The essence of railways

by Gottfried Ilgmann[1]

I. The network: the essence of railway

What is the Deutsche Bahn (DB) up to in Germany? After having made some important take-overs (Schenker; Bax Global) the Deutsche Bahn likes to present itself as “Mobilitätskonzern“ (the mobility group), in which international logistics assumes an equal importance with historical railway activities. The DB is trying to give the impression that its success in the dynamic market of logistics is of such overwhelming importance that the weaknesses the group has in the historical railway market are negligible. However, if one looks at the creation of real added value within the group, one sees a different picture. The added value created by the logistics division amounts to only one fifth of the overall added value created by the organisation as a whole.

The other four fifths of the added value created by the DB are provided by:

- The provision and handling (maintenance, operation of signals etc.) of the railway network (“network“)
- The operation of trains on the tracks (“transport“)

[1] Gottfried Ilgmann, Habersaathstr. 36 B, D-10115 Berlin, G.Ilgmann@gmx.de, www.G-Ilgmann.de

Today the federal government is financing the investment necessary to provide the network, thereby freeing the DB of those costs. In order to give a clear-cut picture, one has to include this “free lunch“. The value added by both the “network” and “transport” then becomes nearly equal[2].

It is important to know that these are the true proportions and thereby to understand the importance of the network, for otherwise one will not understand the agitated debate which has taken place regarding the future of the Deutsche Bahn over recent years.

Railway traffic in relation to road traffic has become a niche product. This was a view already shared by the federal commission on railways (“Regierungskommission Bahn”) which laid the foundations for the launch of the new railway group in 1994. For all the efforts at reform nothing has really changed since then (market shares in 2005: 9% for passenger traffic and 17% for freight traffic)[3].

What are the reasons for the economic weakness of the DB? Are they to be found within the network or within transport?

Lobbyists of the Deutsche Bahn like to argue that the network is the part of the rail system which, under constitutional law, falls under the responsibility of the federal government[4]: it is not profitable. From this argument stems the calculation of the cost of using the network (the prices for the railway slots = “Trassenpreise”) which produces such a low price that transport becomes profitable. It is for this reason that the network is not able to cover its costs, which in turn forces the federal government to step in to provide the finance for extension and modernisation of the infrastructure.

An integrated group like today’s DB therefore has strong incentives to plan its systems in such a way that transport costs will be low and network costs (with the federal government paying for the investment) relatively high. There are many opportunities for doing this.

---

[2] In road traffic (federal motorways and federal roads) the situation is different. The share of the allocation of roads and the management and operation of the infrastructure (maintenance, administration of traffic lights and signs, policing etc) in creating added value accounts for approx. 10%. This means that within road traffic 90% of the creation of value is subject to competition – and has been for decades. Refer to Ilgmann, Gottfried: “Fahrwegkosten im Straßen- und Schieneverkehr “in: “Zeitschrift für Verkehrswissenschaft, Heft 4/1993“.

[3] Figures as stated by the Deutsche Bahn AG.

[4] Article 87e GG, No. 3 and 4.

First example: Guidance and track safeguarding by route or by vehicle?

Depending on the type of track (and on its use by trains) one has to decide how the cost of providing the necessary steering and safety devices can be shared equitably between the tracks and the trains. If the division of costs is done on the principle that each side pays for "what it has installed", the DB would prefer those systems that lead to low costs on the transport side, that is on trains and wagons, and high costs on the network side, that is on the tracks, because those costs will be met by the federal government.

Second Example: Electrification or Diesel-power?

If everything was to be decided according to rational criteria one would substitute diesel engines for electric ones if the comparison between the performances of the two (towing capacity, speed, acceleration), and the costs of providing the electrified tracks would justify the electrification of a specific railway line. In reality, the belief in the blessings of electrification is rooted deeply within the rail road community and politicians tend to believe it as well ("electrification is sexy"). One would electrify fewer tracks if transport had to pay the full costs of transformation - including the interest charges as well as the depreciation on the investment.

If a third party pays the costs inefficiency and wastefulness will be generated. In the long run this means asking too much of the taxpayer. Railways therefore only have a future if the federal government organizes the network, the essence of railways, in such a way that it will be extended, managed and marketed in an efficient way. Only with an efficient network will railways have a future – and that is only if the railways are to be regarded as being a part of an efficient and integrated European production site.

