More shadows than light

Next month, a working party convened by the German transport ministry is due to come up with legislative proposals for the partial flotation of Deutsche Bahn. However, there are still many policy discrepancies, which may impact on the European strategy for greater liberalisation of the continent's railways

Infrastructure management and the operation of regional passenger services will play a crucial role in defining the future of DB under the present reform proposals
Photo: Marcel Vleugels

AT FIRST GLANCE, from a purely economic point of view, Deutsche Bahn AG has been developing very well in recent years, under the dynamic leadership of CEO Hartmut Mehdorn.

Service, staff motivation and DB's image have all improved, and the old government-owned public railway has gradually been converted into a more service-oriented transport provider. Rolling stock, stations and technology have been modernised.

On the freight side, acquisitions totalling billions of euros have turned DB into the second-largest logistics group in the world, and this giant business is profiting from the current global logistics boom.

The extraordinarily high number of employees inherited following reunification has – by and large – been reduced in a socially-compatible way. Infrastructure costs have also fallen, partly through line closures and partly through cuts in maintenance work.

DB reported an operating profit (EBIT) of €1·35bn for 2005, up from its first ever proft of €1·14bn in 2004. This result was buoyed up by the revenues from its logistics business and substantial state support payments for its regional operating contracts. This encouraged Mehdorn to insist that the railway is now ready for a stock market flotation that will provide the capital for further expansion on the international stage.

On November 9 Germany's coalition government finally reached agreement on the accounting treatment of the infrastructure (RG 12.06 p757). Draft legislation is due to be published next month, with the intention of selling up to 49·9% of the company through a stock market listing in 2009.

So far so good. But readers may ask why the title of this article tends towards the negative.

In the last decade, DB has accumulated debts of around €25bn, which are approximately equal to the group's annual turnover. At the same time, radical cuts to the cost base have been at the expense of freight transport in particular. This is definitely not the way to ensure that more freight is moved by rail, which is the declared goal of national and European transport policy.

DB is considered to be setting the pace in terms of on-rail competition in mainland Europe, but in reality it seems to be prepared to do anything to make life for new entrants as difficult as possible.

Competitors must purchase their traction power from DB, but they pay significantly more than DB's subsidiaries Fernverkehr, Regio and Railion. DB has also been systematically scrapping surplus rolling stock to ensure it does not reach the second-hand market and consequently benefit potential competitors.

Arthur-Iren Martini
Secretary General
Netzwerk Privatbahnen

Expressed in military jargon, DB is conducting a temporising battle against competition. All too often it has to be forced to comply with legal requirements by the courts. And in this respect the regulatory authorities are no better off than the private operators.

So how does this all fit together? On the one hand, here is a fast, successful, squeaky clean rail network, number one on the Liberalisation Index (according to a study funded by DB!) And on the other, the 'evil' state monopoly which blocks competition - directly under the eyes of the European Commission and the federal government, both of which sing the praises of on-rail competition.

Policy discrepancies

In order to understand this dichotomy, readers need to know how rail policy is developed in Germany.

During both of the last two legislative sessions (1998-2005) there was a strong rapport between Mehdorn and the then federal Chancellor Gerhard Schröder. DB's CEO was so influential that he not only survived the shambolic attempt to reform the passenger fare structure using market pricing, but was even able to use the opportunity to extend his contract until 2008.

Furthermore, Federal Minister for Transport Kurt Bodewig was asked to resign in 2002 after he expressed support for the separation of rail infrastructure and transport operations. DB's Supervisory Board Chairman Dieter Vogel, a former head of Thyssen and one of the most competent and experienced figures in German industry, also resigned in 2001 for the same reason.

From then on, German railway policy has been primarily shaped by the DB group, whilst the influence of the Transport Ministry has steadily waned. To date, no ministerial bureaucracy has been able to match DB's detailed knowledge, specialist competence and inexhaustible manpower.

