# THE EUROPEAN TRANSPORTATION SYSTEM: ADOPTION OF A MARKET-ORIENTED APPROACH

Craig R. Reistad





Submitted to the faculty of the University Graduate School
in partial fulfillment of the requirements
for the degree
Master of Arts
in the Department of West European Studies
Indiana University
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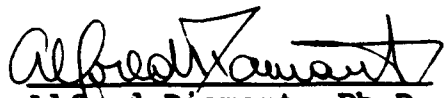
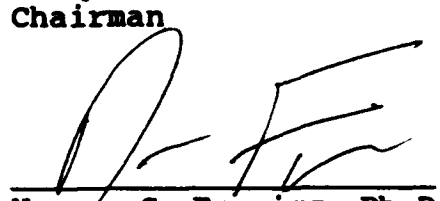


Alfred Diamant, Ph.D.
Chairman



Norman S. Furniss, Ph.D.

William R. Black, Ph.D.

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## INTRODUCTION

As Europe moves towards the Twenty-First Century and the realization of a continent without internal frontiers, the importance of a transport policy which supports the goals of an economically united Europe increases dramatically. No longer can the European Community simply rely upon the twelve member nation's individual transport policies to support the transport needs of a united continent acting as a single economic market. It is important to implement an efficient transport policy, under one unified transport body, which will allow the free movement of persons, goods and services.

While the existing transport systems and policies of Member Countries more or less satisfactorily supported their respective countries' transport requirements and regulations, the systems and policies were never intended to be merged together. Transport infrastructure, equipment and regulations differ from country to country and do not always work efficiently together.

The task of unifying Europe's transport policies and systems into one efficient unit is extremely difficult and complex. Each European Community Member Country has different geographical features, their relative population densities vary and so does the location of their economic activities. Each country, therefore, had developed its own individual transport policy designed to meet the needs of

its own geography, population and economy.

Member Countries also have different and often divergent approaches to transport policy, ranging from a laissez faire to an interventionist approach. The Netherlands, Belgium, Portugal, Luxembourg, Great Britain, Ireland, Greece and Denmark all, for different reasons, generally favor free market practices in the transport sector. Germany, on the other hand, takes a decidedly interventionist approach towards transport policy. France, and to some degree Spain, while interventionist in theory, have been less rigid in practice, and Italy, traditionally favoring free market competition in the transport sector, has leaned more towards state intervention with its policy decisions.

With these differences recognized, and likely to grow with the admission of new Member Countries into the European Community, Member Countries have been working together to forge a common policy which will advance economic activity through transport. After thirty years of protecting their own transport systems, individual Member Country's interests have begrudgingly been set aside for the benefit of the entire Community. It was realized that one set of European Community regulations would make more sense than trying to maintain twelve different sets of national regulations, and that each country could ultimately benefit by compromising.

While a complete Common Transport Policy does not yet

exist, the numerous transport laws and regulations of the European Community have already changed the face of European transport. The European Community, while not the sole authority in transport, has taken the lead in attempting to develop European transport policy. Since 1985, all modes of transport have been forced to loosen, if not eliminate, national restrictions against operators from other EC countries. The result has been the creation of a more open European market, free from much red tape and quota restrictions.

If fully developed along its current trend, the Common Transportation Policy will ultimately take a laissez faire approach and eliminate numerous national regulations and encourage increased participation of the private sector in the planning, funding and management of European transport systems and infrastructure projects. The superiority of private sector over public sector management, however, remains an assumption. It is unknown whether the private sector will work in the interest of the public sector, or whether the private sector will be able to bring the debt ridden transport systems of Europe into the black.

Will Europe eventually transform into one transport market through deregulation and privatization with the European Community as the main catalyst? To answer that question it is necessary to look at the beginnings of the European Community's Common Transport Policy, the road

blocks already hurdled and the current results of deregulation and privatization within Europe's transport market.

## **CHAPTER I:** The Trend Towards a Single Laissez Faire Transport Policy

When considering why the development of a European Common Transportation Policy has been so long delayed, one American observer neatly summarized the problems encountered by European policy makers: "Suppose the Continental United States were made up of independent, sovereign nations, each with its own language, customs and philosophy of government involvement in economic affairs; then suppose an attempt were made to develop uniform policies on a more or less voluntary basis; could this be accomplished in a decade?"[1] The European Community has been in the process of developing a Common Transportation Policy since the early post war days of the development of supranational European organizations, but due to the complexities cited by the astute American observer, the process has moved along slowly over the course of the last four decades.

Nature never intended for Europe to be traversed easily. With its mountainous heartland and inlets that eat into its shores creating a "peninsula of peninsulas," travel throughout the European Continent is a difficult endeavor.[2] Only through the development of modern technology has Europe been able to overcome its many obstacles and reach the point of integrating its people into a single community. A major key to this community is the integration of Europe's transportation system.

