Competition on the tracks: demanded by the EU Commission, undermined imaginatively by the state railways[1]

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The European Commission wants to create a competitive European railway market by enacting several legislative packages - the so-called railway packages. The aim is to enable a Belgian, Swedish or Hungarian railway company to conduct business on the German network as easily as in its own domestic market. This European competitive railway market should be in place by 2050.

As far back as 1991, the European Commission's minimum requirement, to be implemented by 1993, was a separation of network infrastructure operation ("net") and the operation of trains ("transport") in terms of accounting in order to encourage competition. The additional call for a true organizational separation was not followed.

In the first railway package of 2001 the Commission strongly re-emphasized its call for separate accounting. Even if an institutional separation of net and transport was not demanded, such a requirement would have been the logical consequence. Moreover, the Commission introduced a single European-wide licensing system for train drivers and harmonized rules for charging user fees for the infrastructure. By spring 2003, the network operators should have conducted business independently of their parent companies. The penalty for non-compliance was that the allocation of routes and the pricing of the railway slots were to be transferred to independent authorities. In Germany this could have been for example the Federal Railway Office. However, the first railway package has been implemented only half-heartedly.

A year ago, the European Commission reprimanded the 21 Member States for their failure to implement the first railway package, asking them for a justification. These states were Belgium, Denmark, Germany, Estonia, France, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Austria, Poland, Portugal, Romania, Sweden, Slovakia, Slovenia, Spain, Czech Republic and Hungary. Recently, the Commission opened infringement proceedings against 13 states before the European Court of Justice (ECJ). This is an encouraging step (although not a victory), since the ECJ cannot be influenced by the EU heads of state. Truly competitive markets on the tracks will only be achieved if the networks are organized in a way that will remove national barriers and the incentive for discrimination.

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These measures were followed by the second and third railway packages in 2004 and 2007 respectively. In the draft of what is now the fourth railway package dating from September 2010, the EU reiterates the requirements contained in the first railway package - 17 years after it had called for the separation of net and transport for the first time.

Powerless EU Commission?

The creation of a single competitive rail market is within the discretion of state railways, which are backed by the respective Member States. In fact, by undermining the directives of the railway packages, the Member States have ultimately discredited the EU Commission as being a toothless tiger. The damage is being done to the member countries themselves. In pursuing short-term interests they have allowed their national railway companies to maintain market barriers in order to spare them the painful adjustment to free competition. Indeed, the EU Commission had, in principle, a promising set of regulatory policies. Did it fail because the Commission acted awkwardly and inconsistently? Or did it fall prey to the short-term self-interest of the state railways and their owners, the Member States, and thus stood no chance?

These problems can be demonstrated with regard to the separation of net and transport.

- The example of France: The RFF (Réseau ferré de France) is the owner of the French railway network. It has transferred its operation to the SNCF, the national railway company. Formally, this design fulfils the requirements of the Commission because the RFF is legally independent and may at any point overrule the SNCF's decisions if a third party is discriminated against in order to protect the SNCF's transport companies from competition. However, in practice the RFF does not intervene. The Deutsche Bahn for example is only able to operate freight transport in France because it has bought Euro Cargo Rail, a French freight transport company, which has licenses for the whole of the French railway network.

- The example of Italy: Mauro Moretti, boss of the Ferrovie dello Stato (FS), the Italian national railway company, had the number of freight terminals reduced from 400 to 70 while increasing its charges to users to ludicrous levels. He thereby was successful in putting out of business all competitors of the FS unless they cooperated with the FS. As administrator of the Italian railway network he is able to increase the charges to users of these terminals by the factor of ten because Italy does not have any noteworthy railway regulation. Of course, the freight division of the FS will have considerably higher costs, but the network which is run by the FS will at least increase its earnings by the same margin. Only a third party will have to pay the increased charges for using these terminals out of its own pocket.

