The Evolution of the Privatization of the British Railway

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Introduction

The establishment of the railways is seen as "the most important event" in English history[1]. Railways have such an important status in the public imagination that there is an emotional attachment to them. From the opening of the Liverpool and Manchester Railway in 1830, the railway system developed quickly and was accepted as a normal feature of social life[2]. However, with the development of road haulage industry, with bus and coach services, which had spread throughout the whole of the country during the 1930s, railways had to compete with new rivals. Also, the drop in car prices meant that the middle class frequently used private cars and so the railways started to witness a drop in passengers. Thus, the railways faced great financial difficulties by the middle of 20th century. However, the railway companies, which were responsible for running the railways made no strategic planning against these fundamental changes[3]. Failure to invest and improve services, led to state intervention. The railways were nationalized by the Labour Government under the Transport Act 1947. Although the building and management of railways was a great private enterprise success story in the Victorian

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1 **Hibbs**, John, Railways and the Power of Emotion: From Private to Public Ownership, in Hibbs, John&Knipping,Oliver&Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 21-45),Institute of Economic Affairs (IEA), London 2006, p. 22.

2 **Watts**, D.C.H.,On the Causes of British Railway Nationalisation: Re-examination of the Causes, 1866-1921, Contemporary British History, vol. 16, 2002, issue 2, pp. 1-3.

3 **Hibbs**, Public Ownership, pp. 30-34.

period, *laissez-faire* approach did not last long and the railways became subjected to close state control[4].

The main aim of state intervention was to coordinate and to integrate the transport system but it was far from the market principles. By means of nationalization, the Labour Government hoped to protect the railways from financial disaster caused by the competition from the road haulage industry[5]. Yet nationalization did not solve the railways' financial problems and railways have continued to lose market share both in passenger and in freight. The railway industry was largely dependent on public subsidies since the 1950s. The Major Conservative Government started the privatization process to make better use of railways, to ensure greater responsiveness to the customer and to provide better value for money[6]. Nevertheless privatization left railways in chaos and did not bring the desired results. The privatization of the railways probably generated more controversy and more government intervention than all the other privatizations[7]. The Labour Government that came into office in 1997 was committed to returning the railways to the public. It opened a debate which put the railways back on the public sector agenda but it did not happen. Inside making big changes on the railway, they prefered to continue the process of privatization with some regulatory changes in the system.

Although the governments of the day made remarkable changes in the industry, nobody ever seemed to be satisfied with the results[8]. In

4 **Robson**, William A., Nationalised Industry and Public Ownership, 2ndEdition, George Allen and Unwin, London 1962, p. 32.

5 **Robson**, p. 32.

6 **Merkert**, Rico– **Nash**, Chris, The Restructuring of the Rail System in Britain- An Assessment of Recent Developments, in Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 71-104),Institute of Economic Affairs (IEA), London 2006, p. 72.

7 **Tyrrall**, David E., The UK Railway: Privatisation, Efficiency and Integration,in Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government(pp. 105-129),Institute of Economic Affairs (IEA), London 2006, p. 105.

8 **Glaister**, Stephen–**Travers**, Tony, New Directions for British Railways? The Political Economy of Privatisation and Regulation,Institute of Economic Affairs (IEA), London 1993, p. 9.

particular the regulatory role of the state has always been debated in the railway industry.

This article argues that from its inception of the railways, the state always has had an important role in the industry, and privatization did not change this position. The article will evaluate the developments in the British Railway (BR) in the light of the state's role. Firstly, nationalization is evaluated giving reasons for its introduction in 1948. Secondly, the privatization process, which was started in 1993 and completed in 1997, is assessed with its effects on the railway structure and service and the state's role. Lastly, the post privatization process, which started in 1997, is briefly examined again with its effects on the railways and state's regulatory role.