The Nineteenth Century witnessed a massive increase in the development of railroads, improvement of inland waterways and building of roadways to help in the traversing of the European Continent for the purposes of war and trade. The primary axes were dependent upon historic trade routes such as the east-west Hellweg, and the Rhine and Rhone Rivers, with primary emphasis near the coalfields and heavy industrial triangle.[3]

The Twentieth Century brought two major wars and major advances in transport technology, to include air transport and motorized transport. Transportation continued to improve within each country, but the national basis of operations meant that unique systems developed within national frontiers.[4] The devastation of the two World Wars and the subsequent division of Europe into East and West led the West Europeans to the decision that they would be better off both economically and politically by forming a union, a union which would reduce the influence of national borders and bring together the peoples of Europe for peace and prosperity. The transport systems of this period evolved mainly as a result of market forces, with some involvement of national policies, and were not consciously designed to meet the needs of an integrated European community.[5] Bringing the peoples of Europe together, however, would require the integration of the poorly developed and fragmented transport infrastructure of the various European

countries.

The first attempt at integrating the European transportation system resulted from the realization that more efficient transport of goods and passengers would reduce overall costs and improve the competitiveness of participants. The relative efficiency of all economic activity is dependent upon the ease with which raw materials, manufactured goods and people can be moved from place to place, and in industrialized societies this need is catered to by roads, railways, ships and other specialized forms of transportation. Transport costs are an important factor influencing trade and if a common transport system and policy led to more efficient methods of transporting goods between states, benefits would be derived which were similar to those benefits derived from internal tariff cuts. Transport accounts for more than seven percent of the Community's gross national product and employs over ten percent of the Community labor force (both direct and secondary employment).[6] Virtually everyone in Europe is dependent upon and affected by transportation, whether it be to ride the train to work or to transport the products which they consume daily.

While there may be a justification for a common transport policy and an integration of European transport systems, the development has been a slow and tedious procedure which has not lived up to the expectations of

those in favor of a European Community with a unified transportation network. The development and implementation of a common transportation policy is still in progress and may continue to progress at a snail's pace, but with the complexity of the issues and given the nature of the problems confronting the policy makers, this is not surprising.

## ORIGINS OF A COMMON TRANSPORT POLICY IN EUROPE

While historically transport in Europe developed on a national basis, there already existed a tradition of coordinated transportation policies prior to the Second World War. This cooperation can be traced back to the Congress of Vienna in 1815 and the establishment of the Central Commission for the Navigation of the Rhine. Following a series of conventions, the Act of Mannheim, in 1868, consolidated rules and regulations with respect to navigation, safety, and boat construction, among other issues. The Central Commission has survived to this day and has served as a model of transport cooperation.[7]

Coordinated policy was also established early on for Europe's developing railroad systems. The non-governmental Union of German Railway Administration was formed in 1850 and brought together some eighty railways including Dutch and Rumanian railroad systems. State agreements came together thirty-six years later with the Berne International

Convention on the Transport of Goods by Rail and from this arose agreements resulting in technical and operational uniformity of the Continental railroad system with respect to gauge, train formation and timetables.[8]

Both the League of Nations and the United Nations were active in opening successful dialogues on virtually all modes of transport between European nations. The League's Provisional Communications and Transit Committee provided expertise to those European states still in an early stage of developing their primary transport network and initiated research to examine the scope for greater inter-governmental cooperation. The Inland Transport Committee of the United Nations Economic Commission for Europe took up the role of the League following the Second World War. The Commission further facilitated coordination on international standards for equipment and helped to ease the problems of crossing national frontiers.[9]

The 1951 Treaty of Paris, which established the European Coal and Steel Community, while largely ignoring transportation issues, required the signatories to use the same tariff rates for transportation for other member states as they did for their own transport, regardless of origin or destination of shipment. At that time some seventy percent of ECSC cargo was carried by rail and this meant that considerable attention was focused on railroad traffic. In 1951, there were several key features of international rail

freight transport which did not conform to the aims of the Paris treaty. There existed discriminatory railway charges which differed according to the country of origin and destination. Railway charges were altered at national frontiers. There also existed special rates which favored particular producers or consumers in a particular country. The High Authority of the ECSC dealt with 32 cases of rate discrimination (30 relating to railways) and was able to negotiate more acceptable tariff rates between member nations.[10]

The High Authority was also able to resolve the problem of broken freight tariffs between member nations. Broken freight tariffs occurred when a consignment of freight was transported between two member countries and the freight was charged as two separate journeys, while a journey of equal distance in just one country would bear only one fixed charge. Cross frontier charges were thus doubly penalized and resulted in freight charges which were 35 percent higher than those applied to internal traffic. The High Authority's intervention in the problem of broken freight tariffs resulted in international movement charges falling between 96 and 77 percent of their former level. This resulted in lower international transportation rates, but also increased the competition between member nations. Though the different member countries of the ECSC benefited somewhat from the actions of the High Authority, there still

existed differing attitudes towards transport policy.[11]

## THE NEED FOR A COMMON TRANSPORT POLICY IN THE EUROPEAN COMMUNITY

The 1958 Treaty of Rome, which established the European Economic Community and expanded upon the previous successes of the ECSC, dealt more fully with the issue of transportation than did the Treaty of Paris. Apart from agriculture and fisheries, transport was the only domestic sector of the economy singled out by the treaty as requiring a common policy. It was realized that without a common transportation policy the fusing of the economies, which was the intention of the Treaty of Rome, could be no more than a pipe dream. The treaty stated that "the community should establish a common transport policy to enable the free movement of people and goods over national boundaries."[12]