II. The target: an increase in network profitability

The federal government has to alter its future policy so as to achieve the cost-effectiveness of the network, and this can be done on three levels:

- The extension of the network should be planned according to the demands of the whole transport sector and not just be planned by the transport division of the Deutsche Bahn AG. One also has to stop those regional reference projects that cost billions, such as the construction of

Stuttgart's main station as an underground station ("Stuttgart 21") or the high velocity track from Hannover to Hamburg and Bremen (the so-called "Y"), which results in a reduction of only ten minutes travelling time. Instead the investment provided by the federal government should be used particularly for the removal of existing bottlenecks within the network. This would include mainly unspectacular measures designed to allow the operation of more freight trains on the network.

- The management of the network has to become more efficient. This is of course a continuous task. In today's integrated DB group, there is little incentive to reduce over-staffing. Instead the federal government is asked by the DB to provide more subsidies because of the state's responsibility for the railway infrastructure. It is probably because of this that the union Transnet will only agree to the initial public offer (IPO) of the DB if it is done as an integrated group[5].
- The railway slots for trains (the "Trassen") have to be marketed actively. Potential clients must be considered as being the whole of the railway transport sector in Europe. The network capacity could be fully utilised. Since more profit would be generated from the tracks, the payments of the federal government to the network operating company could be reduced. Today's integrated DB group faces a balancing act: if it invites the whole of the railway sector to use its network more efficiently, it will cause its transport branch to be subjected to increased competition.

The federal government should organize its network in such a way as to give the board of directors of the network company a strong incentive to create a profitable business out of its tracks and stations. This would be in the best interests of the federal government.

III. How do our neighbours organize their networks?

In this section Great Britain and France (those with the largest networks after Germany) and Switzerland (Europe's leading country in terms of railway trips per inhabitant) have been singled out.

[5] For further information refer to Section VIII.

Great Britain has organized its network and transport within different companies following privatization in 1996. There were objective reasons for the separation. Originally the privatization of the network was not part of the project. The Conservative majority took a hasty decision on the question before the general election of 1997. Being faced with a possible election defeat, it was thought that the privatization of the network would make the whole process irreversible.

The privatization of the network was therefore made for short-sighted party-political reasons and it went wrong. The investor who took over the network was only interested in short-term profit, causing the already ailing network to go further into decline.

Therefore Great Britain re-purchased the privatised network in 2001 from its shareholders and began its rehabilitation. British railways are now thriving: a 40% increase in passenger transportation, and a 60% increase in freight transport has occurred. Even the British railway unions are content. The number of jobs within the railways sector has remained at a constant level as a result of this success, although they are now divided between more, and new, companies. In addition the British network operator, Network Rail, is now making a profit.

In its press releases the DB denounces the British reform as an argument against the separation of network and transport. It is a clumsy piece of agit-prop.

The separation of network and transport was not the error behind the initiative, but the privatization of the network. This error was corrected by the British. Now the DB wants to repeat the very same mistake – by privatizing the integrated DB group, including the network.

Representatives of Great Britain were so appalled by the way in which the British railway reforms were discredited by the DB, that they staged a conference in their embassy in Berlin in the summer of 2006. The ministry of transport, the regulatory authority, transport companies, passengers' associations and unions together made a presentation detailing the outcome of the British railway reforms. The picture they painted was impressive. Through the regulatory framework and professional regulation they achieved the effective handling of a natural monopoly in such a way that the whole railway transport industry is not only asserting itself over other means of transport, but is in fact increasing its market share.

Our own discussion about the German railway reform remains on a low level. The German transport minister acts as assistant to the egoistic desires of the DB board of directors. Obviously he does not understand his principle role as regulatory policy maker.

France did separate its network from the French railway company SNCF and gave it to the state-owned company RFF (Réseau Ferré de France). It is the RFF that is responsible for setting the track prices and planning any network extensions.

In doing so the French government accomplished the removal of the SNCF's “strategic influence“(a figure of speech used by consultants) over the network. The SNCF is now no longer capable of exerting influence over the network in its own sectarian interests. Instead the RFF is determining the guidelines for the railway network in the interests of the whole transport industry. Until now the RFF has exercised an incorrectly understood solidarity with the SNCF and has made network accessibility for any third party very difficult. However, this behaviour has changed in recent times and has now been reversed. On the 5th of September 2006 during an appearance before the Association of German Transportation Companies (“Verband Deutscher Verkehrsunternehmen“, VDV) RFF-director Jean-Micheal Richard invited all railway transportation companies to make use of his unused network capacity. It is likely that the RFF will in the future invite tenders step by step for the operation of the network, which up to now has been exclusively entrusted to the SNCF.

