Fourth railway package still divides Member States

SUMMARY

The fourth railway package was proposed by the Commission in January 2013. This is the latest in a series of reforms over the past 15 years that have led to deep-seated changes in the rail sector aimed at improving the quality of services, cutting their cost and creating greater interoperability within the European railway area, while provoking a radical rethink of public monopolies in the rail sector. Spurred on by the EU, European railway companies have gradually opened up to competition. Freight transport has been fully liberalised since 2007 and passenger transport has been partially opened up (for international connections only) since 2010.

With the fourth railway package, the Commission wants to take the process a step further. It proposes that, by December 2019, rail companies must be granted access to domestic passenger services in all EU Member States. In addition, it requires the functions of owning/operating the infrastructure to be separated from that of providing train services to customers, whether through institutional separation, or through a vertically integrated (holding) company, to ensure the necessary legal, financial and operational separation.

Furthermore, public service contracts will no longer be excluded from competitive tendering. This obligation will be subject to a value threshold, however, below which there can be a direct award if the costs of tendering would exceed the expected savings in public funds. Lastly, the procedure for vehicle authorisation and certification, from now on to be done on EU-wide scale by the European Railway Agency (as 'a one stop shop'), would be simplified, cutting costs and shortening administrative deadlines.

While the Council of the EU is far from a common vision on the proposal, the Parliament adopted its first-reading position in February 2014. However, the plenary did not follow the Transport Committee, drawing criticism from various stakeholders.

This briefing updates an earlier one of March 2013.
Background
The European rail sector generates turnover of more than €78 billion and employs more than 600,000 people. It benefits from substantial investment by public authorities (€26 billion for infrastructure and €20 billion for public service obligations in 2009). At the same time, a 2014 consumer scoreboard found that rail services were ranked 25th in a list of 31 services markets and came fourth in a ranking based on the number of problems noted, despite improvements in their score since 2011. These findings are nothing new. To remedy the situation and to make the sector more competitive, safer, and more concerned with consumer expectations in the long term, the European Union (EU) has opted since 2001 for gradual liberalisation by means of introducing packages of legislation (see box).

However, the high number of infringement proceedings brought before the Court of Justice of the EU for incorrect transposition of the first railway package is evidence of the difficulty in adjusting to the European Commission’s requirements for opening up the sector, and keeps alive the debate on the pros and cons of railway liberalisation.

Reasons for the fourth package
No effective separation of activities
According to the Commission, most of the EU’s railway network was designed to run as distinct national networks. The Commission also considers that infrastructure in the EU is, and will probably remain, a natural monopoly (a market where, because of high fixed or start-up costs, it is most efficient to concentrate activities in a single company).

Existing EU legislation therefore requires a degree of separation between infrastructure managers, which run the network, and railway companies, which run the train services on it (known as ‘vertical separation’), with the aim of ensuring fair and equal treatment of all operators. The first stage of this policy was separation of accounts (under the 1991 Directive), followed by legal and organisational separation (under the 2001 Directive). However, Member States transposed these Directives into national law in different ways, with the result that in practice the separation models differ.

The Commission maintains that whenever infrastructure managers are integrated into a holding company (a firm owning all of the shares of one or more subsidiaries), the separation requirement is not always respected and new entrants are often placed at a disadvantage. It also considers that the lack of effective separation within holdings companies leads to conflicts of interest and that the absence of financial transparency increases the risk of cross-subsidisation (a system whereby service operating costs are compensated at holding company level by infrastructure managers), thus leading to competitive advantages for incumbents.

The evidence on the overall impact which a degree of vertical separation has had on competition, costs and quality shows contrasting paths of evolution. For example, the cost of passenger rail is estimated to have fallen both in Sweden, where the market is fully liberalised, and in Germany, which uses the holding model, while costs in the fully open...
British market are estimated to have risen (at least until 2007). In other words, appropriate institutional structures and regulatory provisions are necessary to guarantee the full benefit of vertical separation. Similarly, a recently developed Performance Index (2012), measuring the intensity of use, quality of service and safety of European railways, concludes that 'there is only a weak correlation between performance and the degree of market liberalisation or the choice of governance model'.

In 2013, the Court of Justice dismissed the case brought by the Commission against the German and Austrian railway companies, thereby confirming the independence of their infrastructure managers, which are in holding companies.

Dominance of incumbent operators
The rail freight services market has been open to competition since 2007, and the international passenger transport services market since 2010. However, domestic passenger transport, representing 94% of all rail passenger-kilometres in the EU, remains largely closed to new foreign and national entrants.

