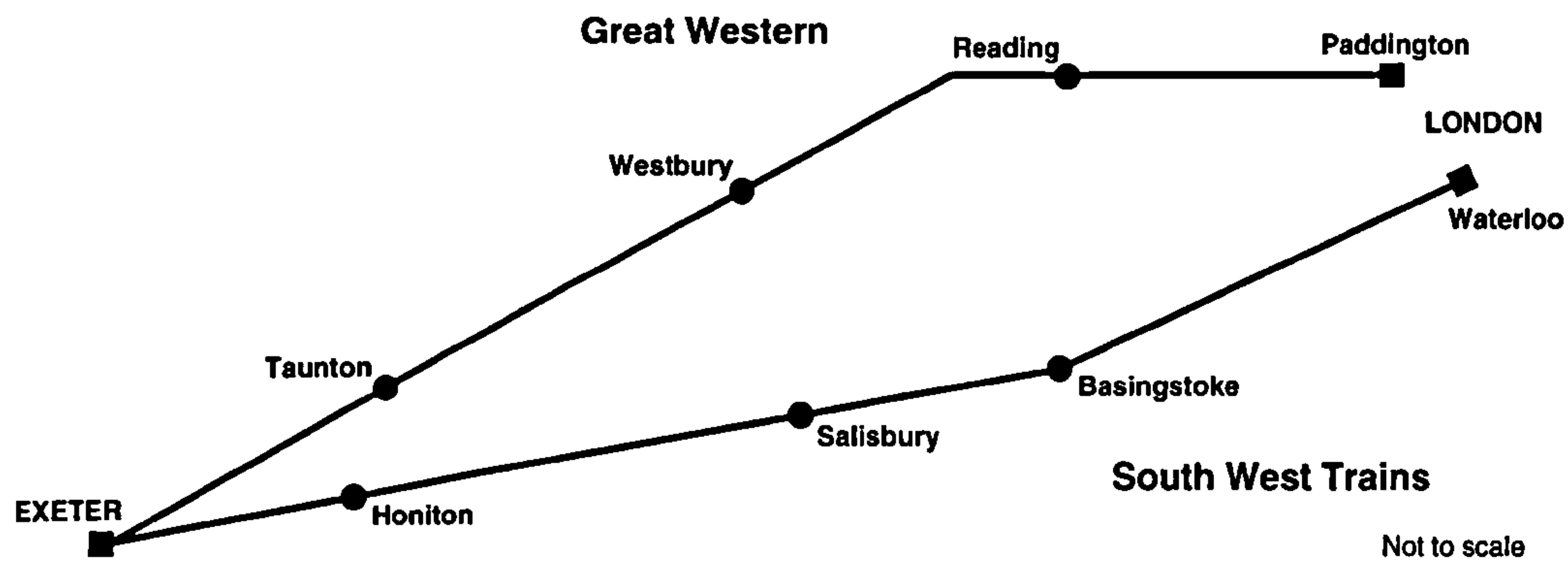


Fig. 5. Competing TOCs between London and Exeter.

6. The re-appearance of monopoly

Although the Conservatives had originally emphasised the fundamental importance of competition to the future of the passenger rail industry, they expressed doubts regarding its viability as an organising principle in 1993 (Department of Transport, 1993). Such concerns most likely arose from two basic problems, both explicitly interlinked. In the first instance, 24 of the 25 TOCs were (and still are) unprofitable and relied upon considerable government subsidy (Modern Railways, 1995). The continued payment of such subsidy was almost certainly related to a degree of political realism exercised by the Conservatives. Perhaps due to cuts which had been proposed by reports in the early 1980s, the privatisation of BR became electorally unpopular and the public sought reassurance that the levels and extent of services would not be detrimentally affected by the privatisation plans (see, for example, *The Economist*, 1996). For this reason, the Major administration acknowledged as far back as 1992 that 'subsidy will continue to be paid where necessary' in order to 'sustain the current national network of services' (Conservative Party, 1992, p. 35). The second problem was (and, again, remains) related to the amount, and routing, of train miles which TOCs were expected to cover in return for their subsidy. Each TOC is required to operate at least the amount of trains specified in its Public Service Requirement (PSR). The purpose of a PSR is to ensure the provision of a minimum level of services across a TOC's franchise region. Whilst not functioning explicitly as a timetable, it does set parameters, based largely on the 'national network of services' of 1992, within which the TOC must design its timetables (OPRAF, 1996). However PSRs, by their very nature, render TOCs uncompetitive, and this issue is explored now.