The emancipation of the RFF is only possible as long as the French State is the sole owner of the SNCF. Only then can the French government delegate the authority for network management from the SNCF to the RFF. This would not be possible if there was a private investor involved. In order to be able to do things the French way, Germany would have to separate its network from the DB before a privatization and would then have to determine explicitly when the remaining authority of the transport group over the network would be transferred to the network company.

In Switzerland (associated with the EU by means of bilateral treaties) the federal Swiss railways (Schweizerischen Bundesbahnen, SBB) own about 60% of the network. The remaining 40% (standard gauge as well as others) are in the hands of regional railways. Their shareholders are for the larger part the Swiss Federation and the cantons, but local authorities and private investors also own shares in them.

The strict application of the principle of subsidiarity should serve as a model for Germany: the cantons have responsibility for the function and the financial aspects of those networks with a regional importance. Despite this, the federal government is still partly co-financing these functions. The network of the SBB is on the one hand taken care of by the federal government under a four year performance request ("Leistungsauftrag"), and on the other - for large projects like the Alp crossing NEAT - by special instruments for project financing.

The SBB, in cooperation with the biggest regional railways, has established a railway slots marketing system, which is open to all railway companies. It also offers some extra services[6]. The extension of the (federal) network is done under the thorough supervision of the Berner ministry of transport (Bundesamt für Verkehr).

But now the SBB is changing its traditional opinion, that is that network and transport have to be in the hands of one integrated company. The retiring SBB boss Benedikt Weibel has started a discussion about selling the freight division of his company. His argument is, in short, that the SBB, whose origins lie within the public sector, will not be able to survive the heavy competition in this market.[7]

A further step towards separation: The "Lötschberg*scheitel*tunnel" (the old tunnel) belongs to and is managed by the BLS AG[8]. The federal government is at present financing a "Lötschberg*basis*tunnel" (a new basic tunnel), which the BLS is allowed to manage from its completion at the end of 2007 onwards. The condition for this is that the BLS has to outsource its complete network (including the two tunnels) to a company, which is dominated by the federal government. This could be a first step on the way to a general separation from network and transport in Switzerland.

---

[6] Most of these services (and those important for competition) are still being offered by the railway companies with networks or their transport divisions to more or less unregulated "market prices". Particularly in freight transport this leads to a distortion of normal trading conditions.

[7] This is quite contrary to the position of the board of directors of the D, which has been buying logistic companies all over the world. Refer also to chapter VI.

[8] The BLS AG was born out of the merger of the old BLS (Bern-Lötschberg-Simplon-Bahn) with the Regionalbahn-Mittelland (RM).

In any case in its master plan “Bahnreform 2“ the federal government wants to divide the Swiss network into a basic (Grundnetz) and a completion network (Ergänzungsnetz).[9] The basic network will include the standard gauge of the SBB as well as the important parts of the standard gauge sections of the regional railways. The federal government will then be financially responsible for its construction, its management and its maintenance. The completion network – standard gauge with regional and local character and other gauges – will be under the responsibility of the cantons.

In our most important partner countries the separation of network and transport has been either already executed (GB) or is strictly (F) or pragmatically (CH) being pursued. According to the board of directors of the DB the so-called synergies between network and transport, which the DB states to be around several billion Euros a year, can only be called upon in an integrated company. Obviously, our neighbours have a different opinion on this point.

IV. The demands of the EU: Competition on the tracks

There is no doubt in Europe that railway transport should be organized in such a way as to ensure competition. Through this there will be competition in innovation and cost-reduction, which will render railway transport better and more affordable in comparison to other means of transport, especially when compared to road traffic. This also applies to local traffic in order either to make it operate with less deficit or in some cases to make it profitable.

In Germany the federal government provides the individual states with more than 7 billion Euros per year for local traffic. From this sum the states use a part for local traffic such as buses, trams and underground railways as well as for investment in local railways. However, the largest part of this money, about 5 billion Euros, goes into the ordering of trains for local traffic. This should only happen by public tendering accompanied by the question, “Who provides the best combination of price and quality for the desired range of trains (capacity and frequency)? “

[9] The draft for this was rejected by the Swiss Parliament in 2006, but will shortly be submitted again by the government.

However, only a small part of the local traffic has been subject to public tendering in such a “competition for the market“. The DB has been highly successful in preventing faster and more extensive tendering by making long term traffic contracts with the states. The states have accepted this because the DB assured them that it would take into account the respective interests of the states when making federal investment in the railway network[10]. As recently as 2006 the EU has made this procedure more difficult after it threatened an appeal before the European Court of Justice for the violation of European law.