I. Nationalization Process of the Railways

It is a fact that the railway industry was born in the era of entrepreneurship and individualism[9]. During the 19th century railway companies, which were almost entirely self-sufficient and serving their own geographic area ran the railways[10]. In 1921 (Railways Act) the companies were amalgamated into four companies. Indeed this regulation is the first chapter of the long story of public regulation[11]. Nevertheless during the First and Second World Wars, the railways found themselves in a difficult financial situation due to the economic depression. But the main reason for the difficulty was the increasing competition of the road haulage industry and road passenger services. Four railway companies, making up the pre-war railway industry, demanded a state regulatory role against the road competition instead of improving their poor service and quality. The Labour Government nationalized the railways under the Transport

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9 **Wellings**, Richard, Rail in a Market Economy, in Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 211-240),Institute of Economic Affairs, London 2006, p. 237.

10 **Welsby**, John– **Nichols**, Alan, The Privatisation of Britain's Railways: An Inside View, Journal of Transport Economics and Policy, vol. 33, 1999, part 1, p. 56.

11 **Clegg**, Hugh Armstrong– **Chester**,Theodore Edward, The Future of Nationalisation, Basil Blackwell,Oxford 1953, p. 31.

Act 1947 to coordinate the whole transport system and to protect railways from severe competition and financial disaster[12].

The State took over an industry and imposed considerable public control on pricing and commercial policy. Under the Transport Act, The British Transport Commission had to submit its charges structure to a Transport Tribunal which had the power to reject it[13]. After nationalization the Railway Executive of the British Transport Commission was formed and the main objectives of the Commission established that "... to provide, or secure or promote the provision of, an efficient, adequate, economical and properly integrated system of public inland transport and port facilities within Great Britain for passengers and goods with due regard to safety of operation ..." (Article 3[1]). It is worth noting that the argument for nationalisation may be a pragmatic argument, but it is not easy to handle. It is difficult to coordinate the whole transport system with a single commission. *Knippings* argued that[14] the nationalization of the railways did not bring the desired results mentioned in the aim of the Transport Act. On the contrary, nationalization created a monopoly that destroyed both actual and potential competition in railway transport. In addition, the main aim of the nationalization, which was to protect railways from financial disaster, was not achieved by the Labour Government and the railway's financial situations got worse after the 1950s[15]. It got worse because the Government was unwilling to grant commercial freedom to the railways to compete with their rivals. These limited freedoms were compounded by poor management, confused organisation and a lack of supervision by the Treasury[16].

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12 **Robson**, p. 33.

13 **Reid**,Graham Livingstone–**Allen**, Kevin,Nationalized Industries, Penguin Education, Harmondsworth 1973, pp. 106-114.

14 **Knipping**, Oliver, Railway Privatisation in the UK – A Laissez-Faire Approach to an Interventionist Failure,in Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government(pp. 159-178),Institute of Economic Affairs, London 2006, p. 160.

15 **Welsby**– **Nichols**, p. 55-56.

16 **Loft**, Charles, Reappraisal and Reshaping: Government and the Railway Problem 1951-64, Contemporary British History, vol. 15, 2001, issue 4, p. 73.

In 1955, the Government started a modernisation programme costing £1.2 million to make the railways profitable. Large amounts were paid on investment in new rolling stock and infrastructure. It was thought that sufficient investment in the railways would be enough to save the railways from the difficult situation[17]. But that investment did not change the situation. Between 1956 and 1962, the railways operating deficits increased from £16.5 million to £104 million, but these losses were "only the tip of the iceberg of financial disaster"[18]. The railways continued to lose substantial sums of money and their market share in the transport system. New solutions had to be found to cure the weaknesses of the system. For this reason the British Transport Commission was divided and a separate British Railway Board was formed. *Dr. Beeching* was appointed as chairman in 1963 to produce a commercially viable railway and the Commission prepared a report known as the *Beeching Report*. The Report recommended the closure of the lightly used parts of the network with supporting the remaining parts of the system with development[19]. The thinking behind the report was that the railways should concentrate on those tasks which they could perform profitably[20]. But this attempt was rejected by the Labour Government. Although many British Railways routes were unprofitable, they were seen as socially and politically necessary[21]. It was accepted that "the railways could have social and environmental objectives and should not be judged on a narrow financial basis. The Government's support for railways was justified also on the grounds that road transport's externalities involve noise, pollution, congestion and accident costs"[22]. This was the first attempt to

[17] **Welsby**– **Nichols**, p. 56.