In general, competition in railways takes either the form of competition for the market, i.e. several operators competing for exclusive rights over a specific route, through a public service contract (PSC) or a service concession, or competition in the market, namely several operators running on the same line, known as 'open access'.

Two thirds of domestic rail services are managed via PSCs, which are governed in principle by the Regulation on public passenger transport services. However, the heavy rail sector (i.e. conventional railways as opposed to light rail, which includes metro and tram lines) has been excluded from the obligation to award PSCs through tendering procedures. Consequently, most local and regional rail services operated under a public service obligation are directly awarded to companies. In several countries, rail service contracts are even granted with an exclusive right – i.e. without a public service obligation, therefore allowing some incumbents to operate as 'legal monopolies' on certain commercial lines (namely high speed trains in France, Spain, Portugal, and Finland). All this explains why, in 23 Member States with rail networks, the incumbent railway companies have a market share of over 90%, the sole exceptions being the United Kingdom (UK) and Estonia (see figure 1).

The degree of liberalisation of passenger rail markets can be summed up as follows (see figure 2):

- **fully liberalised markets** exist only in the UK and Sweden, where all passenger-kilometres are in 'open access', or where all PSCs are competitively tendered.
- **largely liberalised markets** can be found in Austria, Italy and Germany where more than 33% of passenger-kilometres are in 'open access' or correspond to competitively tendered PSCs.
- **partially liberalised markets** can be observed in the Czech Republic, the Netherlands and Portugal, where less than 33% of passenger-kilometres are in 'open access' or correspond...
to competitively tendered PSCs, but where new entrants have taken a significant share of the liberalised traffic.

- **quasi-liberalised markets** exist in Bulgaria, Denmark, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia, where the whole market is open through 'open access', but there is no effective competition in the market, i.e. the new entrants are operating directly awarded PSCs.

- **non-liberalised markets** can be found in Belgium, Finland, France, Greece, Hungary, Ireland, Luxembourg, Slovenia and Spain, where the incumbent operates all commercial services and provides all public service obligations.

Evidence from the OECD (2013) suggests that the formal opening up of freight rail to in-the-market competition has led to only a limited entry of new players. In many OECD countries incumbents still retain shares of between 70% and 90%, by adopting strategies that limit the ability of new entrants to gain market shares. Similarly, the experience of those countries that have used competitive tendering shows that they face complex decisions in achieving an appropriate allocation of risk between government and franchisee (i.e. those who operate a contracted service on a particular part of the rail network under licence from the government, as is the case in the UK), while preserving performance and investment incentives. For example, franchisees may not be in a position to manage certain macroeconomic risks, such as inflation, which may be more appropriate for governments to assume. Also, bidders anticipate that the government will in practice partly insure the winning franchisee, which in turn encourages them to bid more aggressively than is justified by their financial situation, potentially leading to contracts being awarded to the 'wrong' bidder. The scope and duration of contracts involve similar trade-offs. Even though from an economic viewpoint shorter franchises are less favourable, they allow more regular competition for the market by removing the need for cost reduction initiatives with a payback period longer than the lifetime of the contract.

**Fragmented management, profusion of rules**

Rail is the second safest mode of transport in the Union, and EU railways are among the safest in the world (see tables 1 and 2). Management of technical safety standards is, however, split between the European Railway Agency and the national authorities. As a result, there are over 11 000 EU and national rules which exist in parallel to each other.

This system entails very high administrative costs and acts as a barrier to new market entrants. Procedures for authorising new rail vehicles can take up to two years and cost up to €6 million.
The fourth package in brief

The Commission adopted the fourth railway package, comprising six legislative proposals, in January 2013, with the intention of improving the quality of rail services while widening their range. The passenger transport market should be fully opened up by 2019.

Governance

All parties have focused much attention on the underlying principle of railway governance (separation of infrastructure managers and service operators). The media have also highlighted some Member States' attempts to make the separation principle more flexible. The Commission proposal advocates institutional separation as a model for governance. Nonetheless, existing structures could remain in place, provided that companies' independence could be guaranteed within an integrated structure. For this, holding companies would have to meet four criteria: separate decision-making bodies; genuinely independent funding (no cross-subsidisation); independent IT systems, and a waiting period before staff can move from one company to another (to prevent conflicts of loyalty).

It should be noted that once the markets have opened up completely, all Member States would be able to block a foreign holding company's access to their markets, if the Commission has not validated the presence and effectiveness of all four criteria.

Another key point in the field of governance involves the redefinition of the role of infrastructure managers with a view to providing greater guarantees of their independence. The Commission intends to assign to all of them the exclusive right to handle the central functions associated with rail networks, namely those involving development (for instance investment), operation (e.g. traffic management), and maintenance. In addition, all European infrastructure managers will have to cooperate, through a network, to improve the handling of cross-border issues. Lastly, the establishment of a coordination committee should provide infrastructure managers and network users with a meeting point that can be used to prevent and solve problems.

