Britain: Railtrack collapse sparks political crisis

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22 October 2001

Five years after the previous Conservative government broke up and privatised Britain's national rail system, Labour's Secretary of State for Transport Stephen Byers has pulled the plug on the infrastructure company Railtrack. The debt-laden company, which owns the track, stations and signals, has been dependent upon government subsidies throughout its existence. Byers placed Railtrack into administration, using his powers under the 1993 Railways Act.

Railtrack had been on a financial life support machine for more than a year, but its collapse is a major political crisis for the government. Moreover government plans for the company will not resolve the problems facing the industry. Instead they will shift the cost of the debacle onto the workforce, commuters and taxpayers, whilst making the future of the national railways further dependent on the financial institutions.

Late on Friday October 5, Byers informed John Robinson, the recently appointed Railtrack chairman, that the government would not give the company any more cash. Without another tranche of the money promised for its investment programme, Railtrack would be in breach of its debt covenants and could not pay its bills. So Byers obtained an order from the High Court to appoint the accountants Ernst & Young as administrators with full control over Railtrack, and make preparations for it to be transferred to another company. Placing Railtrack in administration serves to avoid bankruptcy and protect it from its creditors.

Byers said that the government would pay Railtrack's trade creditors and service its loans of £3.5 billion until a new company could be set up. In the short term, 1,000 management jobs are to go. Several major investment programmes are now in doubt, including the cost of upgrading the dilapidated West Coast mainline route to the North West and Scotland—promised at the time of privatisation—which has spiralled from £2.3 billion to more than £7 billion, and is still rising. Also in doubt are the second stage of the Channel Tunnel Rail Link (CTRL) to provide a high-speed line from London to the Continent, and the Thameslink 2000 project to link north and south London.

Byers ruled out the re-nationalisation of the track system, saying that the government intends to set up a *not for profit* trust, or company limited by guarantee (CLG). To be run by representatives from the rail regulators, industry, the train operators, the trade unions, passengers and the government, unlike Railtrack the CLG would have no obligations to provide dividends to shareholders. It would borrow money to purchase Railtrack's assets and its income would come, as is presently the case, from government grants and track access charges paid by the train operating companies (TOCs). It would also be free to raise finance on the capital markets for its investment programme.

In effect, the new company is to be little more than a brokering company, outsourcing most of its large scale projects to consortia, financed via Public Private Partnerships with a mix of government grant and private sector debt, thereby further increasing the rail industry's fragmentation. The rail regulators, who oversee the industry, would be merged.

The collapse of Railtrack means that the shareholders of its parent company, Railtrack Group Plc, will get little if any compensation for their shares. Even bondholders (who hold assets worth £1 billion) may not get a full payout. The shares, which cost £3.60 at privatisation, soared to nearly £18 in 1998, but were only trading at £2.76 when they were suspended. Byers said, "I can say for certain that there will be no new tax-payers' money made available to support shareholders". Railtrack Group Plc, while not in administration, is also likely to be wound up or sold on.

Railtrack's directors, widely reviled for their incompetence and greed, are furious that the gravy train has hit the buffers and are threatening to sue the government on behalf of the shareholders. In the five years since privatisation, Railtrack's shareholder have received dividends worth £466 million.

The privatisation of British Rail (BR), the last of the major privatisation's that spawned 24 of the top 100 corporations on the London Stock Market, will go down in history as one of the most conscious looting operations ever carried out. And it was undertaken supposedly to demonstrate the superiority of the free market over all forms of economic regulation.

Britain's nationalised rail system was always beset with major difficulties. Its creation in 1947 was far from being the socialist measure depicted by the Tories under Margaret Thatcher and then John Major. As a highly capital intensive industry, linked in the first place to the extractive industries such as mining, its finances were always precarious, even prior to nationalisation. Most of the profits came not from running the trains, but developing the land that lay alongside the tracks. Working conditions were appalling and there were calls from the workers and the trade unions to take the railways into public ownership as early as the latter part of the nineteenth century.

The rise of road transport worsened the situation confronting the rail system, to the point where its survival was threatened. In World War Two, the railways were brought under government control. Afterwards, the Labour government of Clement Atlee nationalised the rail network as part of a programme of state takeovers of private industries, such as coal mining and steel, which were finding it difficult to maintain profitability but were considered essential to the overall needs of British capitalism. It is no exaggeration to say that without the nationalisation of the railways in order to provide a more efficient and low-cost service, freight transport would have collapsed.

But the railways faced an impossible regime under public ownership. Nationalisation of the bankrupt industry in 1947 had saddled the railways with huge debts and the need to make compensation payments to the former owners. Successive governments compelled BR to finance its capital investment with loans, rather than government grants, and to charge passengers prices that covered their full costs. BR usually made an operating profit, but following the election of the 1979 Thatcher government, BR was required to make a higher rate of return than the private sector. In any case, interest charges always wiped out any surplus.

