What is performance in railways? How can it be achieved? (How) does market organization matter? **A view from ORR**

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Performance and Governance in Railway Markets

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OFFICE OF RAIL REGULATION

Some remarks on the role of economic regulation…

- Competition is preferable to regulation
  - Regulation needs to focus on the natural monopoly
  - Opening up competition / contestability is important
- Aim of regulation is to mimic effective market outcomes
- Regulators don’t run companies or make decisions on structure – they need to deal with the structure that they inherit but…
- Regulatory decisions should promote the evolution of a structure that yields efficient and innovative performance

Looking at GB rail…

- Vertically separated
  - Fair, transparent and non-discriminatory access
  - Liberalisation and competition of train services
  - Independent regulator – focused on infrastructure, applying conventional “incentive based regulation”
- But incentives weaker in rail
  - Network Rail has weaker incentives for efficiency: company limited by guarantee, financial indemnity
  - Franchised operators insulated from changes to charges
  - Lack of domestic comparability on infrastructure performance

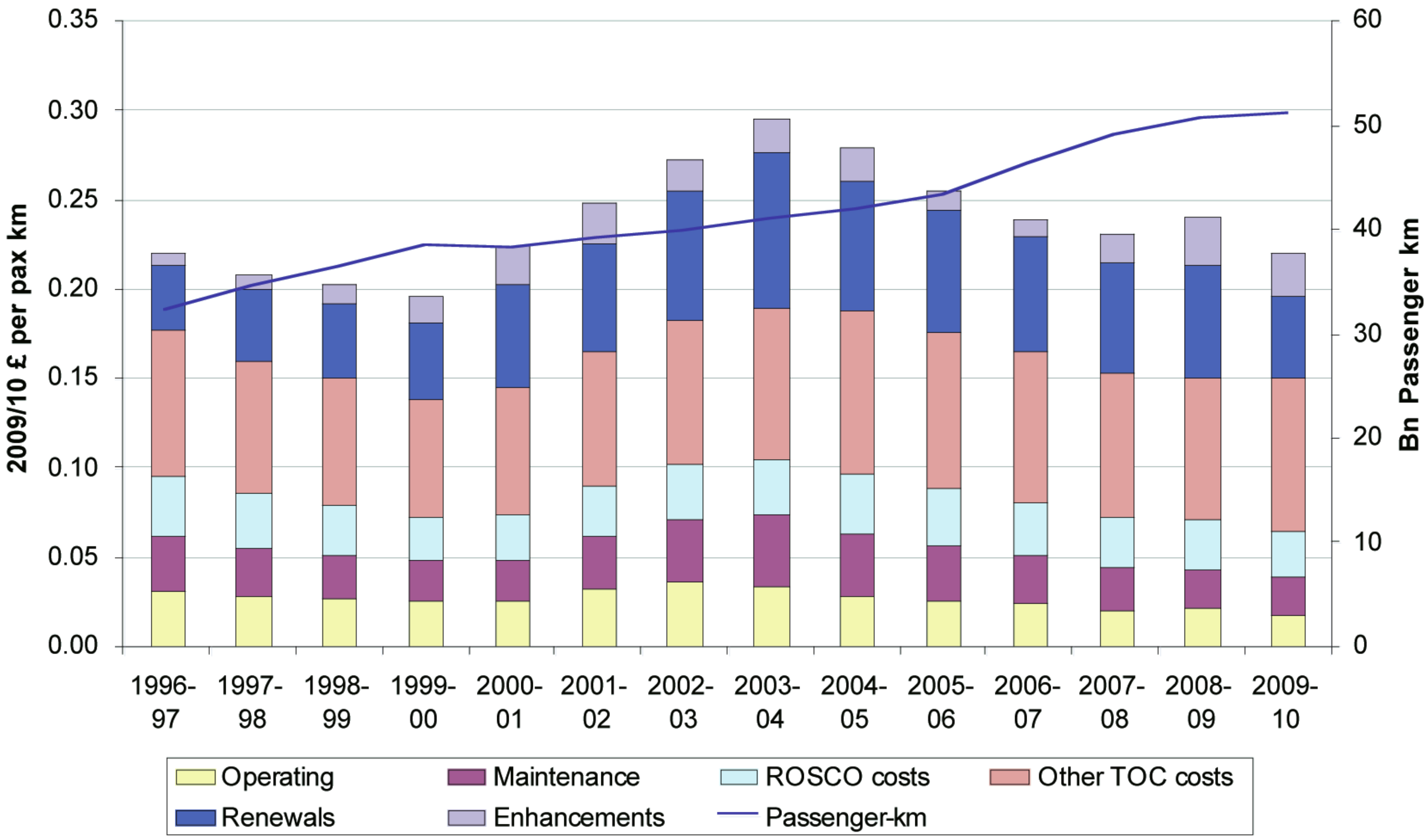
Putting it into practice in GB

- Periodic review process – similar to concept of MACs
- Set performance targets and access charges for the infrastructure manager for five years
  - In context of government requirements and financing
  - Use of incentives – financial and non-financial
- Performance targets/outputs and access charges are largely fixed for five years
- ORR monitors and enforces delivery and publishes assessments

