Karlsruher Institut für Technologie

TransportNET
The University Network for Transport Education & Research

Some options for future EU railway PSO policy - with a particular view on Germany

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TransportNET – 3rd Research Seminar on Rail Regulation
Lyon, 14 November 2014

Institut für Wirtschaftspolitik und Wirtschaftsforschung (IWW) Fachgebiet Netzwerkökonomie

Agenda

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- Deutsche Bahn and recent railway regulatory policies
- An alternative proposal for German national railway policy
- A look at EU markets for regional PSOs
- Some alternative proposals for EU railway regulation policies on PSOs
- Summary

Position of Deutsche Bahn (DB) on recent EU railway policies
(as seen by an outsider)

EU railway initiatives	DB opinion
2011 Recast of First Railway Package	**No**, please
2013 Three Pillars of the Fourth Package:	
1. To establish consistent approvals procedures for rail interoperability and safety	**Yes**
2. To open domestic passenger markets	**Yes**, in France
3. To create better structures and governance for infrastructure managers - vertical separation - retaliatory closing of markets	**No!**

Source Three Pillars: From a presentation by Jean-Eric Paquet, European Commission

Position of Deutsche Bahn (DB) on recent German national railway policies

(as seen by an outsider)

German national railway policy initiatives or discussions	DB opinion
Recurrent discussions about vertical separation	**No!**
Partial privatization in a vertically integrated setting	**Yes**
Any other form of partial privatization	**No**
Strengthening of railway regulator, (proposed Railway Regulation Law 2013)	**No!**
More government money for the railways	**Yes!**

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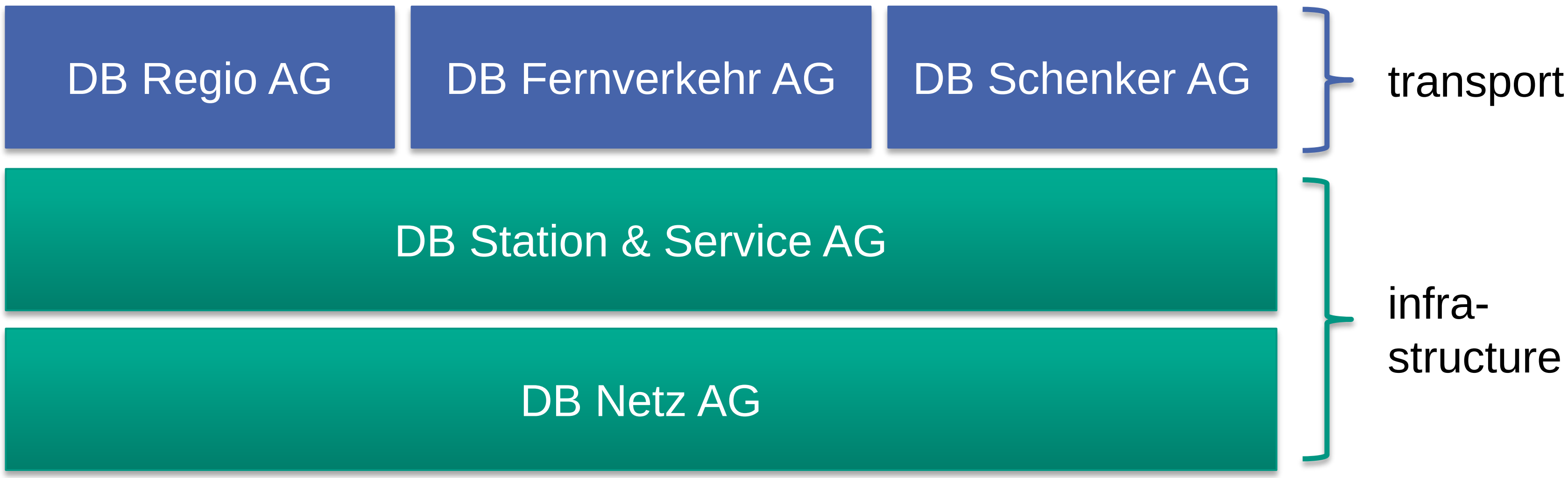
German railway reform of 1994 created several independent AGs (joint-stock companies) under the umbrella of DB AG



- It was foreseen that – may be! – the transport AGs would be privatized one by one, not necessarily jointly!
- This is still possible today at any time: No judicial boundaries, no need for a change of law or for other formal consent by the Länder states

