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Does rail freight market liberalisation lead to market entry? A case study of the British privatisation experience

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ABSTRACT

This paper considers developments since privatisation in the British rail freight market from both general and production supply side perspectives. It also reviews the literature relating to the US railroad partial deregulation in order to identify the main effects and drivers that result from major industry reform. What it finds is that privatisation of the railways in Great Britain has not been followed by the expected dramatic rise in rail freight carriage and more specifically in the provision of intermodal services. Overall tonne kilometres and domestic intermodal have risen considerably, however in both cases for (different) reasons that do not suggest real industry progress. New entrants to the industry have been few, and the sector has now reached a point of apparent stagnation. The research finds little evidence of prohibitive production characteristics in terms of scale and productivity effects, and therefore these cannot be viewed as being responsible for the lack of new entry and general industry progress. Such 'barriers' to progress therefore can only be related to demand, i.e. the economics of consumption. The over-riding conclusion is that key to future growth in the sector is continued productivity improvements and a more pro-active policy stance.

1. Introduction

Privatisation of the railways in Great Britain was intended to reverse the long term decline that was present at the time in the rail freight sector. The 1998 White Paper even went as far as to adopt as official policy English, Welsh and Scottish's optimistic target of trebling rail freight tonnes in the space of ten years. Some early 'successes' were achieved, and these are reviewed in the paper, however the period following this initial growth has seen few new entrants and, despite gains in the intermodal sector (which are also discussed later), the industry appears to have now reached a point of apparent stagnation. This appears to have occurred in both the bulk/general freight haulage and intermodal sectors.

Arguably the largest operational constraint facing rail freight services in general, and particularly rail based intermodal, are the basic underlying economics of operating in the market. 'The market' is a generic term that can be used to describe a large range of issues that vary from fairly simple concepts such as basic profitability to more complex ones like contestability and productive efficiency. All of these issues can have a massive impact on the effectiveness of policy, to the point of rendering it completely ineffectual. The main aim of this paper therefore is to examine one particular aspect of 'the market', that of production economics, in order to gain a better understanding of the potential reasons for the lack of market entry or real industry progress of British rail freight since privatisation.

The paper continues with a brief overview of rail freight as part of the nationalised British Rail, before considering the reforms implemented as a consequence of the Railways Act 1993 and a broad overview of the evolution of the industry since privatisation. The US experience with deregulation is then examined to identify the main drivers/issues that arise out of major rail freight reform, before factors surrounding the production economics of British rail freight are estimated and analysed. The paper ends with some general conclusions, implications for management practice and points for further research.

2. British Rail freight in the nationalised era

Great Britain, like most countries throughout Europe, saw substantial declines in outright tonnage in rail freight over a fairly lengthy period and, more markedly, a virtual collapse of its market share. This 'long term' decline is shown graphically in Fig. 1, which outlines the trends in the four main freight modes since 1953 as measured by tonne kilometres.

Fig. 1 in some ways actually masks the long term decline of rail freight, mainly due to the massive rise in the use of road haulage — over the whole period this on its own almost exclusively accounts for the four fold increase that has occurred when all four modes are added together, and the doubling in more contemporary times (i.e. since 1980). For information, water transport is almost exclusively related to the transportation of crude oil and hence rose with the

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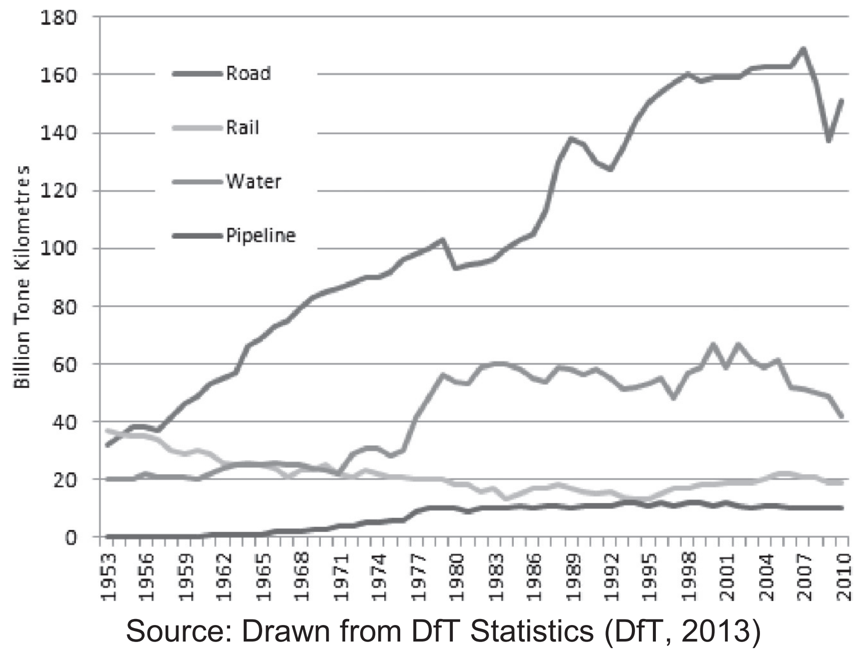