In the U.S.A. anti-trust law regards a vertically integrated national railway company as being illegal. Trying to regulate such a company would be inefficient from their point of view – a never ending game of cat-and-mouse between the regulator and the regulated company. Indeed, Anglo-American law puts forward a convincing argument. It outlaws such business structures not only if they actually discriminate, but even where there is the potential and the incentive to do so. The former EU-Transport Commissioner

Karel van Miert put the logic behind this approach in simple words: “If you give a company the opportunity to restrict competition, it will do so!”

Towards more competition in Germany – but only temporarily?

In the case of Germany, there was at one time a move towards liberalization. The government committee “Bahn” under the leadership of the former CEO and later chairman of the supervisory board of the Preussag AG outlined the basic parameters of German railway reform at the end of 1991. “Deutsche Bundesbahn” and “Deutsche Reichsbahn” (the former East German national railway company) would be turned into a joint-stock corporation; the then existing liabilities – especially its financial debt, pension obligations, increased staff costs due to the continued employment of state officials (“Beamte”), and the backlog of investment in East Germany – were to be taken over by the Federal Government. Regional rail transport operation was to be put out to tender and – in cases where it would not be cost-effective – was to be financed by the public. Thus the new “Deutsche Bahn” was freed of its public obligations and was to be run as a private commercial enterprise.

At first the “Deutsche Bahn AG” was to be divided into several train operating companies and one network infrastructure company (including train stations and energy supply) which were to be transformed into joint-stock corporations within three to five years. The train operating companies were to stand their ground in a competitive environment before being privatized step by step. The “Deutsche Bahn AG” would have been reduced to running the railway network as required by the constitution, the Federal Government being the sole owner. This German approach – to transform the state run railway transport into a competitive private market – belonged to the spearhead of market orientated railway reforms.

- The “Bahnreform” was launched on the 1st of January 1994. During the first few years its recommendations were more or less accepted. Nevertheless, with the passage of time, the violation of its principles and objectives became more serious. Instead of understanding that the transformation of the various transport branches into joint-stock companies was a first step towards independent operation in competitive markets, the “Deutsche Bahn AG” was run ever more at a corporate level – particularly in order to restrict competition. This is clearly visible in the following examples: Its subsidiary company “DB Netz” introduced a railway slot pricing system that granted huge quantity discounts to the various transport companies of the DB-group. No competitor would have been able to enjoy the same discount in the foreseeable future. Pressure from the “Bundeskartellamt” (cartel office) led to its abolition in 2001. Meanwhile the “DB Netz” has been criticized for discriminating against competitors of the “DB AG” by raising railway slot prices. Moreover, it has been accused of raising the slot prices especially for those routes that are of little interest to the various transport companies of the DB-group. Energy supply is also a cause for argument. Competitors of the DB may purchase the necessary electricity for their trains from other supply companies. If they do so however, the charge for transmitting the electricity to the trains will rise to such a level as will make this kind of competition meaningless.

- The “Connex Verkehr GmbH” (today “Veolia Transport”) filed a complaint to the EU-Commission regarding a contract that the two states of Berlin and Brandenburg had signed with the regional transport company of the group, “DB Regio”. It had been signed without a public invitation to tender and included an extortionate fee for the “DB Regio”, paid for out of public funds. From the tax income arising from the sale of fuels, the Federal Governments today transfers about 7 billion € to the states. The larger share of these “Regionalisierungsmittel” are meant to pay for the non-cost-effective regional train routes. The result of the complaint was that the parties concerned agreed that something like this should not happen again and that all future train operating contracts must involve a transparent public invitation to tender. At the same time the EU-proceedings against the “DB Regio” for illegal state subsidies forced the company to repay parts of the fee to the states of Berlin and Brandenburg.

So far the Commission has not asserted its position. In fact, the DB claims that it is not being overcompensated by the Berlin-Brandenburg contract because it runs deficits in other business divisions. If the DB succeeds in asserting that position, it will be the end of the Commission’s power to monitor state subsidies effectively. Companies could receive state subsidies without any interference because they could simply claim that these are necessary for offsetting losses.