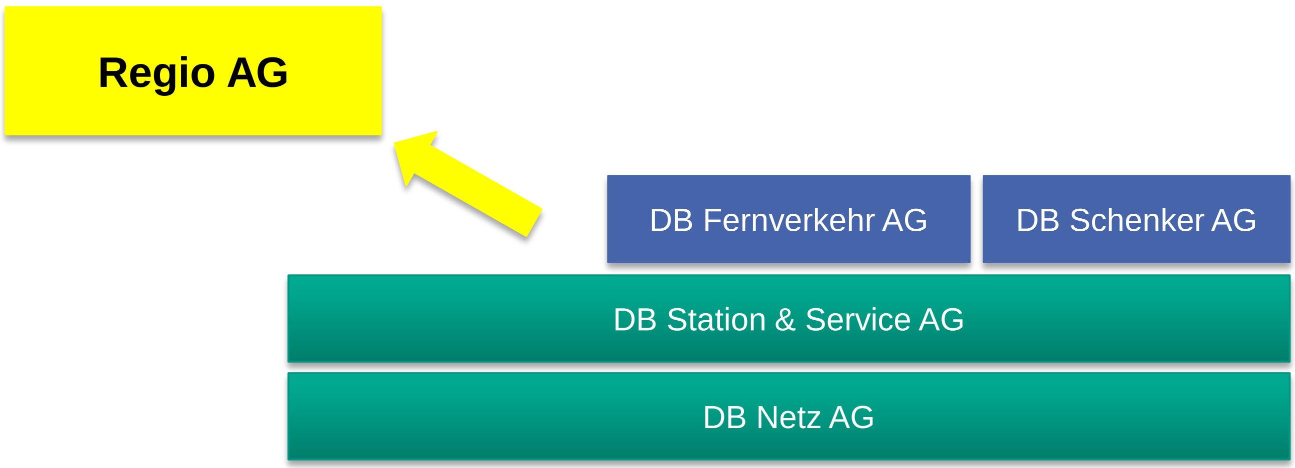
Horizontal axis: no significant real economic synergies between the large transport branches

- Regional passenger, long-distance passenger, and freight need **different rolling** stock and address **different customers** (where the main customers for regional PSOs are the local authorities)
  - Admittedly, there is some overlap of the passenger customer base for regional and long-distance. But use of synergies (for example in marketing) is strongly restricted by "interference" of local authorities
- **On the tracks** they basically compete. As far as track utilization is concerned, the infrastructure manager can easily realize "economies of scope" of mixed-use tracks by selling slots accordingly.
- Two additional **notes**:
  - Therefore the issue of "vertical separation vs. integration" should be addressed for each transport branch separately (regional, long-distance, freight), rather than for "the railways" as such
  - Many "integrated railway systems" are only partially integrated: Japan is not vertically integrated in freight; the USA are not vertically integrated in passenger

Vertical axis: no significant real economic synergies between regional passenger and infrastructure

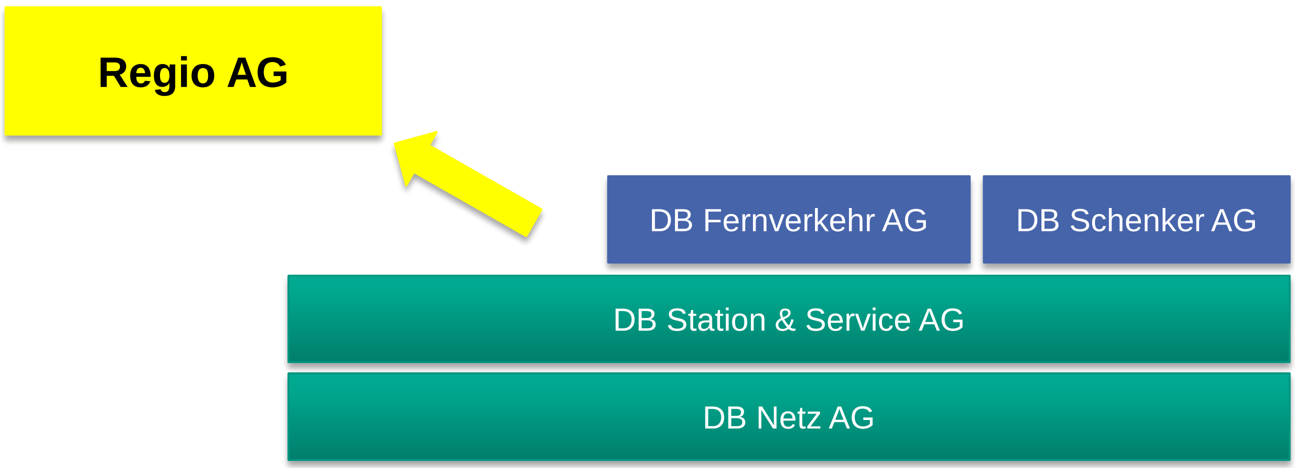
- Activities of regional passenger companies are largely governed by the PSO contracts. Hence it is **the local authorities** who control most aspects of the interface between railway undertakings and infrastructure managers
- Hence the scope for efficient interactions between the latter ones is severely limited
- Therefore, in order to ripe any gains from vertical coordination, a good communication is needed first of all between infrastructure manager and local authorities