There were several reasons why a common transport policy was called for under the Treaty of Rome. First, the results of previous transport agreements between European countries clearly demonstrated that a cheap and well coordinated transport system would lead to a build-up in interstate trade activity. The second reason for the clause was the recognition that transport in Europe was subjected to considerable state intervention, intervention which artificially aided exports and inhibited imports. It was recognized, through experience from the early days of the ECSC, that this would be a problem in a general common

market. The third reason for the transportation clause was to develop a policy which would delicately balance the national interests of the member countries. While the Dutch, who would greatly benefit from growth in intra-Community trade, desired that transport should be brought under the influence of the Treaty, the Germans, with a greater share of the transport market, wished to retain transport policy under national control.[13]

Article 79 of the Rome Treaty required that within two years of the implementation of the treaty the Commission should propose and the Council should approve measures to eliminate any discrimination in transport charges on the basis of country of origin or destination within the Community. In compliance with this requirement the Commission presented the Council with a memorandum on the General Lines of a Common Transport Policy in April 1961, called the Schaus Memorandum in honor of the Commission's first transport minister M. Lambert Schaus. The Schaus Memorandum laid down what the Commission thought should be the guiding principles of the Common Transport Policy. It called for public regulation of railway charges to prevent exploitation of the Community's consumers by the 'natural monopolies'. It also called for public regulation of road tariffs to prevent just the opposite effect and prevent unduly low road charges which would lead to ruinous

competition by the Community's road haulage companies.[14]

The Schaus Memorandum called attention to the fact that most of the Community's transport infrastructure was publicly financed, implying that national government intervention in this sector's operation was inevitable. The combination of both public and private financing also made calculating the true cost of operation in this sector difficult, thus making the establishment of fair transport tariffs for the Community difficult as well. It was also pointed out that state subsidization of transport resulted in lower than market transport costs for other industries, therefore lowering the overall costs for other industries. Finally, the Schaus Memorandum drew attention to the impact of social and environmental issues on the transport sector, issues which were sometimes given higher priority in the transport sector than simple economic interests.[15]

The guiding principles of the Schaus Memorandum led to an Action Program in 1962 which laid down three basic objectives for a Common Transport Policy. The first objective was to remove obstacles which transport facilities could put in the way of a general common market. It was felt that this objective could easily be accomplished because of the extensive amount of work already accomplished by the ECSC. The second and third objectives, however, would prove to be much more difficult due to the reluctance of member countries to turn control of their transport

systems over to the Community. It was desired that a single transport system be created throughout the Community so that transport could contribute to the growth of trade, rather than merely avoiding negative effects on it. The Commission also suggested that healthy competition should be stimulated throughout the transport sector, to include traffic within each member country as well as between them. This third objective was the most controversial due to opposition to open competition and fear of the effects of market forces on the transportation sector, most notably deregulation.[16]

The Commission envisaged that a common transportation system would involve three major elements. The first was complete freedom of establishment to conduct business in any member country. This implied that freight carriers would be allowed to ply their trade anywhere within the Community under a quota level set by the Community. Member countries already utilized quotas established through bilateral agreements, but the Commission felt that a Community system of quotas should be established which would state how many carriers from each member country would be allowed to operate in another member country annually.[17]

The second element was to be the harmonization of operating conditions amongst the member countries. The Commission sought to ensure that taxes levied on vehicles should reflect only the genuine costs imposed on society by those vehicles and should not be used either for national

revenue raising purposes or to discriminate between different modes of transport.[18]

The third element of the common transportation system was to be the formulation of a joint and common policy with regard to the industry's basic infrastructure, the road network. The Commission envisaged a Community-wide plan for a motorway network, taking away overall planning from the national level.[19]

Community reaction to the Commission's vision of a common transportation system was less than favorable. Since an effective system of bilateral quotas was already in effect, a new Community imposed quota system was first seen as unnecessary. At the national level, the loss of control over national borders and the loss of the ability to impose restrictions meant the loss of sovereignty.[20]

The second element, the harmonization of operating conditions amongst the member countries, ran into similar opposition and also made little progress. The taxing of a vehicle based on its genuine costs imposed on society proved to be an ambiguous concept and the problem establishing an agreed basis for the calculation of social costs was insoluble. The only point which the member countries could agree upon was the quantity of fuel which a vehicle could carry into another country without being taxed by the receiving country.[21]

The attempt to establish a common policy with regard to

a Community road network was almost a total failure. The Community-wide plan did not take into account that member countries would not give up sovereignty in this area while still being required to fund the road network integration and standardization. Only very modest sums were provided in the Community budget for road building projects involving two or more member countries, usually for major projects such as the approach roads to the Channel Tunnel or new tunnels through the Alps.[22]

