Abstract

This note reviews the experience of vertical separation in the European railway sector. It discusses the advantages and disadvantages of vertical separation as well as its economic, operational, safety and user impacts. Different approaches to vertical separation have produced different results, some having a substantial positive impact in terms of the competitive development of the railways, but others less so. This note sets out the results of a comparative analysis, drawing on a range of source material.
EXECUTIVE SUMMARY

The objective of this note is to provide a summary of experience across EU Member States concerning the separation (unbundling) of railway operations from railway infrastructure management, looking at the advantages and disadvantages of vertical separation. It also reports on five case studies: Great Britain, Sweden, the Netherlands, Italy and France (in each case, exploring the impact of separation on economic costs, operations, competition and safety, as well as taking into account the perspective of rail users), with these case studies being chosen as representative of the various separation models across Europe. Finally, the note draws conclusions from the European experience of vertical separation with a view to informing future policy discussions.

In several network industries, vertical separation has fostered the development of competition and the realisation of largest and more efficient markets, stimulating additional employment and increased investment. The railway sector differs from other network utilities mainly in terms of systems that require coordinated investment and the substantial technological barriers that remain between Member States.

The experience of other industries suggests that there are significant gains to be made from restructuring and liberalisation, notwithstanding the existence of technical barriers between national networks. The Recast consolidates the requirements in previous Directives and defines them in more detail, but does not go as far as requiring the full vertical separation of the infrastructure manager and railway undertakings.

The findings of this note indicate that the recent EU rail legislation, while having a significant impact on the organisation of rail industries within the various Member States, has done little to increase rail’s share of the passenger and freight markets. The impact of vertical separation may only be evident after a long period and the rail industry is operating within a reasonably stable legislative, regulatory and economic environment. The selected case studies suggest that the observed trends in costs, fares and service quality can be explained by a wide range of factors and cannot be attributed to vertical separation itself.

Nevertheless, it is clear that the development of competition has become more established in countries which have been subject to full separation, such as the UK, than in other Member States where the extent of restructuring has been more limited. This supports the view that separation coupled with a strong regulatory framework can be more effective than regulation alone in ensuring non-discriminatory access to rail networks.

KEY FINDINGS ON VERTICAL SEPARATION

- In the railway industry, the greatest benefits arise from the separation of freight operations - rather than passenger operations - from infrastructure management, as passenger operations are usually highly dependent on public funding and the opportunities for purely commercial operations tend to be more limited.

- In the UK, the introduction of competitive franchise bidding has helped to stimulate market growth and encouraged service innovations as well as constraining elements of the cost base, although costs have increased substantially since 2000. Whilst this is partly a reflection of enhanced investment in response to the effects of previous policies on renewals activity, it has been argued that industry costs are excessive.
and this may be partly the result of complexities and inefficiencies introduced by the contractual matrix put in place at the time of privatisation.

- In Sweden, which has a long history of vertical separation, coordination issues have not arisen following vertical separation. On the contrary, there has been an improvement in performance and a reduction in delays since separation.

- In the Netherlands the evidence suggests that vertical separation of the rail sector has supported improvements in punctuality, reliability, capacity and safety. Furthermore, there is no clear evidence that vertical separation has led to a significant increase in the costs of either the infrastructure manager or the main incumbent train operator.

- In Italy, there has been substantial entry into the freight market following market opening, notwithstanding the fact that there is still partial integration and new entrant operators continue to identify barriers hindering access to the network.

- The experience of the French rail industry provides little if any evidence of the impact of separation. The partial nature of the separation has meant that the scope for introducing competition and increasing transparency has not been realised and that there has been little if any change in efficiency and the passenger experience.

- The authors of this note suggest that future policy options for ensuring non-discriminatory access and encouraging new entry could usefully focus on independence of operational decision making as distinct from legal separation, not least because regulation alone is unlikely to prevent non-discrimination. Other issues, such as the ability of a dominant railway undertaking to unduly influence capacity allocation and other decisions through co-location with the IM should also be addressed.

- **Mechanisms for ensuring full vertical separation need to be informed by a thorough understanding of the potential costs arising from the adoption of a particular structural model.** These may be significant where the model requires the introduction of a complex contractual framework providing for, inter alia, the coordination of the timetable, payment of liquidated damages for delays and extensive consultation across train operators when planning infrastructure enhancements.

- It would also be helpful to have a **better understanding of the impact of vertical separation on the management of the wheel-rail interface** than is currently possible on the basis of previous studies. However, in investigating these issues further, it will be important to avoid drawing overly-simple conclusions on the basis of the experience of individual Member States. As the evidence reported here demonstrates, observed trends in costs, fares and service quality can be explained by a wide range of factors and in most cases cannot be attributed to vertical separation itself.