The EU has enacted guidelines which were made in order to increase competition in the railway sector. The federal government has to turn them into German law. The DB is pressurising the federal government into implementing the guidelines in such a way as to produce the smallest possible impact. For example, the former minister of transport Kurt Bodewig founded a working group (“Task Force“) on regulatory policy and announced that the separation of network and transport was, “not a question of if, but only one of how“. With the help of chancellor Gerhard Schröder DB boss Hartmut Mehdorn had himself invited to join the task force, carrying through his idea of an integrated railway company. Bodewig was made to leave office in 2002.

The DB is afraid that faced with the future implementation of the EU guidelines it will lose market shares to its railway competitors (the “Newcomers“). This fear is justified. The DB has staff costs which are far too high. The wages paid by the DB are 25% to 30 % above the level paid by comparable companies.[11]

The consensus with the unions was achieved by guaranteeing their members’ jobs within the company. This will make it difficult, now and in the future, to reduce the number of employees. The DB also has a top-heavy organisation with several company head offices. The staff costs of the company are at least 50% higher than they should be in a competitive firm due to high pay agreements with the unions and an oversized staff.

[10] Not only did the DB use priority in investments as an incentive, but it also made specific threats. These ranged from the transfer of jobs to the end of ICE connections and they are the subject of complaints to the EU, for example the “Nachprüfungsverfahren“ in 2003 by the Connex Regiobahn GmbH against the states of Brandenburg and Berlin: “Praxis der Auftragserzwingung durch den DB-Konzern“.

[11] Booz Allen Hamilton in his expert opinion for the federal government: “Primon-Gutachten”, January 2006. The figures are in the non blacked out confidential report, which was available to the Süddeutsche Zeitung, cited after the DVZ of the 21st February 2006.

After the railway reform of 1994 the federal government should have constructed a long-run frame work for competition, which would have been calculable and without any room for misinterpretation. This would have forced the DB to become profitable. Instead the federal government remained inert. All ministers of transport have handed over the frame work for action within the railway sector to the respective DB board of directors.

Compliance with EU regulatory policy ("die Öffnung") is forced through by the newcomer railways before the German courts of justice, before the federal government authority concerned with the control and supervision of cartels (Bundeskartellamt), at the federal office of railways (Eisenbahnbundesamt = EBA) and by complaints made to the EU commission, which is capable of breaking any German resistance by initiating proceedings for the violation of European law. Before the European Court of Justice every German intercession will be to no avail. Therefore any organisation of the DB which is contrary to European law is bound to fail.

V. Hope for the railways: profitable European freight transport

Rail passenger transport has a future. However, seen from an entrepreneur's perspective it is not a very bright one. According to the long term demographic projections the population will fall until the year 2050. This is particularly true for that section of the population which is very mobile: the young.

The forecast for the whole of the passenger transport sector is one of stagnation or even a fall in demand.

Rail transport in rural areas could incur even greater losses than at present, since the overall decline in population will be accompanied by a reduction in size of the rural population in favour of the urban areas. Local railways will however remain important in connecting urban centres with the surrounding areas because road traffic cannot replace them because there is insufficient space for the construction of more roads.

In terms of cross border passenger transport there will not be much change – even if Europe will grow together even more. The typical travel distance here is about 1.000 kilometres, e.g. from Paris to Hamburg. Low cost airlines will be far more competitive than the railways in terms of price as well as in travelling time. The average ticket price of the European market leader Ryanair now costs about 46 Euros per flight. Even if there are high taxes on aviation fuel their competitive advantage over the ICE will not be overtaken[12]. For this reason the planned routes of the trans-European long distance traffic corridors (”TEN”) are not efficient.

The sector of rail traffic that has the most positive forecast for growth is Europe-wide freight transport. This will be encouraged further by international sea transport, which has been growing for years and which has a great “railway affinity”. Sea transport allows for the groupage of profitable, very long, long-distance freight trains (“Ganzzüge”) right on the quaysides of the European ports.

If Europe-wide freight transport has the best prospect for growth, leading to the use of the German network to capacity, then the railways have to adapt to this. The German network is not ready for a newly expanded European freight transport requirement and as a whole it is not used to its capacity. Where there are bottlenecks, it is due to some critical knots and to the current investment strategy. Investment is made in high-speed passenger transport but not, in consequence, at a sufficient level in the extension of capacity, above all for freight transport.

On the contrary, through a reduction in the existing network its performance will be diminished, e.g. the reduction of switches and thereby the possibility of fast trains being able to overtake slower ones.