The Community was, however, able to make some progress in the field of transportation policy. In 1969 the Council managed to reach agreement on a complex set of rules governing the maximum number of hours, daily and weekly, for which the driver of a vehicle was allowed to work. This ensured reasonably fair competition between operators in different countries. The following year the Council established the means of enforcing this agreement. Each member nation would have tachographs - instruments capable of recording the hours of operation of vehicles - installed in all commercial vehicles. The Community was also able to agree upon, with much difficulty, a maximum weight of forty tons for road vehicles traveling within the Community.[23]

The Commission, through its concept of "healthy competition", sought to create a system in which price regulation would have a common basis throughout the Community. A tariff rate bracket with a spread of 23

percent was created in which all member nations' transport tariffs must fall. This was a compromise between the exponents of open competition, mainly the Dutch, and those of close official control, the Germans. This regulation satisfied neither party.[24]

The 1960s saw little progress in the development of a common transportation policy due to the reluctance to release control of what was seen as a state resource to a higher power. The possibility of losing the right to set transport tariffs and quotas threatened most of the original Community members. The question was not merely whether a common transport policy throughout the six member states was possible. The question was whether such a policy was even desirable. The problem was one of overcoming what the transport Commissioner referred to as "the narrow vision of a policy designed as a compromise between their divergent interests."[25] In 1971 the Commission acknowledged its failure to create an acceptable common transport policy to the Parliament by saying that "the common transport policy has not made striking progress in recent years."[26]

## THE CHANGING REQUIREMENTS OF THE EUROPEAN COMMUNITY

The 1970s brought many changes to the formulation of a common transport policy. The first major change was the addition of three new member countries. The addition of Great Britain, Ireland and Denmark changed the face of the

Community's transport policy needs. The original focus of the Treaty of Rome's transportation clause was on railroad, road and inland waterway transport. Air and maritime transport were excluded, although a unanimous vote by the Council of Ministers could make provisions to include these two latter modes of transport. The addition of these seafaring nations, two of which have transport systems which are essentially independent of that of Continental Europe, brought about the need to look at the growing importance of maritime transport to the Community. The inclusion of these countries also widened the importance of air transport to the Community. The focus of the Commission began to expand from the traditional cross frontier transport of the original Six to an international sphere which included air and sea transport.[27]

The economies of the member countries also changed over the course of the 1960s and the relative importance of the old heavy industries of coal and steel, whose bulk products were relatively amenable to rate-regulation, was steadily declining. At the same time the importance of more sophisticated industries, whose products were far too varied to be classified as fitting into one transport tariff category, was becoming more important. Simply put, the transportation needs of Europe's economy were changing and so must the scope and focus of the still unfinished common transportation policy.[28]

The Commission, following a shake-up of personnel and a change of attitude towards transportation policy, submitted a new Action Program to the Council in 1975. This program reflected more of a market-oriented approach to transport policy and less of the previously unsuccessful interventionist approach. According to the new program a Community transport policy should seek to establish a balance between supply and demand in the sector without resorting to quotas or other quantitative restrictions. In conjunction with this free-market approach, it was suggested that the Community progressively increase the rights of non-resident haulers to conduct business in all member countries. The final suggestion of the Commission was to encourage the affected industry to establish recommended tariffs on whatever basis it judged best.[29]

Aside from a change of philosophy in transportation policy, little was accomplished in the transportation arena in the 1970s. The Community, however, did agree in 1974 to introduce qualitative criteria in respect to national road haulage licenses. This resulted from the restrictive licensing practices of member states governing access to their own national markets. The criteria specified uniform requirements in terms of professional competence, good repute and financial capacity of prospective operators, thus making each national road haulage license conform to a Community standard and making each member country's license

acceptable throughout the Community.[30] The Community, however, has not agreed to harmonize and loosen up national quantity licensing systems. Some countries, nevertheless, have abandoned quantitative limits.[31]

The view that progress towards a common transport policy had been virtually non-existent during the 1970s was clearly shared by the European Parliament. Member countries still resisted Community intervention, this time fearful that the free market leanings of the new Action Program would lead to fierce competition between road haulers and the eventual monopolization of the road haulage industry - the dominant mode for the transport of goods within the Community. Member countries also feared that the competition of road haulers and resulting cheaper road haulage fees would further hurt their railroad industries.[32]

Surprisingly, after 25 years of waiting for a common transport policy, the European Parliament resolved in January 1983 that the Council of Ministers should be arraigned before the Court of Justice for its failure to establish a common transportation policy as specifically called for in the Treaty of Rome. The complaint pointed to the 16 draft directives - many of which were ten years old - prepared by the Commission on which the Council had failed to act. The Court upheld the allegation in 1985, ruling that the Council had infringed the Treaty by failing to ensure freedom to provide services in the area of

international transport or to lay down the conditions under which non-resident carriers could provide transport services in a member state.[33]

The main result of the rebuke by the Court was that the Council resolved that from 1992 the practice of cabotage - the collection of and delivery of freight by carriers of one member country between destinations in another member country - should be permitted for both sea and road carriers. This had previously been illegal, with some 30 percent of the Community's trucks returning home empty in 1989. The Council also agreed to increase the Community's quota of freight licenses by 40 percent each year between 1987 and 1991 and that all bilateral quotas be scrapped after that.[34]

## THE PROBLEMS OF ESTABLISHING A COMMON TRANSPORTATION POLICY

The Common Transportation Policy of the European Community still remains unsigned and is seen by many as a failure. The successes of the Commission in implementing transport regulations within the Community have been attributed by many to the application of prescriptions for full and free competition contained in Article 85 of the Treaty of Rome and the rights of establishment contained in Article 52 of the Treaty.

