Karlsruher Institut für Technologie

Market entry barriers in railway and aviation?

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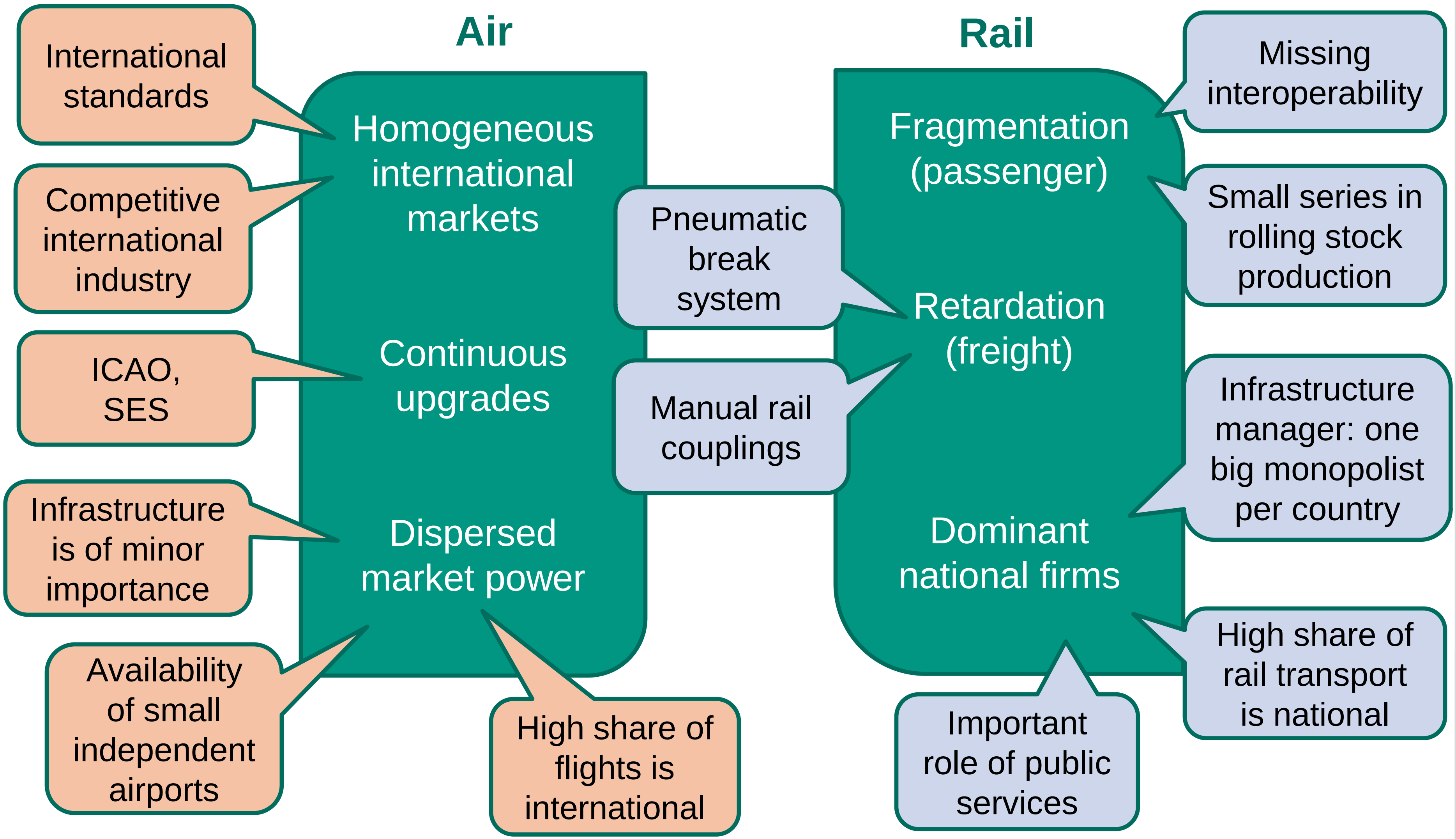
Different experiences with market liberalisation: “The open air versus the closed railways” (?)



The planned 4th EU Railway Package addresses the right topics

Substantial steps towards a single European railway market in the 4th Package:

- Towards homogenization of technical standards across the EU
- Towards centralisation of certification procedures at the European Railway Agency, ERA
- EU wide opening up of railway passenger markets, particularly of the markets for regional / local public service contracts financed by the public

→ **Overcome fragmentation!**

→ **Maybe also overcome technological retardation in freight?**

- **Importance of the EU rail freight corridors!**

Railways are not so closed after all!

