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Foundations for Reform

Selected Case Studies

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The objectives of reform vary by country

- Improve overall efficiency and reduce environmental impact of the transport system by increasing the role of rail
- Reduce government expenditures on railway services and ensure government gets good value for money
- Improve the financial performance of rail
- Eliminate capacity constraints to economic growth
- Increase customer responsiveness and improve services
- Provide cheaper transport services to customers

- Key elements are to separate the management of the railway from policy making and ensure that management is commercialized
- In the initial stages, railway reform requires a set of clear and prioritized goals that specify desired outcomes of the reforms.
- These goals will help establish the types of reforms needed first and how to implement them

Coverage of Case Studies

- Europe:
  - The United Kingdom
  - Two Baltic States which were formerly part of the Soviet Union – Estonia and Lithuania
- Kazakhstan
- Conclusions

Reform in Europe began more than 30 years ago

The EU initially required member states to:

- Ensure railways managed along commercial lines driven by the market demands - independently of the state
- Infrastructure regarded as natural monopoly - separate business with own accounts
- States to support development of infrastructure
- Separation of historic debt
- Access rights to be granted to groupings of companies operating international services and combined transport operators (inter-modal)

Railway reform in Europe - general

Subsequent requirements

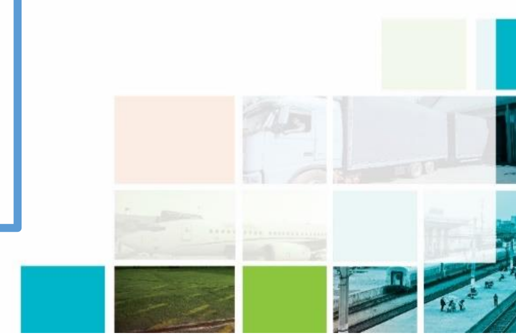
- Access rights were further widened allowing competition between carriers, beginning with all international freight
- Rules for infrastructure charging and capacity allocation were established
- Separation of public funding and accounts between freight and passenger operations

Public Service Obligations

Separately, if a state imposes a public service obligation (PSO) on a passenger transport provider, the state must compensate the provider for the cost

Assessment of reforms

- Some countries made early reforms with generally good results – but most continue to make major changes
- Other countries have hardly started as they are still not clear what to do



UK – a mainly passenger railway

- Reforms in the UK have been controversial, involving initially the complete separation and privatization of infrastructure
- Railways in Northern Ireland (part of UK) not reformed
- Infrastructure has been renationalized and is in the process of being partly reintegrated with passenger services

Railway reform faced major issues in UK

Activity	Initial reform	Issues?	Subsequent changes
Passenger railway operations	Divided into groups of services. All competitively tendered as franchises.	Cost increase as much risk passed to contractor. Misalignment of incentives with infrastructure manager.	Franchises now being replaced by new types contracts let same body that is responsible for infrastructure. Less risk now placed on contractor.
Freight operations and rolling stock	Sold as two separate companies.	New competitors entered market.	None needed.
Rail infrastructure provision	Infrastructure manager sold as single company. Tightly regulated with complex system of access charges and performance incentives	Poor performance. Problems of co-ordination and perverse incentives.	Infrastructure manager renationalized and now being reintegrated with passenger services under an arm's length body of the Ministry of Transport

In future infrastructure and operations should be better coordinated - as in holding company model used in many other countries

Railways in two Baltic States, Estonia and Lithuania

- Adopted very different approaches to reform
- Formerly departments of Baltic Railways, part of the Soviet system
- As part of the Soviet Union, mainly carried freight from Russia to Baltic ports
- Reforms were:
  - partly a response to the decline in traffic following breakup of Soviet Union
  - partly to prepare for joining European Union (EU) in 2004

Reforms in Lithuania have been relatively modest

- Relations with outside bodies redefined
- Other carriers - access to infrastructure at defined charges – though they carry little traffic
- Public Services Obligations (PSO) funded by government - cover 72% of passenger km
- Other bodies have taken on new roles:

Role	Body responsible
Economic regulation of railways	Competition Council
Licensing of railway undertakings (carriers)	State Railway Inspectorate under the Ministry of Transport and Communications
Safety certification of the public railway infrastructure	
Allocation of public railway infrastructure capacity	
Compilation and execution of Timetable	Lithuanian Railways

Lithuania - reforms focused on commercial management

- Converted to Joint stock company
- Directorates for infrastructure (non- commercial), freight and passenger
- Subsidiaries for ancillary services such as construction and repairs (not separated)
- Crucially modern accounting - International Financial Reporting Standards (IFRS)
- Transparent procurement
- Most senior managers now have commercial experience

Conclusion: Modest reforms with some benefits but no apparent problems encountered. Shows merits of a cautious approach.

Estonia's reforms were more radical

As a first step

- Railway was converted into a joint stock company and the operations were separated from infrastructure
- In 2001, 66% of the shares in the rail infrastructure manager were sold to a strategic partner
- A number of marketing initiatives were set up:
  - an on-line customer service system
  - a flexible pricing policy
  - 1/3/5-year contracts were signed with major customers

Results: Private carriers emerged and invested in GE locomotives

Traffic and profitability increased – and Government received dividends from its 34% share in the joint venture

Estonia then renationalized railway infrastructure

- In 2007, following pressure from the public, carriers and shippers, a new government bought back the remaining 66% of shares in the company
- Renationalization made it easier to borrow money from the European Union for Rail Baltica, a major investment project connecting all three Baltic States with the European rail network using standard 1435 mm gauge

In Kazakhstan, railways have seen major reforms

- KTZ has been established as joint stock company owned by the Sovereign Wealth Fund, Samruk
- Samruk defines modern approaches to corporate governance, including an independent board and committees, with some international members
- Freight and passenger operations have been established as separate subsidiaries
- KTZ has adopted international financial reporting standards (IFRS) and is audited by an international accounting firm
- Corporate strategy develop with McKinsey consultants
- Sales and marketing function established

Kazakhstan, external bodies are now involved in railways

- Most wagons are now privately owned, improving the quality of rolling stock and allowing KTZ to focus investment elsewhere
- Markets have been made competitive for transit and containers - tariffs deregulated – covers more than 50% of turnover
- Formed joint venture with terminal Lianyungang at a port in China in which KTZ holds a 49% share
- Some private passenger operations provided under contract

Kazakhstan: some policies have faced obstacles

Policy	Obstacles	Status
Policy to separate decision making from Government	Government sometimes involved in major decisions. e.g. on investment	Boundaries sometimes unclear.
Policy to separate infrastructure from holding company	Not yet possible due to staffing issues	Temporary contracts with freight subsidiary
Government policy was to introduce full competition	Not yet been introduced because KTZ retains many social obligations	Awaiting Government decision on how to create fair competition
Removal of cross subsidies from freight to passenger and between freight commodities	Lack government budget to support passenger services and domestic coal consumption directly.	Awaiting Government resolution
Some but not all social services disposed of	Railway runs through some very remote areas and local government lacks funds to take over	In progress

Despite these obstacles, KTZ has made remarkable progress on reform over past two decades

Conclusions from Case Studies

- Experience shows that railway reform is difficult and takes time
- There is no single ideal “best” solution which works for all countries – the solution depends on Government objectives, transport markets etc.
- There are often obstacles to overcome
- It has been necessary to reverse actions such as the privatization of infrastructure or other monopolies
- Other policies which have enabled commercialization have been more successful
  - ➢ steps to enable and carry out commercialization should be given highest priority and generally be undertaken first