The diversity of the member countries' transport

infrastructure and philosophy of stateseconomic intervention of the state has made the process of formulating an effective and acceptable common commercial policy extremely difficult. Uniform policies are difficult to impose on a community which is far from uniform. Each country is concerned primarily with its own internal transportation and will continue to resist what it considers outside interference with internal matters. Because of this realization there is now a greater interest in finding common threads through national policies rather than trying to formulate an entirely new, overall framework.

In addition to the member countries' opposition to the Commission's proposed transportation regulations, directives, decisions and recommendations, the Common Transportation Policy has suffered from the nature of the policymaking machinery within the Community. The Community's Directorate for Transport, unlike other directorates within the Community, has no executive powers. It depends entirely on obtaining the agreement of member states in the Council for the implementation of its proposals. Council members, however, often horse-trade transport options for preferential treatment in other policy areas such as agriculture or regional aid.[35]

Another stumbling block for transport legislation has been the need for consensus policy agreements. Since 1965 transport legislation has only been on the basis of complete

unanimity. This is because Article 75 of the Treaty of Rome effectively provided a permanent veto in the Council of Ministers where proposed transportation policies "might seriously affect the standard of living and the level of employment in certain regions and also the utilization of transport equipment."[36] Any major transportation policy decision would fall within this category and be subject to a Council veto absent a unanimous decision. Without a change to a majority voting system, the implementation of any transportation policies within the Community will be slow and will inevitably lead to a series of compromise policies which offer less potential than the original policies proposed by the Community-minded Commission.

## THE FUTURE OF A COMMON TRANSPORTATION POLICY

The argument about the European Community's Common Transport Policy as a total failure continues. It would be more fruitful to determine what obstacles have already been overcome by the Commission and the Council and what successes have been achieved. While the policy is far from complete, there exist some 70 or more legal instruments which have resulted from attempts at harmonizing the European transport system. The philosophy of transport policy has turned 180 degrees from one of state intervention to one of free enterprise. The Community has doubled its membership and the face of transport infrastructure within

the Community has changed since the original six members signed the Treaty in 1958 causing the Commission to adapt to continuous change.

The changes have meant new proposals from the Commission to better connect the ever-expanding Community's transportation infrastructure. Though the Maastricht Treaty does not provide any new mandate to the transport sector, the European Commission has recently established a program to strengthen trans-European networks. As it relates to transport, the objectives are to establish master plans, regulations, and technical standards to insure network interoperability; to declare certain essential projects "of European interest" to help implementation and funding; and to identify technical and financial constraints to network development.[37] The Commission has set about integrating the transportation network through numerous initiatives. These cover all facets of Community transport: air, sea, road, and inland waterway as well as safety and environmental issues.

The future of a United Europe provides many new challenges to an already challenged transport Directorate. The issues of privatization and competition continue to increase in importance. It seems safe to assume that the transport industry will continue to liberalize and become more competitive. Cabotage will likely diminish the number of trucking companies from some 500,000 for-hire freight haulers to perhaps a few thousand who have specialized in

niche and regional markets with the large majority of the trucking market being dominated by 10 or 20 large enterprises.[38]

The European airline industry, inspired by the example of the U.S. airline industry example, appears to be headed for some sort of liberalization. This will possibly lead to lower prices and increased competition. The European rail industry is also heading in the same direction, beginning with privatization. Both Great Britain and Germany are moving towards the privatization of their heavily subsidized rail industries. This means that railways will no longer be a sacred cow to Council members and new railway regulations will stand more of a chance for success.

The Transport Directorate and the Commission will also be busy dealing with the ever increasing environmental and social issues which have become involved in virtually all aspects of transportation. Such issues as the environmental impact of trucking through the Alps or the costliness of converting Europe's transport equipment to cleaner burning fuels will take years to resolve and will make the job of creating a common transport policy even more difficult.

As Europe moves closer to the reality of being one community, the importance of completing the Common Transport Policy becomes even greater. This importance, once it is realized, will force the Council to find a way to work together and to implement an effective transport policy

which will meet the needs of a single European economy.

## Chapter II: The Move Towards A Deregulated Transport Market

As European governments are coming under increasing pressure today from both the European Community and the private sector to loosen their control over the transport market, it is necessary to examine the reasons behind state intervention in the transportation sector and determine to what extent the argument for state intervention is still valid. Transportation, while having the characteristics of a profit making industry, is also viewed as a necessary social service. This social service is provided to the public, often at a financial loss, in order to stimulate the private sector through an appropriately priced and dependable service, to provide for national defense and often, as seen in the case of the German autobahns or the national airlines, to provide prestige for a nation. These two views of the role of transport in Europe can be further defined as a free-market approach to transport versus a government controlled and regulated approach.

