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A "fresh start" or the "worst of all worlds"? A critical financial analysis of the performance and regulation of Network Rail in Britain's privatised railway system

Robert Jupe

Kent Business School, The University, Canterbury, Kent CT2 7PE, UK

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Abstract

The purpose of this paper is to examine the degree to which Network Rail, the new not-for-profit infrastructure company owned by members, has provided a "fresh start" for Britain's privatised railway system. Rail privatisation was predicated on the belief that surplus value could be created through redundancies and deskilling in a loss-making subsidy-dependent industry. Network Rail's predecessor, Railtrack, followed a profit-maximising agenda and collapsed into insolvency in 2001, after several years of poor performance. Unlike Railtrack, Network Rail is not under pressure to pay dividends to shareholders, and so in theory can focus on the maintenance and renewal of the infrastructure. However, its reliance on debt rather than equity finance, combined with escalating infrastructure costs, means that its annual borrowing costs have reached £1 billion. Thus, the nominally private company is only viable because of substantial subsidy and explicit government support for its borrowing. Further, the bulk of its expenditure is on renewals work which is outsourced to contractors aiming to maximise surplus value. The paper uses critical financial analysis to show the extensive and continuing transfers from the taxpayers and passengers to the financial elite, highlighting distribution issues which have been largely missing from the policy debate over Network Rail's creation.
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Keywords: Railway privatisation; Corporate governance; Network Rail; Performance indicators; Regulation; Risk transfer

E-mail address: R.E.Jupe@kent.ac.uk.

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1. Introduction

Privatisation was conspicuous by its absence from the successful 1979 Conservative election manifesto, which focused on issues such as deregulation, monetary discipline, and reductions in income tax and bureaucracy (Marsh, 1990, p. 2). Buoyed up by their triumph in the 1983 general election, the Conservatives led by Prime Minister Margaret Thatcher then developed incrementally a wide-ranging privatisation programme in Britain. Amongst the more prominent privatisations, nationalised monopoly utilities such as gas and electricity were sold into private ownership through share flotations. Various motives lay behind the privatisation policy. Early debate was dominated by economic arguments about promoting efficiency through private ownership and market disciplines (Flemming and Mayer, 1997; Goodman and Loveman, 1991; Letza and Smallman, 2001; Ogden, 1997; Shaoul, 1997). Later arguments focused on privatisation's role in reducing the role of government and raising revenue to reduce public sector borrowing (Letza and Smallman, 2001, p. 66; Ogden, 1997, pp. 529–530; Shaoul, 1997, p. 480; Vass, 1992). Additional arguments wielded by Conservatives in support of privatisation included extending share ownership (Shaoul, 1997), and weakening the power of public sector trade unions (Letza and Smallman, 2001). This paper focuses on the performance and regulation of the last industry to be privatised by the Conservatives: rail. In particular, it examines the performance and regulation of the railway infrastructure provider, Network Rail, which replaced the original infrastructure owner, Railtrack, in 2002.

The key element in the fragmentation and privatisation of the nationalised rail industry, British Rail (BR), was the vertical separation of infrastructure and train operations. This principle had encountered severe criticism even in circles sympathetic to privatisation. At a Centre for Policy Studies conference in 1988 it was pointed out that the track authority would occupy a monopoly position, would be remote from customers and that investment might prove difficult to attract (Murray, 2001, p. 11). Despite these implicit risks, the Major Government adopted this fragmented model. It was defended on the grounds that a separate infrastructure authority was needed in order to take the sunk cost element out of rail provision, and so facilitate the franchising of the train operators (Jupe and Crompton, 2006, pp. 1036–1037).

Rail privatisation was only completed in early 1997, shortly before the general election which swept the Major Government from office. Privatisation meant that the integrated railway industry was broken up into various constituent parts: infrastructure, train operations, rolling stock, and engineering and maintenance. The new system allocated a central role to a regulated public limited company, Railtrack, which was the industry's monopoly infrastructure provider. Despite the fact that it was the regulator's duty to ensure Railtrack could finance its activities, the company collapsed into insolvency in 2001, after several years of poor performance. Railtrack's collapse offered the Labour Government, led by Tony Blair, "an unprecedented opportunity to reassert its socialist credentials" by renationalising the company (Whitehouse p. 234). However, Railtrack's replacement was another private sector company – Network Rail. The key differences between it and Railtrack were in its financial and corporate governance structures. Network Rail was established as a debt-financed, not-for-profit private company limited by guarantee, which was accountable to members rather than to shareholders. Two years after its creation, the National Audit Office (NAO) argued,

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