- Together with its complaint the “Connex Verkehr GmbH” presented a report entitled “Vergabe von Nahverkehrsverträgen durch die Bundesländer: Wirtschaftliche Bedeutung für den DB-Konzern und dessen Praxis der Auftragserzwingung gegenüber den Verkehrsministern der Länder“ ["award of transport contracts by the states: economic importance for the DB Group and the practice of enforced contracting against the transport ministers of the states"]. It complained of the arrangements many states had with the DB. In a nutshell, the report stated that the states obtain from the “DB Regio” train operating contracts whose conditions are favourable to the company – and without public tendering. In exchange the DB talks up projects which it knows will be regarded as being of special interest to the respective state by its politicians, e. g. new train stations, new or improved railway tracks, the electrification of certain routes etc. These projects are then pushed up the priority list. Such “combined” contracts pay off pretty well from the DB’s perspective because with such a negotiated contract (“freihändige Vergabe”) the DB is able to generate a very large margin for a long time – usually 8 to 15 years.

- During the mediation of the conflict about “Stuttgart 21” by Heiner Geisler, the opponents of the plan to rebuild Stuttgart’s main station underground argued that the state of Baden-Württemberg would in future order less regional rail transport from its “Regionalisierungsmittel” because the “DB Netz” would drastically increase the prices for the railway slots running through the new tunnels providing access to the station. The uncanny response of the project’s advocates was that this increase in slot prices would be compensated for by an increase in the number of public tenders for regional train operating contracts. In the light of experience, prices do indeed fall by up to 25 % if they are put out for tendering – and they result in a higher quality of service. Why then, one is tempted to ask, did the state of Baden-Württemberg not realize these potential savings earlier? If the new train station is ready by the end of the decade, the competition for the contract by public tendering, as called for by the EU Commission, will come at least twenty years too late. In this event the DB will already have recovered its stake in the project (the lion's share is paid by the Federal Government anyway) by a – actually illegal – very profitable train operating contract. This is paid for by the German taxpayer who indirectly finances the doubtful projects of the individual states, which are of little benefit to the Federal railway network.

- The DB Group has effective means for exacting the train operating contracts at its disposal – largely because of its size, but also because it concentrates all of its interests on a group level. Each year, the group invests more than 8 billion € in equipment as well as infrastructure works and provides about 220,000 jobs. By reallocating investments and jobs the DB Group is able to reward a state while it is capable of sanctioning a non-compliant one by closing down plants. Unilaterally all of the states complain about the DB Group, but each then tries to sign a "combined" contract at the expense of the others. For example, when Schleswig-Holstein put out to tender the regional train operating contracts from Kiel to Neumünster, from Kiel to St. Peter Ording, and from Kiel to Flensburg, the DB Regio was running the risk of losing the contracts during the public tender procedure. Thus, the then CEO of the DB, Johannes Ludewig, threated to remove Kiel from the Intercity Express network. Schleswig-Holstein's MP, Heide Simonis, known as a strong advocate of public tendering in her state, caved in – "for the state's good" – and gave the contract to a syndicate of Connex (the winner of the public tendering procedure) and the DB Regio (which came last or next to last). The MP also feared that the DB would assign a lower priority to the electrification of the track from Hamburg to Lübeck. The president of the Kieler court of audit, Gernot Korthals, criticized the conduct of the state government as "not being in accordance with the rule of law".

A complete list of how competition is avoided would be long indeed: many cases are time-consuming to narrate or difficult to prove. Meanwhile many competitors on the tracks are giving up because asserting their rights costs a lot of money and their small operating margins do not allow for this. Moreover, a decision often takes a lot of time with the result that the client will already have bailed out of the negotiations by the time the decision is taken.