Opening up of passenger transport markets

To ensure that users benefit from a better quality-price ratio after the market has opened up, the Commission is proposing that liberalisation be applied only to markets over and above a minimum size, to be calculated on passenger volume or train-kilometres (i.e. the number of kilometres travelled by trains per year). Regional markets that are too small would therefore be excluded and would continue to be served by the public service only. Larger markets would be opened up to competition through tenders for PSCs running for 15 years at most. In this event, the transfer of staff would also be guaranteed (see below).

Rolling stock (locomotives, carriages) is very expensive and can be depreciated over an operating period of 30 to 40 years. However, the new proposal restricts the length of PSCs to 15 years. In the absence of a mechanism to manage the risk associated with the residual value of rolling stock at the end of a PSC (the risk of rolling stock being sold at a lower price than expected at the end of the contract), tenderers would have to include this in the price of their tenders, which would make them considerably less competitive and would give the incumbent undertakings an advantage. To circumvent this problem, the Commission proposes making it mandatory for the public authorities concerned to take on the financial risk linked to the residual value of rolling stock.

The Commission also advocates the voluntary establishment of integrated ticketing systems to make it easier for travellers to use several means of transport run by one or more operators over one route.
Interoperability and safety
The Commission wants to simplify the authorisation and certification of vehicles, to make it easier for new operators to enter the market and to cut costs and the time involved in these procedures. It suggests that ERA should act as a one-stop shop for issuing EU safety certificates. That will also facilitate deployment of the EU rail traffic management system. The Agency will also supervise the rules and national authorities. In addition to these changes, ERA’s governance structure and internal modus operandi will be improved. The aim of these measures is to achieve a 20% reduction in the time new operators wait to enter the market, and a 20% reduction in the cost and length of the rolling-stock authorisation procedure. This should also help railway companies save €500 million over five years.

Social dimension of the fourth package
Over 600 000 people work in rail transport (see figure 3). According to the Commission's impact assessment, around 30% of workers in the sector will retire in the next 10 years. It may also be necessary to restructure railway companies to improve productivity.

EU directives establish minimum requirements in terms of working hours and working conditions for cross-border workers, and a framework for the posting of workers. To provide the necessary safeguards to workers after market opening, the existing legislation lays down the conditions for the mandatory transfer of staff whenever a PSC is awarded. The Regulation on public service obligations in passenger transport enables competent authorities to require that staff be transferred and/or to set standards and criteria whenever a PSC is awarded to another rail company.

The Commission also thinks that the framework provided by the EU's social and welfare regulations should prevent a 'race to the bottom' once the railway market becomes fully open. It notes, however, that with the number of operators expected to rise after the market opens up, Member States will have to deploy more resources for monitoring and implementing existing legislation. National inspection services already have difficulties in this regard.

In some Member States (Belgium, France, and Luxembourg), employees in the incumbent companies have kept the special status that gives them a high level of social protection. But this situation is changing in some other Member States (Austria, Denmark, Germany, and Greece), although a large number of employees still enjoy this special status.

According to the Commission's impact assessment, full liberalisation should have a fairly gradual impact. Judging from the experience of Member States that have already opened up their markets (e.g. UK and Sweden), market opening should produce new, better-quality jobs. On the other hand, the Commission has made it clear that the impact on jobs will depend to a large extent on measures to improve productivity, and here Member States start from very different points.

A study (2011) on the effects of market liberalisation on the passenger rail market in Sweden, Denmark and Estonia highlights that since market opening, salary levels (for train drivers in particular) have risen and working conditions have improved. The shortage of specialised labour which new operators have come up against has contributed to improving
pay and working conditions, a fact that has, in the long term, once the initial distrust had passed, turned private operators into highly desirable employers.

**European Parliament position**

The EP adopted its position at first reading in February 2014. However, the plenary did not follow the line recommended by the EP’s Transport Committee. One of the rapporteurs, Said El Khadraoui (S&D, Belgium), argued that holding a vote so close to the European elections had been a mistake and might have put a lot of members 'under pressure from their respective national authorities or railway companies', with various MEPs confirming that there had been lobbying from rail companies.

The different elements of the so-called 'technical pillar' of the package (recasts of the Safety and Interoperability Directives and a new regulation on ERA) have not raised any major issues and the corresponding reports were adopted by large majorities. The Agency will work with national rail bodies and have the final say in the event of a conflict, as is the case with the European Aviation Safety Agency for air travel.