[18] **Loft**, p. 73.

[19] **British Railway Board**, The Reshaping of British Railways, 1963, (pp. 3-5). retrieved from. http://www.railwayarchive.co.uk/documents/DoT

[20] **Loft**, p. 71.

[21] **Shaw**, Jon, Design a Method of Rail Privatisation, in Freeman, Roger & Shaw, Jon (Eds.), All Change: British Railway Privatisation (pp. 1-29),McGraw-Hill, London 2000, p. 1.

[22] **Crompton**,Gerald– **Jupe**, Robert, "A lot of Friction at the Interfaces": The Regulation of Britain's Privatised Railway System, Financial Accountability & Management, vol. 19, November 2003, issue 4, p. 398.

reduce the public subsidy by reducing the network, which was not used effectively[23]but it failed.

Government's control over the railways increased up to 1979, but the size and the coverage of the passenger network remained virtually unchanged and government failed to set clear objectives for railway[24]. British railways had generally been seen as a "social railway" with a strong culture of public service engineering[25]. By the early 1980s the public expenditure pressure drew into attention to railway finances. At that time again a new inquiry was set up to examine railway finances. Not surprisingly the report known as the *Serpell Report* was met with strong criticism in Parliament and the media. The report had little effect and it was rejected by the Government. Once again politicians were afraid of the social consequences of the cessation of the network and looked for another solution. That is why the Government stimulated a drive for efficiency improvements to reduce the level of the public subsidy flowing to the railways[26].

It is generally agreed amongst scholars that the state ownership of the railways produced poor results in quality and value for money[27]. British Railways ignored the commercial realities of the market and it was led by operational and engineering consideration rather than the requirements of the market place[28]. Also nationalization brought continuous and inconsistent state interference in the management of the company. Politicians had always seen the railways as an area to be regulated. Furthermore, investments were allocated for political rather than

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23 **Welsby**– **Nichols**, p. 56.

24 **Welsby**– **Nichols**, p. 56.

25 **Tyrrall**, Efficiency, p. 106.

26 **Charlton**, Clive, The Structure of the New Railway, in Freeman, Roger & Shaw, Jon (Eds.), All Change: British Railway Privatisation (pp. 31-56),McGraw-Hill, London 2000, p. 31.

27 **Knipping**, p. 161, 163; **Hibbs**, John,Railway and the Power of Emotion: Seeking a Market Solution, in Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 46-47), Institute of Economic Affairs, London 2006, p. 46.

28 **Welsby**– **Nichols**, p. 57.

economic reasons[29]. The negative effects of the nationalization brought into question whether the state regulatory role in natural monopolies like the railways was necessary and what should be the role of the state in the railways? This question is again responded to by Conservative Governments differently during 1980s.

II. Privatization Process of the Railways

Secondly, now let us examine the privatization process, which started under the Major Conservative Government in 1993 and finished in 1997. The Conservative Government promoted free market policies to reduce public sector involvement after 1979. At the heart of this policy was the privatization of public-sector industries, particularly natural monopolies such as gas, water, electricity and telecommunications. The transport industry as a whole also experienced massive restructuring in forms of privatization and regulation such as British Airways, National Freight Corporation, coaches and buses all experienced deregulation or privatization. However, the privatization of the railways was particularly difficult because of their unique place in British public life. Moreover, the railways are neither profitable nor easily divided into parts to promote competition[30]. Because of the unique structure of the railways, the privatization of the service was not a priority of the Thatcher Conservative Government. The privatization of the railways was feared to become "the waterloo" of the Government. A decade of privatization activity had passed before the sale of British Rail was attempted[31].