A franchisee operating lucrative services between, say, Manchester and Birmingham, is obliged to run those services and a whole host of other routes contained in its franchise region. On the other hand, a non-franchised new entrant on the same route, although ineligible for government subsidy, would be able to 'cherry pick'—i.e. operate trains on the most profitable routes at the most profitable

times—without the statutory obligations of a franchisee. This could result in a substantial decline in revenue for the incumbent franchisee whilst its subsidy remained static. Thus the franchisee's ability to cross-subsidise its network would be reduced, and the profitability of the TOC would diminish. Given this scenario, potential franchisees were dissuaded from bidding for contracts which presented them with the threat of financial uncertainty or even insolvency (*The Guardian*, 1993). The success of the rail privatisation project was therefore jeopardised and, despite its initial enthusiasm for market liberalisation, the Major government was forced to accept that the objectives of promoting on-rail competition and maintaining socially necessary, loss-making services were manifestly conflicting. Accordingly, it modified its views when it announced that 'competition on routes to be franchised should be moderated to the extent necessary to ensure the successful launch of the first generation of franchises' (ORR, 1994, p. iii).

Just as the methodology used to restructure the industry was not made explicit by the 1993 Act, details regarding the mechanisms employed to restrict competition were absent. Outlined instead was the duty of the Rail Regulator and the Franchising Director to act upon guidance (objectives, instruction and guidance in the case of the Franchising Director) issued by the Secretary of State from time to time (ORR, 1995; OPRAF, 1996). Guidance regarding the need to substantially restrict competition in the provision of passenger train services was non-specific in form, and the composition and implementation of relevant policies were left to the Rail Regulator and Franchising Director. The Rail Regulator restricts the entry of non-franchised, open-access competitors to the service provision market. No new entry will be permitted on any route nominated by incumbent TOCs before 31 March 1999. Following a review of the situation, 'significant restrictions' (ORR, 1994, p. 19), which will permit only limited entry on certain nominated flows, will remain until 2002. However, even after 2002, the Regulator acknowledges that any further change to the existing regime will be incremental by nature, and restrictions will continue where the presence of competition would discourage major improvements to passenger rail services (ORR, 1994).

Therefore, so long as TOCs continue to run at a loss—or appear vulnerable to the threat of open-access newcomers—this kind of competition is likely to remain largely absent. Given that the Directors of Railtrack see ‘little prospect for . . . increased rail usage in the near to medium term’ (SBC Warburg, 1996, p. 13), restrictions excluding newcomers look set to remain well into the twenty-first century.

The Franchising Director, who supervised the transfer of franchises from the public to the private sector, promotes a great degree of harmony in the pricing strategies of nearly all TOCs who share route miles through a policy of compulsory inter-availability (OPRAF, 1996). By virtue of this arrangement, the lead operator—usually the TOC with the greatest commercial interest in a particular flow—creates through and inter-available fares and requires other TOCs which run trains on the flow to honour them. This requirement does not extend to advance purchase, train-specific fares such as APEX. Nevertheless, OPRAF itself acknowledges the limitations such a policy places upon the operation of a competitive market. The compulsory inter-availability requirement will only be lifted by the Franchising Director if ‘he considers that the benefits of inter-availability will be outweighed by the potential benefits of price competition’ (OPRAF, 1996, p. 186). Currently, the only passenger flow where the latter is considered to outweigh the former is that between London and Gatwick Airport. There are no plans to lift the requirement more widely at present. Interestingly, though, the policy of compulsory inter-availability may have been unnecessary as representatives of TOCs who share route miles have recently indicated at conferences the intention of their companies to work together, rather than compete, for the benefit of the railway as a whole (see, for example, *Save Our Railways*, 1996).

With competition so heavily restricted throughout most of the passenger railway industry, there remains only one area where it is practicable in the new structure. Coincidentally, this is where the big four could compete for traffic following the 1921 Railways Act: in the ‘frontier’ regions where TOCs’ territorial borders collide. Although some key passenger flows fall into this category—London–Exeter was mentioned earlier but other examples are London–Birmingham, London–Southend or London–Glasgow—instances of this kind are more limited now than in the 1920s owing to rationalisation trends which have occurred in the recent history of Britain’s railway industry (see, for example, *British Railways Board*, 1962). Despite the original intention of the 1993 Railways Act to produce a competitive passenger train service market, it is in fact the case that most TOCs will retain ‘effective exclusivity’ for the foreseeable future (OPRAF, 1996, p. 65). In other words, 25 regional monopolies have, with only a few minor exceptions, replaced BR’s national one.