However, concerning the more political 'market pillar' of the package, the approach of the Transport Committee has been weakened as a result of amendments adopted by the plenary. On governance and market opening, although the EP did agree upon the financial separation of companies within a single structure, it will still be possible to make financial transfers between the units in the form of dividends and losses. Infrastructure managers will share some of their powers with network operators, since only key functions will be subject to separation and it will be possible for management boards to remain interconnected.

The report on the proposal concerning public service obligations, adopted by a small majority (386 to 296 votes, with 78 abstentions), would give Member States the option of organising a call for tenders or directly awarding a PSC. Granting contracts directly will however only be possible if strict cost/benefit requirements are met. The new measures would come into force only from 2023 onwards with a 10-year transition period. The EP has also introduced a controversial reciprocity clause to ban operators from countries that have not opened up their markets from responding to public calls for tender. Accordingly, it has adjusted the minimum number of operators for any bid to match the size of the contract in question (in terms of number of train-kilometres). Social standards will have to be taken into account when awarding PSCs, but the plenary rejected an amendment to ensure minimum services have to be provided during strikes.

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<th>Reactions to the European Parliament vote</th>
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<td>Except for a number of major railway operators, the EP vote has been met with criticism. Between 2 600 and 4 000 railway workers (according to the press and the European Transport Federation, respectively) gathered in protest outside the EP in Strasbourg ahead of the vote. The trade unions were not reassured by the provisions adopted to guarantee the public nature of the railways. However, they welcomed the efforts by MEPs to protect workers' social rights. The Community of European Railways representing the major EU railway monopolies welcomed the vote and particularly the amendments on the railway governance model, which were largely inspired by its position on the subject. In contrast, Siim Kallas, the then Commissioner for Transport, regretted that &quot;vested national interests [...] proved more appealing to MEPs than the balanced and well-reasoned compromises reached [...] by [the EP's Transport Committee]&quot;. Similarly, the European Railway Freight Association deplored the fact that the EP had not supported the full independence of infrastructure managers and its amendments neutralised most of the 'market pillar' measures.</td>
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In October 2014, MEPs from the Transport Committee confirmed their positions on the six regulations and appointed two new rapporteurs: David-Maria Sassoli (S&D, Italy), to report
on railway governance, and Wim van de Camp (EPP, the Netherlands) on public service contracts. Transport Committee Chair Michael Cramer (Greens/EFA, Germany) also asserted that the railway reform would be discussed as a package, without separating its political and technical elements.

**Council discussions**

After several rounds of discussions, EU Transport Ministers are still very much divided over the ‘market pillar’ of the railway package. During their latest meeting in the Transport Council on 8 October 2014, the Italian Presidency called upon them to express their views on the three main issues under discussion: the liberalisation of passenger transport at EU level, the model of governance and the allocation of PSCs. Their reactions were mixed.

Liberalisation seems to be the most controversial issue in the dossier. Some countries – namely the UK, Germany, Spain and Sweden – see it as an opportunity, while others are less favourable and call for prior impact assessments and long transition periods. Cherry-picking (i.e. choosing the most frequented and thus most profitable lines) is a concern shared by most delegations, since it could lead to the neglect of less profitable lines. This also accounts for the fact that many countries wish to keep the option of direct allocation of PSCs. To counter cherry-picking, various delegations raised the possibility of including both profitable and less profitable lines in contracts open to tender.

The model of governance is yet another major concern. Germany, Austria, Slovenia and Luxembourg indicated that they wish to maintain the system of integrated holding companies. Several countries – among them France – argued that the choice of governance should be left to the national authorities. However, in order to guarantee non-discriminatory access to the network, delegations were generally of the opinion that regulators should be reinforced and that financial transparency should be the general rule.

**Endnotes**

1 However, the results of the latest Eurobarometer survey on railway services (December 2013) show that on average, more respondents are satisfied than dissatisfied with the individual aspects of railway travel.

2 In 2012, the French competition authority fined SNCF (the incumbent operator) €60.9 million for various anti-competitive practices.

3 All of the Member States were late with transposition of the Directive concerned.

4 This is a unit of measurement showing the development of the basic demand for passenger transport. A journey of one person over 100 kilometres yields 100 passenger-kilometres.

5 Concessions are typically high-value, complex and long-term contracts. Under a concession, an economic operator receives substantial remuneration through being permitted to run the work or service, whereas under a public contract, an economic operator is awarded a fixed payment for completing the required work or service.

6 25 of the 27 Member States prior to Croatia’s accession have a rail network, i.e. all Member States apart from Malta and Cyprus.

7 S. El Khadraoui (S&D, Belgium) did not get re-elected, and M. Grosch (EPP, Belgium) did not run for another term.

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