A defensive battle: train and track belong together

These deliberate infringements of competition law are only possible because the DB is an integrated group. Recently France demonstrated the possibilities of restricting competition on the tracks which are given through control of the network. The technical specifications of the Eurostar, the high speed train that runs through the Euro Tunnel, is very close to those of the TGV. The management of the company that operates the Euro Tunnel has been trying to change these completely out-dated specifications for a long time. However, when it ordered – in anticipation of these modifications – ten new Intercity-Express (ICE) trains worth 600 million € from the Alstom rival Siemens, Alstom filed a lawsuit in the British court in order to prevent Siemens from being awarded the contract. The public tendering procedure, in which Alstom participated, is denounced as being illegal. Experts see its justification for the law suit as a desperate attempt of Alstom to defend its monopoly in the Euro Tunnel.

Last October, Europe was invited to witness an embarrassing spectacle. During its maiden voyage through the Euro Tunnel to London St. Pancras, the ICE was towed by a French Eurostar-locomotive – without passengers of course, “for safety reasons”. The Federal Minister of Transport Peter Ramsauer and DB CEO Rüdiger Grube came by plane to the inauguration.

What are the standard arguments put forward by state railways to justify the fact that train operations and network operation must be under common control? The DB plays a leading role in Europe in vindication of this position – not because Germany has the largest network (or is, at the same time, Europe’s most important railway crossing point), but because the DB wanted to go public as an integrated group. Therefore convincing arguments were required in order to get the CDU/SPD coalition’s (2005-2009) approval. The arguments were:

- Synergy: Train and track are one system. To the lay person, this seems plausible at first sight. However, the experiences of aviation for example tell a different story. If an Airbus is forced to land at Hannover-Langenhagen at night time due to bad weather conditions, the airport, airline, meteorological service, and air traffic control (and also, in the case of problems with the aircraft, the manufacturer EADS) co-operate very efficiently, even though all the agents involved are institutionally independent and that the required degree of interaction is a lot more complicated compared to railways. This is the case worldwide. In a January 2006 report of the Federal Government – alternative approaches to privatizing the DB “with or without the network” (PRIMON) – the experts stated that “from a scientific point of view, there is no general advantage of any method of coordination” [internal or external] and they caution about the “rising costs due to deficiencies in the coordination of processes and increasing complexity respectively” within large corporate groups. However, these arguments were not included in the summary of the report, a fact which was picked up immediately by the members of parliament and their assistants.

- Market indicators are only transferred efficiently from trains operation to the network: It is the operation of trains that provide the signals as to how the network infrastructure operator should act. Although this is true, according to the DB, it is only in an integrated group that these signals would be transmitted in the form of pressure by the train operating companies (e. g. Schenker Rail) to the network operator. This means that “DB Netz” would be unable to understand market signals and would be slow to respond to them. According to this logic, Fraport (the airport of Frankfurt) would have to be a subsidiary company of Lufthansa. Moreover, electricity companies would not be able to sell their supplies – as demanded by the EU Commission.

- All the successful railway companies in the world are integrated companies: The Japanese Railways as well as the U.S. freight railways are cited as evidence. However, the creation of a common railway transport market out of mutually exclusive national railway companies was not the issue in either Japan or in the U.S.A. Japan, for example, broke up its national railway, dividing it up according to region and transport purpose. The U.S.A. has exposed their historically private freight railway companies to intermodal competition – without

> subsidies – and has forced their railway companies into a state of mutual openness. A very simple counter-argument is that nearly all unsuccessful railway companies worldwide are also integrated companies.

The initial public offering of the DB was cancelled – not because the DB had not been successful in convincing the Federal Government of the advantages of an integrated group, but because of the developing financial crisis of 2008 which promised only a very small amount of revenue from the public offering.