It is not only the competitors of the DB who are complaining about this, but also DB employees, because a small delay in the arrival of a single train may have a significant effect on the functioning of following trains.

The perspective of the DB, that it has to optimise “its” network for “its” freight transport, may be meant to be positive, but it is wrong. From a European perspective the German network is the centrepiece of the European network. The national railway networks have to understand that they are part of a wider European railway network, which has to market, (especially with regard to the rapid growth in trans-national freight transport) its railway slots (the “Trassen”) by

[12] Refer to Frankfurter Allgemeine Sonntagszeitung from the 24th of September 2006, Wissenschaft, pp. 69-70. The report makes a comparison between the ICE and the Transrapid. Both of them are in this respect dramatically inferior to the low cost airlines.

creating an international market for them, a railway slots exchange ("Trassenbörse"). The "booking" of a slot for a freight train from the port of Hamburg to Warsaw, Prague or Graz has to function in a simple way in accordance with normal market mechanisms.

Arising out of such marketing the co-operation and standardisation of the European networks will be advanced. The influence of the freight transport divisions on their "sisterly connected" national network companies is an obstacle in this regard. Under market pressures every freight transport division of a state-owned company would try to seek advantage through this connection with its sister network division in order to assert itself over its competitors on the Europe-wide market instead of adapting to the free market environment.

One of the biggest winners in this European vision will be the taxpayer. The network capacity would be fully used, thereby causing a fall in the price for railway slots as well as reducing the subsidies for the network paid for by public finance.

In most cases those who want to travel from the north of Europe to the south, or from the west to the east, have to travel long distances over the German network. This huge opportunity should be taken into account when the federal government extends the railway network, because the trends have been visible for years.

VI. The vision of the DB board of directors: national champion without restoration to profitability

What is the DB board of directors' idea of the future and which ones are disseminated?

The new name "DB Mobility Networks Logistics" stands for this vision. An interpretation of this idea is given by the statement of the "Bundesarbeitsgemeinschaft der Aufgabenträger der Länder" (BAG-SPNV)[13] regarding rail privatization. That statement characterizes the DB's strategy like this[14]:

[13] The "Aufgabenträger" allot the contracts for the local railway traffic within their respective regions.
[14] "Positionspapier zum Gutachten ‚Privatisierungsvarianten der Deutschen Bahn AG mit und ohne Netz" from the 2nd of March 2006, p. 7. It is a response to the previously mentioned "Primon Gutachten". The online version is available under: http://www.bag-spnv.de/posi/Poso6-03-02.pdf. See also appendix A.

The DB group should remain an integrated company and through the acquisition of logistic and urban rail passenger transport companies[15] should become an international logistics and mobility group – on water, in the air and on land (roads and railways). The marketing power and the network monopoly of the railways guarantee that nobody will fail to note the "importance" of this mighty company. The integration of the network allows the group to have a strategic influence on the network. Because of the constitution the network has to remain in the majority ownership of the federal government, thereby guaranteeing that the whole of the international logistics and mobility group also remains as a majority shareholding in the hands of the federal government. This gives the DB a very high rating (low interest rates, the possibility of engaging in high levels of borrowing in order to finance its expansion). The biggest part of the risk of this expansion strategy is born by the federal government as the majority shareholder[16].

A champion is not created by buying other companies internationally on credit and then claiming that in conjunction with a railway company which had not yet been restored to profitability this would lead to the benefits of integration and a worldwide presence, and that one would win clients because one can offer a full range of transport services from one source.

Following this concept one would take the rented DB bicycle to the train station, take the train to the airport and, with the probability of a DB-acquired airline, to the DB-Business airport at Berlin Tempelhof.[17]

The credits with which the DB is buying other companies are, at the end of the day, federal debts. Without the legally imposed backing of the federal government

[15] The "Hamburger Hochbahn" was also on the shopping list. A share in the "Hamburger Hafen und Logistik AG" (HHLA) with 60 % market share in seaport handling in Hamburg is still required.

[16] Neue Züricher Zeitung from the 8th of December under the title: "Unklarer Kurs der Deutschen Bahn – von der Staatsbahn zum privaten Logistikkonzern" (Unclear course of the Deutsche Bahn – from a state owned railway company to a private logistics group):
"A fully privatized and independent railway company would be more consistent with the notion of Mehdorn, the global, integrated, logistics group. Instead Mehdorn seems to argue – like the management of the Swisscom in the on-going conflict with the [Swiss] "Bundesrat"- a privatized and independent company, but at the same time he is not willing to forego the protection of the network monopoly as well as that of the state as a passive but still majority shareholder. This does not correlate". See also appendix B.