Netzwerk Privatbahnen recently discovered that neither the Transport Ministry nor its subordinate, the Federal Railway Authority (EBA), were aware of the detailed condition of the German railway infrastructure. The government

Operating mainly in the intermodal, chemicals and unit train markets, open-access freight operators are starting to attract new business to rail both domestically and on international routes despite ongoing problems dealing with German infrastructure manager DB Netz
Photo: Ernst-Joachim Gerlach

didn't know, and still doesn't, what effect the billions of euros of state funding pumped into the railway each year have had on the general condition, availability and capacity of the network. In Germany only one side knows the exact condition of the rail infrastructure, and DB guards this knowledge like the crown jewels.

For comparison, Netzwerk Privatbahnen recently arranged a presentation to experts in Germany of the UK railway business structure, whereby Network Rail is required to report regularly to the Office of Rail Regulation. Here the infrastructure manager is clearly subordinate to a strong executive authority, and cannot circumvent the obligation to provide detailed information about the state of the network.

In contrast, the German parliament has been trying to obtain a detailed report on the actual condition of the national rail infrastructure for more than four years – and so far without success.

No cash cow, no IPO

DB's extremely close relationship with its infrastructure is probably the most critical factor in the plans for both privatisation and for greater on-rail competition.

It is no secret that no European rail network is able to finance itself without state support. However, last year DB was able to declare a positive operating result. This, of course, is absolutely critical for the planned stock market listing - otherwise no investor would be interested in purchasing shares in the DB group.

Industry observers deduce that DB is now mature for the capital markets. But this 'profit' is only made possible because DB owns the rail infrastructure. 'The one who controls the infrastructure is the master of the business', Mehdorn said recently.

This has important consequences for passenger transport, where the various *Länder* are responsible for awarding operating contracts for regional and suburban rail services. Running for between seven and 15 years, such contracts are typically worth several billion euros.

If these transport contracts are not awarded to DB, there is a risk that investment in the local rail infrastructure will be neglected, or that DB will axe jobs, for example by shutting down a maintenance workshop. No *Land* government can afford this, especially in Germany's federal structure where regional elections are held regularly.

As DB's operating businesses are typically 20% to 30% more expensive than their private competitors, DB Regio can only win regional contracts if they are awarded without an open tendering procedure. As a result, DB Regio and DB S-Bahnen have proved to be the group's 'cash cows' with operating margins alleged to be more than 13%.

I believe that if the DB group no longer had the right to manage the rail

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Private operators already run many regional passenger services in Germany under contract; opening up this market fully could save the Länder up to €1bn a year

infrastructure, then the *Länder* could not be held to ransom and would be free to award transport contracts on a competitive basis. This could save them up to €1bn a year, but the cash cows would be slaughtered and the regional passenger business would emerge as a serious burden for the logistics group. In turn this would mean that DB was no longer mature for the capital market, so a share flotation could not be considered.

The German government has recently expressed its commitment to get EU Directive 1191/69 replaced, with the aim of allowing public passenger transport services to be awarded without going through a competitive process. This is not so much about open competition and customer service, but much more about saving DB's IPO. It is pure flank protection for DB and is not aimed at getting more traffic onto rail.

Infrastructure control

Whether or not a free and fair railway market emerges in Germany will depend largely on who controls the rail infrastructure.

In drawing up its compromise proposals for the DB flotation last year, the coalition government decided that the national rail infrastructure should become property of the state (legal ownership), but that DB should retain its current position as infrastructure manager (economic ownership).

This compromise, however, does not correspond with the spirit of EU law, and it also contravenes German constitutional, corporate and financial law. The coalition's plans only include a formal separation of rail infrastructure from transport operations. But in practice the potential for discrimination by the monopoly infrastructure provider will remain, and might even increase.

Germany's private train operators would like to see the rail network become completely user-neutral. We fear that an integrated state-owned railway, which itself competes against private operators, can never ensure genuine equality between users, even if the government were to place a regulator next to every DB employee.

Consequently, we feel that the infrastructure must be legally and practically separated from the rail operator. This is the private rail industry's core demand to both the federal government and the European Commission.

The outcome of the debate is not just important for Germany. It could also affect rail policy in neighbouring EU member states, some of which are currently at the start of their own privatisation debate. Perpetuating what is to all intents and purposes an integrated railway group in Germany would send out false and damaging signals.