During the 1990s the railways across the European countries, like in the UK had great difficulties of public finance and politics. Despite protection from competition, the railways failed to compete successfully

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29 **Hibbs**, Market Solution, p. 46.

30 **Gibb**, Richard– **Lowndes**, Theresa–**Charlton**, Clive,The Privatisation of British Rail, Applied Geography, vol. 16, January 1996, issue 1, p. 35.

31 **Crompton**,Gerald– **Jupe**, Robert, "Such a Silly Scheme": The Privatisation of the Britain's Railways 1992-2002, Critical Perspectives on Accounting, vol. 14, August 2003, number 6, p. 618.

with other modes of transport[32]. In 1991 the European Union (EU) prepared a directive which required railway infrastructure to be separated from operations in order to liberate services and increase the internal competition. To show the determination of the Government on its privatization programme, by 1992 the John Major Government proposed the privatization of the railways with the White Paper entitled "New Opportunities for the Railways". The Railway Act authorising privatization was based on the interpretation of European Directive 91/440 on the development of European Community's railways[33]. The privatization process was started in 1993 and completed in early 1997, just before John Major's Conservative Party lost the general election of that year[34]. The Government's aim of the privatization of the British Railway was "to see better use made of the railways, greater responsiveness to the customer, and a higher quality of service and better quality of service and better value for money for the public who travel by rail"[35].

However, the privatization of the railways was the last and the most complex privatization of the Conservatives[36]. Within the railway sector, the service was still regarded as a "natural" monopoly because of the fixed costs of the network and vertical integration. Moreover half of the costs of operating a railway are associated with providing infrastructure[37]. It is generally accepted that a single vertically integrated firm can fulfil the market requirements more cheaply than two or more[38]. Also selling a

32 **Knipping**, p. 159.

33 **Crompton– Jupe**, A lot of Friction, p. 399.

34 **Shaw**, p. 1; **Weidauer**, M., Transportation British Railway, in von Weizsäcker, Ernst Ulrich& Young, Oran &Finger, Matthias (Eds.), Limits to Privatization: How to Avoid Too Much of a Good Thing: A report to the Club of Rome(pp. 87-92), Earthscan Press, London 2005, p. 87.

35 **Department of Transport.** (1992). New Opportunities for the Railway: The Privatisation of British Rail, p. 19. retrieved from http://www.railwayarchive.co.uk/documents/DoT.

36 **Nash**, Chris A., Rail Privatisation – How Is It Going? Institute of Transport Studies,University of Leeds, Working Paper 497, 1997, p. 5.

37 **Crompton– Jupe**, A lot of Friction, p. 398.

38 **Starkie**, David, British Rail: Competition on the Network, inVeljanovski, Cento (Ed.) Privatisation &Competition: A Market Prospectus (pp. 178-189), Institute of Economic Affairs (IEA), London 1989, p. 179.

public monopoly, like railways into the private sector does not bring satisfactory results. Hence the promotion of competition is very important to reach the potential benefits of privatization[39].

Thus the privatization model was discussed heavily and finally a 'track authority model' was adopted to increase internal competition for privatization. According to this model the main railway system was divided into about 100 separate organisations to create market economies. Firstly, Railtrack which was a new publicly owned company took over the railway infrastructure from British Rail in 1994. At the same time all British Rail's other activities, including train operation and track maintenance, were divided into a large number of separate freestanding units, and these were privatized one by one over three years. The Railtrack Company was privatized in May 1996[40]. The company was the owner and operator responsible for the maintenance and management of track and other rail infrastructure. Government's regulatory bodies controlled the companies' activities and fees[41]. However this complex privatization model did not have the support of the railway professionals[42]. Opponents of the track-authority model pointed out that such an arrangement did not exist anywhere despite of the EU Directive. This type of structure was described as "unworkable", "unsafe" and "poll tax on wheels"[43]. An interesting comment about the privatization came from Conservative Party's shadow spokesman, Chris Grayling "we think that the complete separation of track and train into separate business at the time of privatization was not right for our railways. We think the separation has helped push up the cost of running the railways … Too many people and organisations are now involved in getting things done … As a result, the industry lacks clarity about who is in charge and accountable

39 **Shaw**, p. 1.