[17] During the last election for the "Berliner Abgeordnetenhaus" the DB confirmed its thoughts on Tempelhof when being officially questioned by the "Berliner Morgenpost". Instead of the foreseen closure, the DB would continue to manage it together with other partners as a small business airport. Refer to http://www.morgenpost.de/content/2006/09/03/berlin/851705.html.

the capital markets would only lend this money to the DB, if at all, only on the worst financial terms.

A champion would (probably) be created, if one were to restore the company to profitability first. Under those conditions the company would grow as a result of internally generated growth and only then, from its retained profits, and if the opportunity arose, would it buy other companies which would fit in with its strategy.

Takeovers offer opportunities, but in the first instance they carry high risks, as is proven by the many statistics that have been published by various investment banks. When the German chemical industry was expanding into the difficult American market by means of takeovers it paid for it largely out of retained profits and it then needed many years to make those takeovers become successful. Daimler-Chrysler is in the middle of this process and has used retained profits generated internally in order to establish itself as a worldwide car group. The German post (DHL) has managed to become a major logistics player in the USA as well – paid for with money that it earned through its monopoly on letters in Germany. Now it is running into trouble.

Today the DB has become a market leader in the field of logistics and is now competing in the US market against, among others, the German post. The US economy has to be grateful to Germany. It is profiting from low prices, the burden of which is being born by the German consumer and taxpayer.

Creating a “Mobility Network Logistics“ champion by making a shopping trip on credit is a foolishness which it is difficult to match. When difficulties first arise, the federal government will be forced to inject more money into the company. If the federal government is not able or not willing to do so it will be subject to the threat of even higher losses, because the value of the companies acquired could then fall sharply.

VII. The controversy over the privatization of the DB: Parliament versus the federal government

The DB board of directors is insisting on the “national champion“ solution and is arguing against any other solution quite vehemently.

- In the short run the highest privatization earnings will accrue to the federal minister of finance, although the company itself is highly in debt and is on an unchecked worldwide shopping trip. An incredible increase in its dividend payments is forecast, as though the company has already been restored to profitability.
- The First Ministers (the ”Ministerpräsidenten”) of the states are lured with the bait of representative railway investments in their states, paid for by federal money for infrastructure, which will almost certainly not be available to the extent of the original promises. Besides, these investments are also the most inefficient ones.
- The public is being tricked into believing that the dynamic quality of the DB board of directors will lead to success. One only has to unchain the board of directors in order for them to take off[18]. However, the DB group is only dynamic in that it is buying up other companies.

The members of Parliament suspect that the DB board of directors wants too much (“Mobility Network Logistics“ world-wide). The risks of this project will fall back on the federal government, probably within this parliamentary term. The members of Parliament are insisting on a coalition agreement, in which it is stated that they will decide on the nature of the initial public offer and through this on the future of the railways. Now they have resorted to installing “emergency brakes“ on the champion model proposed by the DB board of directors. However, they do not have a fully planned and computed counter-model. The minister of transport has not provided them with one. The alternative models presented by Booz Allen Hamilton, the expert/consultant of the minister of transport, are ”to put it politely, very simple“.[19] They have been defined as deviations from the DB’s market leader model – as if one would define a hamster as a deviation from a muskrat.

Over recent months members of Parliament and ministry staff have come up with new emergency brakes, options for re-acquiring the network, like usufruct, and so on.

[18] Interview with Hartmut Mehdorn with the Stern on the 29th of July 2006: The politicians have to unchain us, and then we will release them from their investment step by step. See also appendix C.
[19] “Positionspapier“ of the BAG-SPNV, p. 12.

The suggestions as to how one could undo the privatization of the network in case of emergency have become more and more absurd.

Members of Parliament also want to rescue the real estate of the DB from economic utilisation by private investors. The DB board of directors wants to be free to dispose of the real estate as they wish, most likely in using the profits from their sale for the acquisition of further companies.