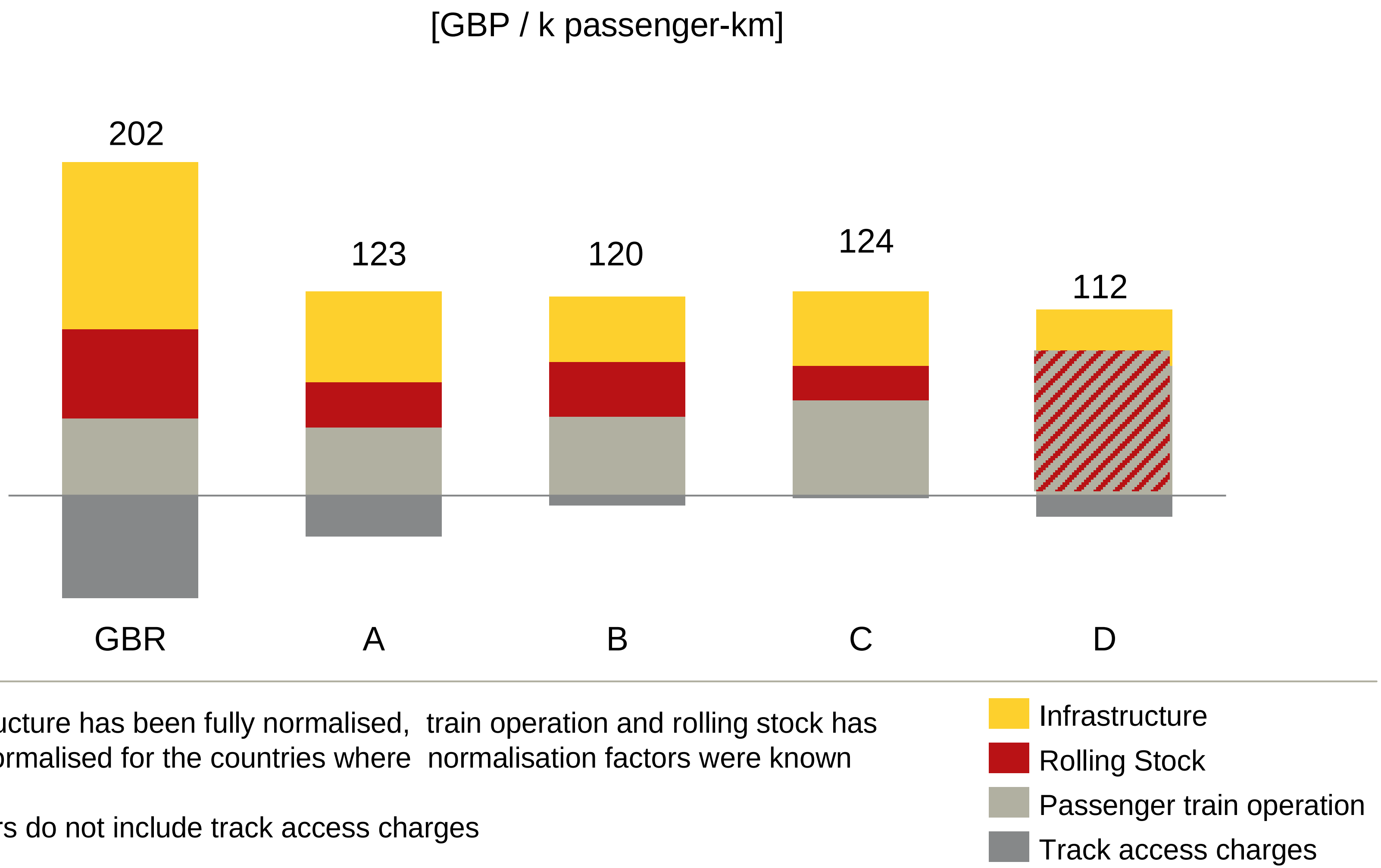
Is the GB model flawed?

- Criticisms of the GB approach… does it provide evidence of a fundamentally flawed model? **No**
- Fastest growing railway in Europe, performance, safety and asset condition compare well…
- But serious issues with the GB privatisation model…
  - Asset knowledge and outsourcing strategy
  - Loss of focus on the track-train interface
  - Adversarial industry relationships
  - Divergence of incentives
- Came to a head with Hatfield accident in 2000. Period since has focused on recovery and re-organisation
- Costs exploded and remain too high

But costs are too high…



GB rail costs do not compare favourably…



1) Infrastructure has been fully normalised, train operation and rolling stock has been normalised for the countries where normalisation factors were known

Numbers do not include track access charges

McNulty review of rail value for money

Causes of problems…

- Fragmentation (including separate regulation)
  - Complex legal and contractual framework
  - Poor relationships
  - Lack of openness and transparency
- Government involved in too much detail
- Poor alignment of incentives

Solutions include…

- Focus on cost reduction
- Transparency
- Industry leadership / government step back
- Less tightly specified and longerfranchises
- Incentive alignment
- Move to single regulator
- Improvements to structure…