When discussing government regulation it is useful to separate what is called economic regulation from social regulation. While both are intended to serve public interest, they achieve their results differently. Economic regulations explicitly affect the prices charged for transport services and the amount of services which may be offered. Rate, or price, controls have an extended history

going back to the initiation of the various transport technologies and have been used in most industrialized countries. Suppliers of transport were required to price their modes of transport so that a predefined rate of return was achieved. This allowed the supplier to recover costs while at the same time earning a normal profit. A bracket or fork tariff was designed to enable the supplier some flexibility to respond to short-term fluctuations in market conditions.[1]

Price controls in transport have often been accompanied by subsidies, either government funded or cross-subsidies. Government subsidies have been used to economically bolster a transport system which is considered necessary for society but operates at a deficit. Because the system is unable to survive under the imposed economic restraints of rate control, it is subsidized in order to serve the public.[2]

In many instances cross-subsidies are utilized to prevent deficits. Rate controls often prevent a normal profit from being earned on the less-travelled, but socially necessary, routes. In order to recoup the losses of operating these unprofitable routes, governments often permit higher rates to be charged on the more profitable routes. This means that both groups involved are charged at rates which deviate from their allocated marginal costs and that one group of travelers finances another.[3]

Entry controls, which effectively control the supply of

transport, are usually operated through a government regulated licensing system. This system of economic regulation limits the number of operators in a particular area and often oblige a license holder to carry all traffic at a prescribed rate. In many cases the licenses are given to specific transport suppliers and are non-marketable so that it is not simply the amount of transport which is limited but who actually supplies it. In other cases licenses may be traded or sold, thus only limiting the number of suppliers of transport.[4]

At the extreme end of the economic regulation spectrum is the direct ownership of transport supplying industries by government. Direct ownership allows governments more immediate control over the way facilities are used and the level and types of investment which go into them.[5]

Social regulation, the other form of regulation, is designed to influence the impact that transport has on both those involved in working in the industry and those third parties which are affected by transport. Over the years there has been an increased recognition of the impact that transport has had on non-users and on the environment. "Transport is an engineering industry carried on, not privately within the walls of a factory, but in public places where people are living, working, shopping and going about their daily business. The noise, smell, danger and other unpleasant features of large, fast-moving machinery

are brought close to people, with potentially devastating consequences for the human environment."[6]

Some of the effects of transport are of a purely local and immediate nature, such as noise, vibration, and odor, while other effects have much wider and longer-term implications such as the vehicle exhaust emissions which contribute to acid rain and to global warming. Environmental protection measures are designed to cope with these problems. There are regulations which limit the types of fuels allowed to be burned, either through a direct limitation on the fuel source or through a tariff which will encourage users to utilize an alternate source of cleaner burning fuel. Tax differentials on leaded and unleaded fuels are increasingly common with a positive impact being realized on reducing the use of the more-polluting leaded fuels. In many countries there are regulations governing local compensation for the traffic nuisances caused.[7]

Social regulations also influence safety in the various transport markets ensuring the care of both operators and the public. These regulations involve traffic laws, driver training standards, vehicle standards and also limit the amount of time vehicle operators can work in any given period.

There is no single theory for the regulation of transport and no single interested party is served by regulation. Everyone from vehicle owners, operators and

manufacturers to the traveling public, the tax payer contributing towards subsidies, and the the police authorities concerned with safety all have an interest in transport regulations. Regulations develop over the interaction of many interested parties and evolve in different patterns. In Europe, there tend to be two prominent views towards regulation. In countries which are said to follow the Anglo-Saxon tradition of industrial policy there is a tendency for governments to intervene in markets only when it appears that transport supply could be improved by such action. Sometimes government regulation is utilized in order to make industry respond to certain required needs more quickly than would be possible if left to market forces. These countries feel that markets cannot always be trusted to optimize the provisions of transport services and that therefore there is in certain circumstances a need for government intervention, a need which is called public interest.[8]

Countries which are steeped in the traditions of the Napoleonic Code, such as France and Germany, tend to treat transport as an input into a wider social production function involving broader industrial matters, regional policy and social equity. These countries are willing to sacrifice transport efficiency to serve other needs.[9]

There are a number of reasons why markets may be said to have failed and governments intervened. The most obvious

is that the market does not always achieve economic efficiency because of the monopoly power which suppliers can exercise. The traditional notion that price should be set equal to marginal cost will not be achieved if there are profit-maximizing monopolists in the market, and monopolies inevitably charge above minimal cost and restrict supply. This can also occur with oligopolies and cartels.[10]

The existence of imperfect competition, where a large number of firms supply a diversified product, means that although competition will keep down excessive profits, suppliers do not produce at minimum cost and marginal costs will be higher than under the conditions of perfect competition. This can lead to instability in the supply of transport services as firms continuously enter and leave the market with consequential disruptions to those wishing to use transport services. Regulation in these circumstances imposes pricing rules which essentially force the suppliers to mimic the behavior of a perfectly competitive industry.[11]