What is the fair market value of that part of the real estate owned by the DB which is not required in order to allow it to fulfil its primary objective (that is providing rail services) and which can therefore be sold off? In the worst case scenario, that part of the real estate which can be converted into cash most easily will be sold while those parts where the financial liabilities are higher than the actual value will remain unsold. This latter part of the real estate will be returned to the federal government when, at some point in time, it will re-acquire the network using one of the available options

VIII. The controversy over the privatization of the DB: Parliament versus the federal government

The DB board of directors' model (champion with an integrated network) does not promise any chance of success. It is not in the best interests of the federal government, and has not been properly thought through. The federal government should therefore postpone the initial public offer using the following argument:

- The European vision for railways is not followed through. The greatest hope for a profitable railway is long distance, Europe-wide, freight transport. It is in need of a railway slots exchange ("Trassenbörse") where a European network operating industry actively markets its railway slots.
- The DB as a whole is not ready to go public. It has only been declared fit to do so by the board of directors in order to satisfy their own interests. Not even the prerequisites for the initial public offer, which

have been formulated by investment banks hired by the DB board of directors, have been fulfilled.[20]

- The champion model poses a great risk for the federal government. It has legal liability for the mobility and logistics empire which has been constructed on credit as it is compelled to remain a shareholder in transport and logistics because of the integrated network. For a complete sale of any of the individual transport companies within the DB group (logistics included), the federal government would require approval for the sale by the private investor. It is very unlikely that an investor would renounce the comfortable position of having the federal government as a shareholder, because with the federal government as the majority shareholder all parts of the company are protected from bankruptcy, as it is also the case with the public “Sparkasse“(banks where the legal liability lies with the states).
- There is no compliance with EU regulations. Arising from this is the risk of having to restructure the DB against the will of the private investor in the short term. Integrated into the DB group the network will be suffocated by regulation (“totreguliert“). The necessary entrepreneurial freedom of the board of directors of the network will be lost.

The federal government should – without being influenced by the DB group – be allowed to develop its own ideas regarding its railway policy. It should consider the interests of the federal government as a shareholder, subsidy giver and law maker and not just those of the DB’s board of directors. It should have no influence whatsoever on who will develop these ideas. The DB should merely be heard.

[20] These conditions were formulated as follows by Morgan Stanley, hired by the DB board of directors:

1. The “Regionalisierungsmittel“ (subsidies for local traffic) have to remain at a high level. The reality is that in the budget of 2006 there has been a first wave of reductions, and more are likely to follow.
2. The highly profitable local traffic contracts with the states have to remain in existence. The reality is that due to a complaint to the EU commission contracts like these can no longer be made. Further complaints for dissolving the existing contracts are still pending.

The DB receives a total subsidy of 2.5 billion Euros a year for maintaining the existing network in its current state. The means for extension of the network will come in addition to that from the federal government – according to the existing procedure of the “Verkehrswegeplan“((German) Federal Transport Infrastructure Plan. In reality it is not sure whether parliament will accept the de-facto eternal obligation of the federal budget to pay this 2.5 billion. See also Appendix D, The federal government has in any case a keen interest in maintaining the company's real interests, because it will remain responsible for the network in the long term. Furthermore, it wants to make the highest possible profit from a privatization of the transport components of the company. It has to function as a regulatory policy-maker for the railway industry and as subsidy giver for investment in the network and for the "Regionalisierungsmittel". Only the federal government is able to find the right balance between those interests. It cannot give this task to the board of directors of their own company.

To what extent can foreign models be an example here?

- The French method of the RFF is a possible way in principle because it allows for an orderly transformation into a European vision. The "crash solution" of an immediate separation of the network before the initial public offer will be avoided. The risk that all the burdens of "the railway system" will end up with the network company will be circumvented.
- The solution adopted by Great Britain that is of dismantling the group at a certain point in time, is not advisable for it would break a lot of tableware, which has to be mended afterwards. Besides, the ministry of transport lacks the appropriate planning capacities for such a solution.
- The pragmatic method used by Switzerland is not feasible for Germany, because we do not have a consensus democracy, in which – as is the case in a country the size of Switzerland – all the relevant protagonists know each other and can therefore balance their diverse interests. However, the principle of subsidiarity in Switzerland should be emulated.

The states should therefore take over responsibility for those networks which have regional importance, including the respective investment by the federal government. In this case the responsibility for tasks and expenditure for the whole added value chain of local railway traffic will lie within one entity. The states then can invite tenders for the operation of the network. Evidently the daughter company DB Netz AG (which now operates the whole network) could participate. Protests against the closure of tracks will be the problem of the states.

The Bundesarbeitsgemeinschaft der Aufgabenträger“ (BAG-SPNV) is the association of ministries and organisations of the states, which orders the regional trains. It is asking explicitly in its position paper on the DB privatization for this reorganisation.[21]

The union Transnet and the GdBA (Gewerkschaft der Beamten und Angestellten der DB = union of state servants and employees of the German railways), which have very similar motives, will not react aggressively against a postponed initial public offer.