Example – freight:

- **Competitors have about 50% market share on the main German routes from the Northern ports to the South**
- **Main reasons:**
  - General Open access in Germany since 1994
  - Long distances, simple production processes (block trains)
  - German regulator (Bundesnetzagentur, BNetzA) is quite strong concerning general access conditions (except access charges)
    → reduces discriminatory behavior by incumbent
  - Initially, German ports and some companies helped competitors to get started and develop (even took part in some of them) in order to reduce their dependence on DB
- **Remark: The biggest threat to the development of EU railway freight is political ignorance for this segment (its infrastructural and regulatory needs, upgrade of technical standards) and in particular political capture by national trucker interests.**

Railways are not so closed after all!

Example – long-distance passenger:

- **High speed competitor NTV in Italy (Torino-Milan-Rome-Naples)**
- **Main reasons:**
  - Substantial competitive advantage of rail over to road and plane on this line
  - Relatively simple business: Mainly just one line (not a complicated network of lines with passengers changing trains)
  - Sufficient slots on the line are obviously available
    $\rightarrow$ hard to deny access by the vertically integrated incumbent
- **Remark: The biggest threats to the development of a common EU market for long-distance are:**

  1. Co-operation among the national incumbents (creating some international trains, but also creating an anti-competitive atmosphere among them)
  2. The vanishing of independent competitors
  3. Technical fragmentation

Railways are not so closed after all!

Example – regional / local passenger:

- **Competitors have about 15% market share (pass. km) for German public service contracts (PSCs)**
- **Main reasons:**
  - Quite some money to earn on PSCs in Germany
  - Relatively simple business: many details of traffic (incl. passenger fares) are determined by the public authority, track access charges paid by them
  - Initially, German federal states and regional public authorities helped competitors to get started (even took part in some of them) in order to reduce their dependence on DB
  - Later on, national incumbents from other European countries (Italy, France, Netherlands) took over several of the new entrants

Remark on regional / local passenger:
Obstacles for the development of a common EU tender market for public service contracts

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 vanishing of strong independent competitors (Arriva!)
4. Market closure justified by social concerns
5. Fragmentation of the market (different types of rolling stocks, different types of public service contracts)
   - → 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 also addressed in 4th Package]

Political recommendations

(1) Technical standards

- **Support the 4th Package's thrust on <u>harmonising technical standards and certification procedures and strengthening the European Railway Agency (ERA)</u>**
- **After the 4th Package:**
  - For a long time, national particularities will have to be considered in certification. ERA should become responsible for the national particularities as well. If national institutions remain responsible here, they will develop a second tier in certification, making everything more difficult.
  - EU should as soon as possible monopolise certification of new technologies like locomotives driven by hydrogen (i.e. forbid national institutions to grant such certification)
  - EU should push for the definition of a future common standard of traction power (voltage, details of the overhead traction line, etc.) in the Union. Maybe by an auction among the efficient standards already in use. Conversion period of about 30 years.

Political recommendations

(2) A single EU market for public service contracts

- **Support the 4th Package's thrust on <u>creating a common market in passenger transport, particularly for public service contracts</u>**
- Mandatory open tendering of public service contracts
- **After the 4th Package:**
  - Set common standards for tendering procedures and contractual types
  - Add common standards for rolling stock for regional / local traffic (maybe at first on a voluntary basis, like a quality label)
  - Also add common standards for infrastructure aspects (in particular length and height of station platforms)
  - Beware that the issue of social standards of the employed might be used to effectively block market opening and fair tendering

Political recommendations

(3) We need a "Lex Arriva"

- **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 public service contracts
- 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, ...
- Note that integrated railway companies benefit from an exemption from State aid regulations – it therefore seems to be justified to subordinate them to special antitrust regulations

Political recommendations

(3 cont'd) We need a "Lex Arriva"

- **Proposal for a "Lex Arriva":** Any proposed merger in the transport sector in which a railway undertaking is affected either as target or as overtaking or as equal part should need the explicit consent of a special EU board to be made up by DG Mobility and Transport and DG Competition
- **The merger should not be allowed if the long-run development of competitive railway markets in the EU will likely be hampered by it**
- 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 good 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

Political recommendations

(4) Strengthen access regulation

- **In order to assure open access for competitors, strong and independent national regulators are needed**
- **Task 1: Guard fair <u>general access conditions</u> and licensing conditions**
  - Mind the problem of "non-price discrimination" in railways
- **Task 2: Regulate <u>access charges</u> with a view to "achievable efficient costs"**
  - This is relevant for all countries that allow infrastructure managers (IMs) to levy mark-ups for full cost recovery according to Art. 32 of Dir. 2012/34/EU (irrespective of vertical separation or integration)
  - These mark-ups shall not be based simply on the actual costs of IMs: Cost plus problem!
  - Rather they <u>should be based on critical cost assessments by regulators using benchmark methods and comparisons of various kinds</u>
  - This is what regulators usually do in other regulated sectors (telecom, energy, ...)

Thanks for listening & greetings from Karlsruhe!

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