## THE DEVELOPMENT OF TRANSPORT REGULATION

There were several reasons behind the early regulation of the transport sector in Europe. While government regulation of private transportation efforts existed as early as the early 17th century when, under British law, ferries and bridge tolls were subject to state control, the current pattern of government transport regulation began

with the growth of railroads in the 19th Century.[12] At the time of the great expansion, virtually all governments either built railroads outright, or heavily subsidized the private sector in their efforts. Governments which built railroads retained control over the railroads. Governments which subsidized the private sectors efforts, as in Great Britain and the United States, soon implemented regulations to establish freight rates, control competition and ensure a steady flow of rolling stock.[13]

Regulations over the private rail lines grew out of the desires of railroad companies, governments and numerous special interest groups. Privately owned railroads, suffering from excess freight and passenger capacity caused by competition on several rail lines, were forced to bid down their rates. The resulting lack of profit caused the railroads to support regulations which would stabilize rates at a profitable level on competitive routes. On routes which did not have competition, businesses dependent upon single railroad routes for shipments feared the railroad monopolies and wanted the government to regulate the rates which the railroads could charge.[14]

The same pressures for regulations existed around the world but, probably because central governments were stronger than in the United States, state ownership was often substituted for regulation. In fact, in the 19th century, the U.S. government could not own or operate a

railroad, or almost any major business, because there was not provision in the Constituion that explicitly permitted it (this inerpretation of the Constituion did, however, change in the second half of the twentieth century). Regulation was the only way available for the government to control industry. "It is not coincidental that the industries subject to the most extensive regulation in the United States - railroads, airlines, power companies and water companies - were the ones that abroad were government-owned."[15]

Transport regulations remained about the same for the remainder of the nineteenth century and the beginning of the twentieth century. It was the advent of the large-scale use of motor vehicles which caused a change on the transport scene. As more and more trucks, buses and automobiles were introduced to the roads, a huge drop in railroad use was experienced. The new vehicles were more flexible in both schedule and destination and created great competition for the railroads.

Throughout most of the world, new regulations over trucking and busing soon grew out of this competition with the railroads. Railroads, which often enjoyed monopoly conditions, faced a growing competition on short-haul routes from motor carriers. While the railroads still enjoyed only limited competition from other railroads on the long-haul routes, the threat imposed on the short-haul market by the

motor carriers sparked protests from the railroad operators. It was argued by those with vested interests in the railroads that the motor carrier industry was excessively competitive and that entry into the motor carrier market was too easy. They claimed that motor carrier firms bid their prices down too low and it was becoming increasingly difficult to compete with the new mode of transport. Many economists and transport scholars supported this view.[16]

The road haulage industry was taking the most profitable traffic and leaving the railroads with uneconomic goods, goods which the government required the railroads to transport at a loss. Bus transport was also having a devastating effect on the railroads by eating into the lucrative passenger market. In order to protect the interests of the government owned railroads, motor carriers, which were performing satisfactorily, were brought under government supervision. In countries were the railroads were controlled by the private sector, the influential owners were able to petition their governments to extend regulations to trucks and buses.[17]

Germany intervened in the transport market by imposing controls over its motor carrier industry in 1931. Profits from Germany's state railroad had helped finance the government for over one hundred years and the losses suffered in the railroad's competition with motor carriers was felt in the state treasury. The government regulations

established comprehensive rate controls that tied truck rates to rail rates, thus eliminating the truckers' ability to offer a lower bid to customers. In Great Britain the Road and Rail Traffic Act of 1933 established controls over entry into the trucking industry, thus limiting the number of competitors.[18]

The Great Depression also influenced the introduction of regulations over the motor carrier industry. The severe economic conditions led society to believe that competition had failed as a regulatory mechanism. The depression also contributed significantly to a rejection of the free market. "The growth of socialist ideas, positive reports from Communist Russia, and a belief that government engineering of the economy could cure instabilities and inequities all contributed to the belief that regulations were superior to the market."[19]

Trucking was a highly competitive industry which, for the most part, could perform well without government supervision, but the interests of the railroads and the influence of the Great Depression brought about regulations which would heavily control the motor carrier industry for the next forty years. These regulations would reduce competition and lead to higher rates and tariffs. Passengers, shippers, and, ultimately, consumers were forced to pay more for goods.[20]

## A CHANGE OF ATTITUDE

The regulation of transport remained the norm for most countries following the Second World War. The consensus view was that because of the scale and frequency of market failures it was important for government to take an active role in regulating industry. At the end of the war the prevailing paradigm was socialism and the belief remained that heavy government regulations were still necessary in the transport industry. These attitudes, however, were slowly changing. The Keynesian ideas of the immediate post-World War Two period were giving way to economic ideologies with greater emphasis on supply-side considerations and monetary matters.[21]

By the mid-1970s much of Western Europe was suffering from a severe economic slump which would not respond to Keynesian economic measures. Almost every European nation suffered from the recession, which was blamed on high energy costs, a drop in productivity and increased competition from low-cost, high-technology countries (West Germany, with its huge trade surplus, was spared much hardship). After numerous failed attempts to fight off the recession with inflationary economic policies which ran up huge budgetary deficits in many countries, European governments began to impose austerity measures. Beginning in the late 1970s, price and wage controls, higher taxes and interest rates, and curbs on government spending were imposed in most

countries in order to bring down inflation.[22] Political economists argued that removal of regulations would not only produce lower costs but would also increase productivity. There was a feeling in some quarters in the early 1970s that there was a need to clear some of the deadwood of regulation.[23] This change in economic attitude affected both the public and private sector. High levels of public expenditure were now seen as crowding out other, potentially more productive, economic activities. These potentially productive activities included transportation.