Between 1976 and 1994, when it was restructured for privatisation, BR shed one third of its workforce. Labour productivity, already the highest in Europe, rose. Government grants fell from 26 percent of revenues in 1976 to 15 percent in 1994, making it the least subsidised railway system in Europe. Ticket prices rose repeatedly to make up for the fall in passenger numbers and diminishing government subsidies, which only served to further choke off demand.

After decades of deliberately undermining the state-owned rail system in favour of the auto industry and private road haulage, the Conservative government announced in 1993 that the railways were to be broken up and sold off.

Publicly the government argued that the decline in mass industrial manufacturing, the disappearance of the coal industry and the transfer of freight to road transport meant there was no argument for a state run rail system. Like other formerly publicly owned corporations, it should be made to stand or fall in the private sector. This would encourage BR to "trim the fat" and make itself attractive to corporate investors, while providing a new and more efficient service to passengers.

In truth, however, BR's privatisation was never left to the market forces supposedly considered sacrosanct by the Tories. Firstly, the price of the share issue was set artificially low in order to provide the major investors with a speculative windfall. Train services were carved up into 25 franchises and offered to new companies on seven-year contracts. The rolling stock was divided up among three leasing companies, from whom the train operators would lease the trains. Engineering and maintenance services were also split up. Sold at knock down prices, nearly all the newly formed companies were sold on within a matter of months at three times their original price.

Railtrack formed the core of the privatisation. It would run the infrastructure and charge the train operators for the use of the track. However, its mandate to run all major capital projects made it the least profitable part of the privatisation. In order to encourage a take-up, therefore, the Tories once again cooked the books. The government wrote off £1.6 billion of public debt, (which taxpayers are still paying) and transferred £1 billion of liabilities to the County Councils. It promised Railtrack all sorts of tax breaks and capital allowances. The company was able to inherit a pension fund that was in surplus, and was granted a pensions holiday, freeing it from making contributions into the fund for a period. Above all, the government actually trebled subsidies, without establishing a unified system of regulation.

Under the Tories, subsidies that had once been given to the public monopolies were now given to private sector corporations. This marked a new stage in the decline of British capitalism and the on-going assault on the social position of the working class. Not surprisingly, therefore, when Railtrack shares were offered for sale in May 1996 at £1.9 billion—a fraction of the £4.5 billion book value of the assets—they were oversubscribed. Even the government's watchdog, the National Audit Office, criticised the sale.

But rail privatisation was no more successful in restoring the fortunes of British capitalism than it was in delivering an efficient rail service. The restructured and highly subsidised Railtrack, the leasing and engineering companies and some of the train operators initially made a profit. But far from bringing efficiency and benefits to passengers, as the Conservatives had promised, privatisation led to a hike in fares—already the highest in Europe—huge cuts in the workforce, and a dwindling investment and maintenance programme. Within a few years, Railtrack was more heavily in debt than its nationalised predecessor.

The fragmentation, outsourcing and subcontracting undertaken to cut costs in the rail industry, also led to a situation where each of the component parts blamed the others for any problems. The service deteriorated rapidly, as trains were cancelled or delayed due to a shortage of staff. Despite this terrible record, and substantial public support for the rail system to be taken back into state ownership, Labour refused to countenance such a move.

The mission statement of the incoming 1997 Labour government was to extend privatisation by turning over public services, such as air traffic control, London Underground, hospitals, schools and prisons to the corporate sector via the Private Finance Initiative (PFI) and Public Private Partnerships (PPP). These new policies were a bonanza for the bankers and construction corporations and spawned the facilities management industry that fed off the public services. Outsourcing in its various guises rose from 40 percent of annually managed public expenditure at the beginning of the 1990s to 60 percent at the end of the decade.

In the context of the railways, Labour's sole practical contribution was an attempt to beef up regulation by establishing the Strategic Rail Authority and appointing a rail regulator who would "incentivise" Railtrack to improve its performance.

Running Railtrack for profit had a catastrophic effect on safety. The fatality rate soared, with three major crashes in as many years. The last, at Hatfield in October 2000, which killed four people and injured dozens more, was caused when a track, known to have been broken for months, derailed a 120mph London-Leeds express train. Hatfield replicated many of the features of previous crashes, which in turn could have been prevented if the recommendations of the Inquiry into the Clapham disaster in 1989 had been implemented.

Such was the public outcry that Railtrack was forced to announce an emergency track replacement programme, plunging the entire network into chaos. The cost of the repair work has already risen to more than £600 million, with no sign yet of achieving a turnaround. Railtrack was pushed into the red and found it difficult to raise funds from either its shareholders or the financial institutions. The company's very survival was now at stake.

Labour's reaction displayed its commitment to the inalienable right of the corporations to make a profit at public expense. The Blair government had sought to legitimise its creeping privatisation in two ways. Firstly, it was declared to be essential if adequate investment was to be found to refurbish Britain's crumbling infrastructure without increasing government debt. Secondly, it downplayed the Tories' mantra of private sector efficiency and substituted its own one of "risk transfer". Labour argued that PFI/PPP would provide value for money over the life of the project, because the private sector would be carrying the risks and the costs if things went wrong.