40 **Gibb– Lowndes–Charlton**, p. 42; **Evans**, Andrew W., Rail Safety and Rail Privatisation in Britain, Accident Analysis &Prevention, vol. 39, May 2007, issue 3, p. 510.

41 **Haubrich**, Dirk, UK Rail Privatisation Five Years down the Line: An Evaluation of Nine Policy Objectives, Policy& Politics, vol. 29, July 2001, number 3, p. 320.

42 **Crompton– Jupe**, A lot of Friction, p. 399.

43 **Edmonds**, John, Creating Railtrack, in Freeman, Roger & Shaw, John (Eds.), All Change: British Railway Privatisation (pp. 57-81),McGraw-Hill, London 2000, p. 57.

for decisions"[44]. It is important to note that after privatization, the state still controlled the prices that operators charge customers and provides a subsidy[45]. So privatization of the railways has never reduced the role of the state overall.

It is generally argued that "railway privatization has been a mixture of success and failure". There has been a substantial increase in the volume of the service and quality of rolling stocks since 1995. The UK has newer trains with higher speed capacity and greater comfort and that has been the achievements of the privatization[46].However, increasing public expenditure due to complex nature of the new railway structure is a failure of the privatization[47]. The level of government subsidy for the railways has risen considerably since the mid-1990s despite initial hopes that efficiency savings would in the medium term reduce the demand for taxpayer's support. The responsibility for this outcome clearly related to state interference because of the 1993 Railways Act, which made it virtually impossible to close loss-making lines[48]. Line closures would substantially reduce the need for taxpayer funding but government did not find this socially acceptable. Indeed, it is the political decisions taken by politicians that put railways on the edge of financial disaster. Also high expenditure on rail safety is another reason for the increased public subsidy. In 1999 the Government decided to roll out a new Train Protection and Warning System across the network at the cost of £585 million[49].

Natural monopolies, such as gas, telecommunications and railways have retained a significant amount of monopoly power since privatization. These industries have been expected to pursue commercial objectives and to improve efficiency, but have not had the capacity to exploit

[44] **BBC Online**, Torries Change Policy on Railways, 17 July 2006. http://news.bbc.co.uk/1/hi/uk_politics/5186196.stm.

[45] **Croizer**, Patrick, Why British Rail Privatisation Has Failed, Economic Notes No. 91, on May 25th 2001, p. 3.

[46] **Tyrrall**, Efficiency, p. 113.

[47] **Tyrrall**, David, The UK Railway Privatisation: Falling to Succeed?, Economic Affairs,vol. 24, September 2004, issue 3, p. 32.

[48] **Wellings**, p. 225.

[49] **Wellings**, p. 226.

consumers by charging high prices or providing poor services. Economic regulators have been established to protect customers. Privatization, in many industries has seen a "replacement of public ownership by regulation" and the state's role has changed from being "a producer of goods and services to that of the regulator of the producers"[50].

In the railways two regulatory bodies were established by the 1993 Railway Act to check economic and quality issues. The key economic regulator was the Office of the Rail Regulator (ORR), which supervised Railtrack's economic activities. The other quality regulator was the Office of Passenger Rail Franchise (OPRAF), headed by the Franchising Director monitoring the performance of the Train Operator Companies (TOCs). The Franchising Director also assumed responsibility for making subsidy payments to the TOCs and, in the long term, receiving payments from profitable franchises. Safety issues were overseen by Her Majesty's Railway Inspectorate[51]. It can be seen that regulation is the new type of state intervention.