The unions' interests

History teaches us that unions are opposed to privatization because the Federal, as the owner of a company, guarantees that it will not go bankrupt even if its business strategy is unsuccessful. Why then was there a rather odd closing of ranks between the rail unions Transnet and GDBA (today unified to EVG) and the executive board of the DB with regard to the upcoming initial public offering? Both unions would have preferred that the DB group would have remained an integrated group with the Federal Government as the sole shareholder. However, there was a danger that a new Federal Government would have established separate companies to operate the trains and the network infrastructure. The Liberals (FDP) in particular had voiced this intention, but advocates of a separation could also be found within the parliamentary groups of the CDU and SPD. These ambitions should have been thwarted by the initial public offering because no private shareholder of an integrated group would ever agree to a subsequent separation other than for an inordinately high level of compensation. The integration was evidently so important to both unions that they would have accepted the privatization. Historically both unions had been founded especially for railway workers with today roughly 260,000 members (many of them pensioners and retired "Beamte"), and they feared for their survival. They would have been confronted by a diverging interest that so far had been resolved within the DB group. Moreover, there were rumours that Verdi would launch a membership campaign in the transport companies while IG Metall would do the same thing in the network operating company. This would most likely have been the beginning of the end for Transnet and GDBA.

With the privatization of 1996, Great Britain established the rail network and trains operation as independent companies. Originally it was planned to separate the network but without privatizing it. Indeed, the privatization was pushed through by the Conservatives before the last re-election of Prime Minister John Major in order to make a revision of the reform under a future Labour Government more difficult. The privatization of the network was done short-sightedly, out of regard for partisan party politics, and failed miserably. Investors in the network infrastructure were interested in short-term profits and thus let the already ailing British network degrade still further. Therefore, the British government re-purchased the network in 2001 from the shareholders and has started a complete restoration and restructuring program. Since then, British rail transport has boomed. It is Europe's leader in term of transport growth rates.

Even the British transport unions are content. The railway's economic success has stabilized the number of jobs in their industry – even if they are now located in other companies. This is the message that was delivered by the British unions at an event that took place at the British embassy in Berlin in the summer of 2006. The British Ministry of Transport, the regulation authority, the network company, the transport companies, the passenger federations, and the unions had come to Germany in order to explain the British railway reform, which has been labelled devil's work by the DB and by some German politicians working on transport issues.

A detailed account of the various railway packages

The second railway package of 2004 addresses the harmonization of railway security, interoperability in order that trains may run problem-free on all networks, the complete opening of all networks for freight transport from 2007 onwards, and a European railway agency as a coordinating institution.

The third railway package of 2007 deals with the opening of cross-border passenger transport from 2010 onwards – again with many exemptions from the regulations for a period of fifteen years – as well as a European license for train drivers from 2009 which allow drivers to be used on transnational routes. Simultaneously the EU enacted two directives concerning the rules of the game in public transport. On the one hand it regulated the ordering and financing of public transport. In Germany, regional passenger rail services are being purchased by the individual states. In some larger states, e. g. Nordrhein-Westfalen, the purchase is delegated to the transport association (Verkehrsverbünde). The EU also allows for an abundance of exemptions from the regulations for a period of fifteen years. On the other hand it introduced unified European passengers' rights, comparable to those in aviation.

The fourth railway package – until now just a draft – addresses the issue of competition, e. g. access to services related to the tracks such as terminals or ticket vending machines, the terms of use, the empowerment of regulatory authorities (in Germany the "Bundesnetzagentur") especially in terms of their independence but also in terms of possible sanctions, and with the harmonization of the financial "architecture", that is the financial relationships between state and infrastructure company (network, railway station, terminals, energy supply etc.) as well as the charging of infrastructure- related and external costs (e. g. noise emission) by way of user charges.

It is difficult to create a fully competitive market out of two dozen integrated national railway companies, which historically have evolved into distinct entities. The challenges associated with a European-wide opening up of railway transport as visible in the various railway packages are by no means trivial. In some parts it is in fact a Herculean job. The most difficult part, the independence of infrastructure and transport on the tracks, was rightly put at the centre of the EU's efforts to open up the market ever since 1991. This is strategically correct because independence is the key to a competitive railway sector. It is a necessary, although not the sole, condition for competition.