Prospects for private operators

How can DB solve its equity and under-capitalisation problems? The private rail freight operators advocate the outright sale of DB's logistics division, which currently generates around 50% of group turnover. In addition, the state would be freed from any economic risk. Is it not an anomaly that the German government is actively competing with private-sector logistics companies around the world?

As it is, DB can only finance its 'fairy-tale' expansion plans, costing around €12bn, with the German government protecting its flanks. This also includes the proposal to change the EU directive on the award of public contracts. The federal government would like to build up DB into a 'national champion', comparable with electricity group E.ON which is currently conquering Spain.

In the eyes of private operators, the future of the German rail industry should look like this:

- separate infrastructure management and train operations;
- sell off DB's logistics division;
- restructure DB's passenger and freight rail operating divisions over two or three years, with the aim of forcing them to be competitive;
- complete the privatisation of DB's operating businesses.

We believe that such a process would generate deeper trust in the railway among German and international business circles, and spark significant investment from the private sector.

The UK might serve as a role model here. Despite the total break-up of Great Britain's former state-owned railway, the number of jobs in the newly diversified rail sector has remained stable, a sensation in the current European railway climate.

Under our proposal, the privatised ex-DB operators would still be the strongest force on the German rail network, but with an increasingly pan-European dimension to their activities. We believe that the move to a genuine free market would help develop a dynamic railway culture in Germany financed by private investment. Competition stimulates creativity and significantly influences price/performance ratios.

No monopolist or virtual monopolist is capable of meeting the permanently-changing demands of the market and of shippers. Only many providers in competition with one another can achieve this. That's what makes the rail network attractive. And only an attractive railway will encourage more traffic to rail. ■

Plus d'ombre que de lumière

Le mois prochain, un groupe de travail mis en place par le ministère allemand des Transports doit présenter des propositions législatives pour la cotation en bourse partielle de Deutsche Bahn AG. Cependant, Arthur-Iren Martini, de Netzwerk Privatbahnen, indique qu'il reste beaucoup de contradictions dans le plan. La rentabilité de la DB dépend de la subvention du gouvernement et la cotation est basée sur un chemin de fer propriété d'état conservant le contrôle effectif de son réseau. Les opérateurs indépendants pensent que séparer véritablement l'infrastructure et rendre l'exploitation des trains de la DB vraiment compétitive seraient plus conforme à la politique de libéralisation de l'Europe et attireraient plus de trafic vers le rail

Mehr Schatten als Licht

Nächsten Monat soll eine Arbeitsgruppe, angeführt vom deutschen Verkehrsministerium, mit den Gesetzesvorschlägen zur teilweisen Privatisierung der Deutschen Bahn AG auftreten. Arthur-Iren Martini von Netzwerk Privatbahnen gibt jedoch zu bedenken, dass immer noch viele Diskrepanzen in diesem Plan vorhanden sind. Die Profitabilität der DB hängt von Regierungssubventionen ab und die Privatisierung basiert darauf, dass die sich im Staatsbesitz befindende Bahn die Kontrolle über das Netz behält. Die unabhängigen Betreiber glauben dass eine vollständige Abtrennung der Infrastruktur und eine vollständige Wandlung der Betriebsbereiche der DB zu kommerziellen Unternehmungen eher den Zielen der europäischen Liberalisierungspolitik entspräche und mehr Verkehr auf die Schiene bringen würde

Más sombras que luces

El próximo mes se reunirá un grupo de trabajo convocado por el ministro de transporte alemán, con el fin de lanzar propuestas legislativas para la salida parcial a bolsa de la compañía Deutsche Bahn AG. Sin embargo, Arthur-Iren Martini, de la Netzwerk Privatbahnen, argumenta que existen todavía muchas discrepancias en este plan. La rentabilidad de DB depende de la subvención del gobierno y la salida a bolsa se basa en la conservación real del control de la red ferroviaria por el ferrocarril estatal. Los operadores independientes creen que una adecuada separación de la infraestructura y la conversión de los servicios de transporte ferroviario de DB en un negocio realmente competitivo podrían cumplir mejor con la política de liberalización europea y atraería más tráfico al ferrocarril