Summary on synergies between DB Regio and other branches of DB AG



- A separation of Regio would not cut through significant economic synergies
- Exceptions: Synergies possible with DB Arriva or DB Stadtverkehr (local buses)
- But need to adjust monetary flows between central government, Länder, and all railway companies involved

The option of full privatization of DB Regio



- **<u>Recommendation for German national policy:</u>** Fast and full privatization of DB Regio AG including Arriva and maybe DB Stadtverkehr

- This would improve the strength of competition on German tender markets, thus save tax money resp. enable better services for given money (see also next slides)

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Obstacles for the development of a common and competitive EU tender market for PSOs

1. Side deals of regional authorities with the vertically integrated national incumbent
2. Forbidden information transfers about competitors' offers in the vertically integrated national incumbent
3. The capital cost advantage of government-owned national incumbents – particularly after the financial crisis of 2008
4. Market closure justified by social concerns
5. Fragmentation of the EU-wide PSO markets

   → See next slide

6. The vanishing of strong independent competitors

   → See slide: The Arriva catastrophe

Fragmentation of the EU-wide PSO markets

- Different types of public service contracts in different Member States
- Different types of rolling stock in different Member States:
  - ⇒ No homogenous EU market for new or used rolling stock
  - ⇒ High sunk cost share of rolling stock
  - ⇒ High risks due to long life of rolling stock (about 30 years)
  - ⇒ Difficulties of obtaining financing
  - ⇒ Barriers to market entry!
- Problem was partially addressed in 4th Package, technical and market pillars

The Arriva catastrophe

- **The acquisition of Arriva by Deutsche Bahn did not violate any national or EU antitrust law**: In no country did it create or add to a dominant firm
- **Still, it was a disaster for the long-term development of European railway passenger markets:** Arriva was the single purely private firm of significant size, active in almost all European markets for PSOs
- Deutsche Bahn bought it using, among others, its privileged access to credit markets as a publicly owned company
- Independent Arriva is lost. We can only learn for the future. Next targets could be Transdev/Veolia, FirstGroup, National Express, DHL, Kühne & Nagel, …

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We need a “Lex Arriva”

- **<u>Proposal for a “Lex Arriva”:</u>** Any proposed merger in which a railway undertaking is affected either as target or as overtaking or as equal part needs the explicit consent of a special EU board to be made up by DG Mobility and Transport and DG Competition
- **<u>The merger should not be allowed if the long-run development of competitive railway markets in the EU will likely be hampered by it</u>**
- The board should have ample discretionary room to make this assessment

- **Criteria: Approval should be less likely if the target is:**
  - an active or potential future participant of railway markets
  - independent of national railway incumbents
  - privately owned
  - financially sound with a fairly stable economic outlook
- **Criteria: Approval should be less likely if the overtaking party is:**
  - a national railway incumbent, particularly if vertically integrated
  - has significant market power in a large EU country

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- Note that integrated railway companies benefit from an exemption from State aid regulations – it therefore seems to be justified to subordinate them to special regulations against the acquisition of other firms
- In my view such a rule would be preferable to retaliatory market closure as proposed in 4th package

Regulatory option: Compensating interest rate subsidies

- Integrated national railway companies enjoy many benefits from being public concerns, closely entangled with the national governments
- As a consequence, rating agencies, banks and other lenders grant them credits at best conditions (ratings often at AA+ and AAA)
- Resulting distortion on PSO tender markets!
- Particularly strong impact after the crisis of the financial markets and the ensuing Euro crisis

- **Proposal:** Regional PSO authorities should get an additional fixed sum of money from central government (depending only on characteristics of the tender), if they grant a contract to a privately owned firm (resp. to any firm that does not enjoy the privileges of government lending conditions)

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Recommendation for German national railway policy:

- Fast and full privatization of DB Regio AG including Arriva

Recommendations for EU railway policy:

- Control of all mergers affecting the railway sector by DG Move and DG Comp with a view to creating or preserving non government-owned European players ("Lex Arriva")
- Compensating interest rate subsidies for regional PSO authorities if they grant a contract to a privately owned firm

- Apart from that and much more realistic: Fast progress in the technical pillar is of utmost importance! Go ahead without regards to the market pillars

Thanks for listening & greetings from Karlsruhe!

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