The mechanisms used by the Rail Regulator and the Franchising Director to restrict competition in the provision of passenger train services confirm the first of two key similarities between the policy outcomes of the 1921 and 1993

Acts. Despite their significantly different methods and ideological underpinnings, both Acts effectively legislated to produce a passenger rail industry characterised by monopoly. The 1921 Act, formulated in a time of increasing political interventionism (Gray, 1995), restructured the railway industry to create four, vertically integrated railway companies. The big four were territorially based, and virtual monopolies in the sense that they faced competition from other railway companies only in ‘frontier’ regions. In contrast, the 1993 Act aimed to promote competition in the industry through the common carrier methodology. Twenty-five regionally based TOCs were created and designed to face competition not only from each other—where two or more companies share route miles—but also from open access newcomers. However, it is apparent from evidence presented so far that difficulties encountered throughout the legislative process, such as the need to maintain socially necessary, loss-making services, significantly altered the Act’s intended outcome. The diminutive existence of, and prospect for, competition within the passenger rail industry necessarily means that the 1993 Act is failing to meet one of its key objectives as TOCs are trading in ‘effective exclusivity’ (OPRAF, 1996, p. 65). TOCs parallel the big four in the sense that they too are, generally speaking, virtual monopolists facing meaningful competition only in frontier regions. The ability of monopolists to maximise profits by abusing their position has already been discussed in this paper. Regulatory measures taken by the 1921 Act in order to prevent the abuse of monopoly power were conceptualised as surrogate competition. Such regulation has also been imposed upon TOCs, and is explored below.

7. TOCS and surrogate competition

Surrogate competition has been divided into two categories for the purposes of this paper, economic regulation and quality of service regulation. The economic regulation of TOCs is effected through provisions made in franchise agreements. Unlike in the 1921 Act, no mention of specifics is made in the 1993 legislation. The 1993 Act instructs the Franchising Director that he must stipulate the provision of ‘reasonable’ fares in the franchise agreement if he considers that passengers’ interests so require (House of Commons, 1993: 28 (2)). The mechanism employed to achieve this is the RPI minus ‘x’ method, created in the early 1980s to regulate British Telecom (BT). The fundamental requirement of RPI minus ‘x’ is that regulated firms keep price increases at a fixed level below the rate of inflation for a given number of years (Thatcher, 1993). In this way, TOCs theoretically receive an incentive to increase efficiency as they are allowed to retain any profits they make within the specified period. Currently, ‘x’ is set at zero, but will increase to one in January 1999 where it will remain for four years. The Franchising Director has also indicted that

the price cap is likely to remain at RPI minus one after January 2003 (OPRAF, 1996).

Only certain fares are regulated, namely: unrestricted standard class return fares (which permit outward and return travel on any train); certain single fares for short journeys; 'saver' fares (which, subject to certain conditions, offer a discounted rate when used on most journeys over 50 miles) and certain standard class season ticket fares including all weekly season tickets (OPRAF, 1996). In certain commuter markets, PTEs are entitled to set fares and, as such, these will remain unregulated by OPRAF. In London, Cardiff, Edinburgh and Greater Manchester, however, a more comprehensive approach is taken to regulating the price of fares. A performance incentive regime applies to all season tickets, whereby failure to meet punctuality and reliability standards set within the franchise agreement can result in the price cap being increased by two percentage points to RPI minus three.

Quality of service regulation is again stipulated within the franchise agreement, details of which are contained in the *Passenger Rail Industry Overview* (OPRAF, 1996). TOCs are expected to maintain an operational environment at or above standards prescribed by National Conditions of Carriage (NCC) (British Railways Board, 1996). The purpose of the NCC is to outline the contractual obligations train operators have towards their customers. Each TOC is bound to produce a 'user-friendly' synopsis of the NCC—a passengers' charter—in order that customers may obtain a clear understanding of the services they can expect to receive. In particular:

the Franchising Director expects franchise operators to provide a commitment to publish independently audited figures, comparing actual performance with agreed standards for punctuality and reliability and to explain what compensation is available if performance falls below an acceptable level (OPRAF, 1996, p. 82).

The passengers' charter is also expected to outline TOCs' commitments in other areas of their operational environment such as: ensuring acceptable train capacities; providing information on services, fares and facilities; meeting the needs of disabled travellers; making alternative arrangements to transport passengers if services are disrupted; and disseminating information in advance of delays and non-emergency engineering works. Finally, TOCs are obliged to participate in ticketing and other schemes organised by the Association of Train Operating Companies (ATOC), in order to secure the provision of network-wide products to customers. Examples of such products are the national rail enquiries telephone service and discount rail-card schemes.