They are against privatization anyway. They have bitten the bullet of the privatization (including the network) only because they have seen their power as “house” union of the group at risk when it came to the alternative of network separation. The winners would be the unions Verdi and the union of engine drivers (Gewerkschaft der Lokführer = GdL).

A strike would only be imminent if the federal government had developed its own ideas for privatization. Strike threats are unavoidable, because a restoration to profitability of the DB can only be successful if the combination of comparatively high wages and guaranteed jobs for its surplus personnel can be reduced to a degree which is comparable with that of its competitors.

The public will not have much sympathy for a Transnet strike if it becomes known that the fight is on for privileges that cannot be found to this extent in other railway companies. A reduction in these privileges will also be demanded by future private investors in the DB. The federal government has to endure a possible showdown with the unions in any case.

[21] Positionspapier der BAG-SPNV, p. 5.

Appendices

Appendix A:

„Der DB-Konzern soll ein integrierter Konzern bleiben und durch Zukauf von Logistik- und Stadtverkehrsunternehmen ein internationaler Logistik- und Mobilitätskonzern werden – zu Wasser, zu Lande (Straße und Schiene) und in der Luft. Die Marktmacht und das Netzmonopol auf der Schiene garantieren, dass an diesem mächtigen Unternehmen ‚niemand vorbeikommt'. Die Integration des Netzes erlaubt den 'strategischen Einfluss' des Konzerns auf das Netz. Weil das Netz laut Grundgesetz mehrheitlich im Eigentum des Bundes verbleiben muss, ist garantiert, dass der gesamte internationale Logistik- und Mobilitätskonzern DB mehrheitlich im Eigentum des Bundes verbleiben muss. Das wiederum verschafft der DB ein vorzügliches Rating (niedrige Zinsen, Möglichkeit, sich hoch zu verschulden, um Expansion zu finanzieren). Das höchste Risiko dieser Expansionsstrategie trägt der Bund als Mehrheitsaktionär."

Source: Positionspapier zum Gutachten ‚Privatisierungsvarianten der Deutschen Bahn AG mit und ohne Netz'" vom 2. März 2006, S. 7. Adressiert ist damit das erwähnte PRIMON-Gutachten. Online-Version des Positonspapiers: http://www.bag-spnv.de/posi/Pos06-03-02.pdf.

Appendix B:

„Ein voll privatisierter und unabhängiger Bahnbetreiber entspräche viel konsistenter dem Leitbild Mehdorns, dem weltweit tätigen, auf allen Verkehrswegen fahrenden Logistikkonzern. Mehdorn scheint dagegen – ähnlich wie das Management der Swisscom im laufenden Konflikt mit dem (Anm: Schweizer) Bundesrat – ein privatisiertes und völlig unabhängiges Unternehmen zu führen, gleichzeitig aber nicht auf den Schutz des Netzmonopols sowie des Staates als stummer, aber doch mehrheitlicher Eigentümer verzichten zu wollen. Das passt nicht zusammen."

Source: *Neue Zürcher Zeitung* vom 8.12.2005 unter dem Titel „Unklarer Kurs der Deutschen Bahn – Von der Staatsbahn zum privaten Logistikkonzern".

Appendix C:

„Die Politiker sollen uns von der Kette lassen, dann lassen wir sie auch schrittweise aus ihren Investitionen raus!“

Source: Interview with Hartmut Mehdorn published in the *stern* vom 29.7.2006.

Appendix D:

1. Die Regionalisierungsmittel sollen sich auf weiter hohem Niveau bewegen. Realität: In den Haushaltsbegleitgesetzen 2006 hat die erste Kürzungswelle eingesetzt, weitere werden wahrscheinlich folgen.

2. Die üppig dotierten pauschalen Nahverkehrsverträge mit den Ländern müssen Bestand haben. Realität: Aufgrund einer Beschwerde bei der EU-Kommission dürfen solche Verträge zukünftig nicht mehr abgeschlossen werden. Weitere Beschwerden, die bestehenden Verträge zu kippen, sind bereits anhängig.

3. Die DB erhält einen pauschalen Zuschuss von 2,5 Milliarden Euro pro Jahr, um das bestehende Netz in seiner Qualität zu erhalten. Mittel für den Neu- und Ausbau kommen zusätzlich vom Bund – nach dem bisherigen Verfahren des Bundesverkehrswegeplans. Realität: Ob die fast ewige Zahlungsverpflichtung von 2,5 Milliarden Euro pro Jahr aus dem Bundeshaushalt zustande kommt, ist offen.

Source: Investmentbank Morgan Stanley for the DB board of directors.