III. Post-Privatisation Process of the Railways

Thirdly, we will analyse the post-privatization process, which started in 1997 with New Labour Government. The New Labour Government was committed to return the railways to the public sector but it did not stop the privatization process after coming into power. With respect to state regulatory control, the Strategic Railway Authority (SRA) was formed and took over the functions of the Office of Passenger Rail Franchising (OPRAF). It awarded and oversaw passenger franchises and consumer protection. It also was given the responsibility of strategic planning and coordination of rail policy and investment. It is intended that the SRA will work closely with local and national organisations in the public and private sector[52]. The aim of this regulation body specific to

50 **Veljanovski**, Cento,The Regulator Game, in Veljanovski, Cento, (Ed.) Regulators and the Market: An Assessment of the Growth of Regulation in the UK (pp. 3-28),Institute of Economic Affairs (IEA), London1991, p. 3.

51 **Crompton– Jupe**, The Privatisation, pp. 623-624.

52 **Charlton**, p. 56.

the railway industry was to prevent market failure and to make a balance between commercial interest of privatized companies and public interest. For instance, it was decided that the level of quality of services should be maintained after privatization regardless of whether they were profitable or loss-making[53].

Although regulatory bodies checked safety issues closely after the privatization, between 1996 and 2003, five fatal train collisions happened on the main railway system, at Watford Junction in 1996, Southall in 1997, Ladbroke Grove in 1999, Hatfield in 2000, and Potters Bar in 2002. The Hatfield accident was caused by a broken rail and led to a prolonged disruption of the network. It is argued that the objective of maintaining safety after privatization was not achieved[54]. A huge programme of inspections was undertaken by the Government. This led to an increase in Rail track's maintenance and operating costs of £644 million in 2000[55]. Railtrack Company was brought under administrative supervision in 2001 and government control increased considerably after these accidents. Thus, Network Rail, a new not-for-profit company was formed to run the track network and it also took over the maintenance of the rail network in 2003[56]. *Tyrrall* argues that increasing public expenditure, funding crises and serious accidents led to new government interventions into the railway system and caused the failure of Railtrack[57]. *Knipping* argues that railway privatization process failed and heavy state intervention term started[58].

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53 **Swift**, John, The Role of the Rail Regulator, in Freeman, Roger & Shaw, John (Eds.), All Change: British Railway Privatisation (pp. 1-29),McGraw-Hill, London 2000, p. 205.

54 **Evans**, 511; **Weidauer**, p. 90.

55 **Crompton**– **Jupe**, A lot of Friction, p. 411.

56 **Weidauer**, p. 93; **Tyrrall**, Falling to Succeed, p. 33.

57 **Tyrrall**, Efficiency, p. 109.

58 **Knipping**, 2006, p. 162.

Conclusion

To sum up, the railways always have remained open to state intervention since its foundation. The railways have been seen as different from other sectors and regulated largely by the state. The railway networks were mainly politically and socially and not economically managed. Although the railways were privatized in 1993, unlike other privatized industries they remained under state financial and political influence. The benefits of railway privatization, which were intended to remove the railways from political control, have never been achieved. Railways are tightly regulated with large public subsidies and therefore the market economy has never worked properly. This has brought the railways to the edge of bankruptcy and has increased dependency on public subsidies. Privatization could not change the financial situation of the railways and the public expenditure increased substantially. After five fatal accidents, state interventions have increased concerns for safety. The Labour Government changed the regulatory bodies' structure and the Railtrack Company, which was mainly responsible for infrastructure, was replaced with the Network Company. With privatization, the state's role in the railways has changed from public ownership to that of regulator of the producer. It is not surprising that railway as a strategic actor in the national policies will always be "playthings of the politicians"[59].

[59] **Booth**, Philip, Foreword, Hibbs, John &Knipping,Oliver &Merkert,Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 13-15), Institute of Economic Affairs, London 2006, p. 13.

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Knipping, Oliver, Railway Privatisation in the UK – A Laissez-Faire Approach to an Interventionist Failure, in Hibbs, John & Knipping, Oliver & Merkert, Rico. et al.(Eds.), The Railways, the Market and the Government (pp. 159-178), Institute of Economic Affairs, London 2006.

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