The existence of surrogate competition in the new railway structure is the second key similarity between the policy outcomes of the 1921 and 1993 Acts. In both cases,

surrogate competition was necessitated in order to prevent the abuse of virtual monopoly power. An exhaustive comparison of the two Acts' regulatory minutiae is beyond the parameters of the current paper. However, it is important to note one ironic difference between the different regulatory regimes, namely that the surrogate competition measures which resulted from the supposedly market-oriented 1993 Act are notably more comprehensive than those imposed by the specifically interventionist 1921 legislation. To illustrate, the RPI minus 'x' regulation, to which the TOCs are subject, makes no attempt to guarantee train operators revenue at a favourable level as was the case in the 1921 legislation. In terms of quality of service regulation, a comparable equivalent to the NCC was not imposed upon the big four.

To some degree, the extent of the TOCs' statutory obligations may reflect the different regulatory experiences of the governments of the 1990s and the 1920s. Legislating to prevent the privatised utilities, such as British Telecom and the water industry, from abusing their monopoly positions provided the Thatcher and Major administrations with an unrivalled opportunity for experimentation with, and the development of, suitable and effective regulatory mechanisms. Equally, however, it is probable that such exacting regulation was a result of the electoral unpopularity of the rail privatisation programme. The likelihood that public opinion dictated the maintenance of subsidies, and the introduction of PSRs, has already been discussed. However, evidence also exists to suggest that political and consumer pressure groups were instrumental in determining the comprehensive and stringent nature of surrogate competition. Partially because of reports which predicted, among other things, post-privatisation fare increases of between 50 and 130%, the rail sell-off became the most unpopular privatisation ever undertaken by a British government (The Guardian, 1993; The Economist, 1996). In May 1995, the policy of economic regulation of fares, 'a multi-billion pound sweetener to get passenger backing for privatisation' (The Guardian, 1995, p. 1), was announced by the Franchising Director. Although this is not to suggest that a change in policy was necessarily forced by a disgruntled electorate, it is one of a number of examples where specific regulation not included in the 1993 Act was imposed following obvious public consternation.

8. In conclusion

The railway industry in Britain has long been subject to the play of political ideologies. Although the industry was initially developed in a *laissez-faire* environment, governmental regulatory involvement from 1840 reflected the newly fashionable mood of increased political interventionism (Gray, 1995). A significant manifestation of the deepening interventionist trend was the 1921 Railways Act. The Act was formulated with a view to eliminating

the role of the market from the provision of passenger train services as far as possible, and four regional ‘monopolies’ were created in an attempt to improve the quality and efficiency of the industry. The Act’s provisions ensured a sizeable and active governmental role in the future of the railway industry by establishing regulatory mechanisms and institutions—so-called surrogate competition—to prevent the big four from abusing their monopoly powers. The operational arrangement created by the 1921 Act lasted until the outright nationalisation of the big four in 1948 (Ellis, 1959).

Following the election to power of the Conservatives in 1979, political focus shifted away from interventionist ideals towards the neoliberal philosophy of the competitive, ‘free’ market. Improving the quality and efficiency of train services by removing Britain’s railways from the public sector was explored throughout the 1980s (Zahariadis, 1995, 1996; Gibb et al., 1996), and BR was ultimately privatised as a result of the 1993 Railways Act. In direct contrast to the intentions of the 1921 Act, a key objective of the Conservatives was to re-introduce free market principles into the provision of passenger train services by ending BR’s monopoly and promoting on-rail competition. However, despite the contrary objectives of the two Acts, the present paper has shown that their policy outcomes have, in fact, been broadly similar in two key areas. First, the 1993 Act has also established monopolistic regional train operators. Although the Act provided the theoretical potential for liberalising the service provision market, the Major administration faced difficulties, such as the need to maintain socially necessary, loss-making services, which undermined the viability of competition as an organising principle. As such, measures restricting competition have been established to guarantee TOCs ‘effective exclusivity’ (OPRAF, 1996, p. 65) in their operations. Second, surrogate competition has been imposed upon the TOCs by the 1993 Act. The re-emergence of monopolies forced the Conservatives to introduce economic and quality of service regulation in order to prevent TOCs from abusing their monopoly positions. Somewhat paradoxically, the surrogate competition introduced as a result of the supposedly market-oriented 1993 Act has been shown to be notably more comprehensive than that imposed by the specifically interventionist 1921 Act. By achieving a policy outcome comparable with the 1921 legislation, the 1993 Railways Act has largely failed to meet one of its key objectives, namely to introduce competition into the provision of passenger train services. Rather than the market determining the future of the industry, the state, through regulation, retains effective control. Early indications given by the recently elected Labour administration suggest that, if anything, the role of statutory regulation in the British railway industry is likely to further increase over the coming years. It remains to be seen whether, as the first generation of franchises expire, such governmental influence will once again remove the responsibility for

running Britain’s passenger train services from the private sector.

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