Nevertheless, in this key question the EU Commission has yet not asserted its position. It now takes a detour and tries to restrict the leeway for discrimination and the foreclosure of markets. Thus, it is curing the symptoms. In doing so, it will most likely fail if one admits that in Germany, Europe's largest railway crossing point, the strong vested interests of politicians, the railway companies, and the unions are prepared to go a long way to avoid the Commission's main point, that there be institutional independence. No set of laws, which are designed to regulate the behaviour of market participants, is able to replace the institutional separation of infrastructure and train operation.

Re-thinking railways from the network

In Germany the value added of the network is as large as the value added of railway transport. However, public perception is almost exclusively focused on what happens on the tracks. More often the perception is restricted to high speed trains: the ICE in Germany, the TGV in France or the Velaro in Spain. The biggest competitive advantage of railways lies nevertheless in long freight trains travelling over long distances ("European Routes"). Freight transport however receives little political support. Stuttgart 21 and the new track from Wendlingen (near Stuttgart) to Ulm are controversial public issues. It is about a reduction in ICE travelling time of about twenty minutes – amongst others justified by the European railway corridor Paris-Bratislava. Why is that an important European axis in any case? Today, there is a lack of capacity in the corridor running from the North Sea harbours of Antwerp and Rotterdam and along the Rhine through Switzerland towards north Italy, an axis which runs through the main areas of west European heavy industry.

The railway industry as a whole should be planned from the network infrastructure because of its high value added and because of its key role in organizing competition on the tracks. Only a very few people think about how to restructure, reorganize, improve, operate, and market the infrastructure effectively. Under the control of integrated railway companies efficient infrastructure companies cannot develop. They even lack the incentive to market their capacities to everyone – the key to entrepreneurial behaviour. Instead, and with few exceptions, the rail infrastructure is used in Europe as a strategic instrument for foreclosure and discrimination.

Europe needs independent, self-confident rail infrastructure companies. A promising privatization alternative for these companies is however nowhere in sight. All attempts to privatize the railway networks have so far failed e. g. in Great Britain, Estonia, and New Zealand. Nevertheless, as in regional transport, there could be competition for market share by the gradual public tendering of network operation. Thereby one would be able to determine benchmarks for efficient network management – in combination with intelligent regulation it would at least provide a second-best solution for the provision of market incentives to infrastructure companies.

Initiatives from the infrastructure sector instead of regulation

In 1993 the key issue of network independence should have become reality. After 17 years, there is still no light on the horizon to suggest that this will happen in the foreseeable future. Instead the EU Commission gets lost in issues that are of minor importance in comparison to the institutional separation of network infrastructure and train services. There are many justifiable doubts as to whether the many technical and organizational requirements of the EU do yield any additional utility. Criticism is for example directed against the European Train Control System (ECTS), a uniform European railway traffic management system which is to be installed on all European railway networks in the long term. It is clearly obvious, however, that most European countries will not be able to afford such a system. Many do not want to comply and some are already changing it unilaterally, with the result that the variety of systems employed is growing.

The details of technical and organizational requirements lead to a time-consuming struggle for progress – provided that the directives of the EU are seen as progress at all. It is the railway sector which has to spearhead the quest for innovation. The initiative could come from the infrastructure companies. Every new competitor on the tracks is a huge gain – not only if it taps new groups of clients, but also if it pushes less efficient competitors out of the market. An infrastructure sector will also find more efficient ways of overcoming the constraints of a single European railway transport market than the EU Commission. It has a better understanding of the problems of its clients, who will operate the trains, and the success of the rail transport companies will raise income from slot user fees.

The push for innovation will in any case not come from the integrated state railways. For them short term protection against competition on the tracks is more important that the long term survival of the railway sector as a whole. They still believe that the state will take their business model into the future – by means of large subsidies and an ever increasing burden on the intermodal competition of road and air transport. Nevertheless, until 2050 its competitors, road and air transport in particular, will experience pushes for innovation and cost reduction due to intense competition. If railway transport is completely liberalized in the remote future, the railway sector will then be on the defensive towards its competitors due to its reduced level of innovation and cost reduction**.**