But it was Labour that forced the taxpayer to shoulder the cost of a last-ditch attempt to save Railtrack. It put together a financial rescue package to fund one third of Railtrack's five-year investment programme of £15 billion, making extra cash available to replace broken rails and for new signals safety systems. Railtrack was also allowed to raise track access charges to the train operators, which would inevitably be passed on to passengers in the form of higher fares.

Though never financially viable and always heavily dependent upon government subsidies, Railtrack continued to pay out dividends to its shareholders. After the government's initial rescue package share prices rose 13 percent. But this could not last. Railtrack shares began to collapse. It was unable to raise cash from the Stock Exchange and went back to the government for £2.6 billion in May and a further £1 billion in July this year.

Byers, newly appointed as Transport Secretary, called in financial advisors who effectively said that with or without the government taking a stake in the company, rescuing Railtrack was tantamount to writing a blank cheque. Moreover, such another bailout would have been hugely unpopular.

By the beginning of October, Railtrack needed an immediate cash injection to stave off collapse. But allowing Railtrack to slide into bankruptcy would have caused chaos, effectively bringing the entire rail network to an immediate standstill. Byers therefore decided to pull the plug, first checking with the Office of National Statistics that any debt incurred by the new *not for profit* trust would not count as government borrowing, thereby securing Treasury approval for the scheme.

Byers hoped that a public announcement under the cover of the Afghanistan air strikes would keep the whole affair off the front pages, so was unprepared for the political and financial backlash that followed.

The train operating companies opposed the government's scheme. The regulators, who were not even consulted and knew nothing about Byers' proposals, have been scathing in their condemnation.

Many railway workers who had been encouraged to buy shares, and those who were given shares in exchange for productivity deals are furious at being short changed.

Railtrack's directors, to divert attention from their own disastrous record, have threatened to sue the government for compensation for their shareholders. They claim that without discussing the administration order with the Board, the government allowed a false market in Railtrack's shares to take place.

Their claim has little legal substance, but there are wider concerns in the City that are not so easy to dismiss. The financial institutions, such as the pension funds, which traditionally depend upon the top 100 blue chip companies for a constant stream of dividends to be able to make payments to pensioners, own three-quarters of Railtrack's shares. They fear that the other privatised utilities, which have seen their profitability decline, could also be brought into administration at some future date.

Byers did receive a rapturous endorsement from the likes of Will Hutton, the liberal journalist who functions as an advisor to the government, however. In an article in the *Observer* newspaper, headlined "Byers deserves a round of applause", Hutton welcomed Byers's plan as a 'third way' alternative to nationalisation and a model for all the privatised utilities to adopt.

In reality, any public scrutiny of either Railtrack's fate or the contradictions and the inconsistencies in Byer's proposed rescue plan undermines the government's policy of using private finance to privatise public services. It is not just the shareholders but also the creditors—the banks and other lending institutions—upon whom the Blair government depends for its privatisation schemes.

Already the financiers of the London Underground PPP have indicated that they will need a tighter legal agreement to prevent the government terminating their contract. The alternative is a higher rate of interest to compensate for the additional risk, adding to the enormous cost of the project.

Other PFI/PPP projects that had calculated that they could go back to the public sector for more cash when costs rose, are set to follow suit. This will expose Labour's deeply unpopular policy and its threadbare justification for PFI/PPP: that it will provide greater value for money than conventional public funding, transfer risks to the private sector and "incentivise" the contractors to deliver an efficient service. Far from transferring risk to the private sector, the private sector is demanding that the government provides copper bottom guarantees.

"Son of Railtrack" will need to raise finance to take over the company's assets and implement the investment programme. But in the absence of an adequate revenue stream from passenger traffic and grants or guarantees from the government, such loans would have junk bond status. In this case, the new company, with or without shareholders, would be unviable. While the French rail company, SNCF, and the German bank, WestLB, have indicated an interest in taking over Railtrack, similar considerations would apply.

Alternatively, the government will have to provide more subsidies and/or guarantee the debt, or the administrator will have to give away Railtrack's assets, built up over decades with taxpayers' money. Thus irrespective of the legal form of ownership, the real beneficiaries will be the financial institutions and bondholders. Whoever the new owners are, the CLG will own the debts and the banks will own the revenue generated by the company's assets.

Byers' half-baked plans serve only to make the rail industry ever more subservient to the demands of the City, leading to further job cuts, fare increases, line closures and cut backs in investment that will jeopardise both services and safety. Already he has made it clear that he will do his best to placate the City. While he has refused any "new" money for shareholders, he has announced that the licence to run the Channel Tunnel Rail Link, worth £400 million and £370 million of cash in the bank will be given to Railtrack's parent company, and ultimately the shareholders.