Fig. 1. GB freight transport modal trends 1953 to 2010.
Source: Drawn from DfT statistics (DfT, 2013).

development of the North Sea oil fields. On closer examination therefore, it can be seen that rail's market share has fallen considerably, from 42% in 1953 to 10% in 1980, and since then has varied between 6 and 10%, although has been generally rising since privatisation in the mid-1990s.

The main reasons for this long term decline are open to debate, but are closely linked to major structural changes in the British economy over time, which has radically shifted from traditional heavy industries where carriage was well suited to rail, towards lighter industries in which rail freight is far less economically competitive. The period has also been characterised by the move from Fordism to post-fordism production with the need for flexibility and just-in-time logistics. A third possible reason arises from the suspicion of an inefficient nationalised operator where passenger operations historically received priority and one that lacked the ability to adapt to the changing business environment.

3. British Rail freight pre and post privatisation

Prior to privatisation, within the nationalised operator rail freight was organised into four business divisions, Trainload Freight, Freightliner (container traffic), Rail Express Systems (parcels) and Rail Freight Distribution (Channel tunnel operations). Under British Rail's sectorised structure, each of these divisions operated as a separate profit centre within the corporation. Rail freight was completely unsubsidised, with grants only available under the Railways Act 1974 to third parties to install sidings. It was however indirectly subsidised through the (internal) infrastructure charging system, where on most parts of the network freight only paid the marginal cost of its infrastructure charge due to BR's division (and costing) of the whole network by prime user. The organisational structure was aimed at giving more focus for each profit centre on the market, and whilst for rail freight this seemed to have little effect on carriage, it did have a massive effect on productivity. Cowie (2010a) found efficiency improvements over the ten year period of reorganisation to be substantial, at around 11% per annum. This was a classic case of the eradication of x-inefficiency (Leibenstein, 1966), where increased focus on the market (rather than on internal processes) led BR to withdraw from the less than wagonload market, dispose of countless excess wagons (around 120 k) and close a large number of depots that were simply uneconomic. The whole process led to the eradication of massive inefficiencies in the whole operation, and resulted in the very high productivity gains that were estimated.

Under the provisions of the Railways Act 1993, BR freight was split into six companies, each of which was offered for private sale. These companies were basically the BR freight sectors, with Trainload Freight, by far the largest of these, divided into 3 separate companies. It was recognised very early that it would be difficult to sell these as separate entities, and this ultimately proved to be the case. The first sale occurred at the end of 1995 when Rail Express Systems was sold to English, Welsh and Scottish Railways (EWS — formed by a consortium led by Wisconsin Central), and this was quickly followed by the sale also to EWS of the three trainload companies and Rail Freight Distribution. Freightliner was sold to a management buyout in 1996 and set up its heavy haul business in competition to EWS in 2003. Canadian National bought Wisconsin Central in 2001 and sold EWS to DB Schenker (formerly known as Railion) in 2007.

Since privatisation, new entrants to the market have been very few. Direct Rail Services was created in 1995 by British Nuclear Fuels (now the Nuclear Decommissioning Authority) to operate nuclear flask trains. This remains the bulk of its business, however the company have successfully expanded into the intermodal market as traction provider for services arranged by 3PLs (Monios, 2012). GB Rail Freight was formed in 1999 as an offshoot of the Anglia Railways passenger franchise. The company runs mainly intermodal and coal haulage services, and has changed ownership several times since its formation. It is now currently owned by Eurotunnel. Colas Rail was formerly known as Seco Rail, and began operations in support of the railway engineering holding company. The company subsequently diversified into timber haulage, and its portfolio now also includes steel, coal and some intermodal, although with around 3 to 4 services a day, operations remain relatively low key.

In addition to those mentioned, three other companies have entered the market during this period. National Power operated trains hauling coal for its power stations under open access regulations during the later stages of the nationalised era. These were subsequently acquired by EWS in 1998. Advenza Freight operated a (very) short lived pallet service between London and Glasgow in 2004, and Jarvis Fastline commenced operations in April 2008 by operating a container train to Thamesport on the Isle of Grain. The company was also successful in

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