Experiences with liberalizing rate regulations over portions of the trucking industry in the United States in 1950 resulted in freight rates for agricultural products falling from 12 to 59 percent. Shippers of these products also preferred the unregulated service over the regulated service. A later study showed that shippers found no difference in all aspects of service quality between the regulated and deregulated service. A number of other early studies also showed that unregulated trucking in the United States was superior to regulated trucking.[24]

The American experiment of deregulation was also tried in the United Kingdom with similar results. In 1970, through the Transport Act of 1968, the British government removed all quantitative controls over its trucking industry by abolishing licensing limits. This, in turn, made market entry easier. The government did, however, replace the

quantitative controls with qualitative controls. Applicants for the new license had to show their competence either by experience or formal qualifications by nominated examining bodies. The trucking market could therefore expand, but it would not be flooded by unqualified entrants.[25]

While the United Kingdom never imposed very restrictive measures on road haulers, it was feared by some that lifting restrictions on trucking would disrupt the market. The number of market entries and exits did rise considerably following the abolishment of market entry limits, but without causing any lasting instabilities in the market. It was also found that road haulage productivity rose substantially after deregulation and that capacity utilization was considerably improved. Since deregulation of the trucking industry, rates appear to have fallen, competition has increased and the decline of own-account transport (self hauling by companies) demonstrates that the quality of service of commercial haulers has improved.[26]

A study of truck transport rates paid during 1973-74 in Germany, the United Kingdom, and other European countries with light regulation showed that costs were highest in heavily regulated Germany and considerably lower in the unregulated or lightly regulated countries.[27] The theoretical justification for believing that a free market works better than regulation was starting to be proven with statistics. The evidence that unregulated trucking worked

better than regulated trucking might also translate well to other sectors of the transport market.

The change in attitude in the mid-1970s was also evidenced at the Community level with formulation of a new Action Program for Transport and its free-market approach to European transportation (see chapter 1). The fact that the New Action Program suggested that the transport industry be responsible for establishing tariffs on whatever basis it judged best demonstrated that the interventionist approach to transport policy was giving way to a market oriented approach in Europe. It must be remembered, however, that the program was not a law and could only recommend "general principles on which national principles may be based."[28]

Though the effects of deregulation on the trucking industry in the United Kingdom proved favorable, most European countries were not sufficiently impressed enough with the results to attempt to liberalize their road haulage regulations until the late 1980s. The United Kingdom, however, continued to move forward in the liberalization of transport regulations, testing the waters for the rest of Europe. The pace of deregulation in the United Kingdom was speeded up with the election of the Conservative Government in 1979.

## DEREGULATION EXPERIMENTS UNDER THATCHER'S CONSERVATIVES

The new government's manifesto contained the intent to

promote competition and efficiency throughout the economy by removing bureaucratic restriction and by implementing a program of privatization and efficiency within the public sector.[29] The deregulation of public transport was part of this program. While the intent of the Conservative Government was to deregulate the entire transport industry, not enough political support existed initially to carry out such sweeping changes and the government was limited to deregulating just one sector of the transport market.[30]

In October 1980, the United Kingdom's express coach industry was deregulated with the removal of its quantity licensing system. The Transport Act of 1980 presented individual coach firms holding the necessary vehicles, crew and operator licenses with complete freedom to enter into direct competition with established bus firms on routes with minimum sector lengths of over 15 miles.[31] Competition would be permitted on any express route, at whatever fare and on any timetable desired.

The direct goal of the Transport Act of 1980 was to remove bureaucratic restrictions from the express bus service in the hopes of ensuring that almost everyone would gain good access to, and have maximum choice in public transport. This goal was expected to be realized by stimulating activity and innovation within the private sector, and, at the same time, by promoting competition between private and nationalized carriers. It was expected

that these actions would yield significant cost and service benefits to travelers, improve efficiency of the nationalized carriers and even increase patronage of express coach service.[32]

These expectations were immediately realized after deregulation. Many new independent express coach services were formed and the independent services began a fierce competition with the nationalized operators. Prices dropped and demand rose throughout the express coach service. While a number of independent coach services were unable to successfully compete with the nationalized and larger independent services, the opening of the market to independents did cause a reduction in fares and an increase in service. Travelers benefited greatly from deregulation, and the express coach service increased its patronage. Forty percent of the new patronage, however, came at the expense of British Rail, a state transport monopoly.[33] This caused the nationalized railroad to enter into the competition and fight to gain back its lost patronage. The competition caused by a "limited" transport act had spilled-over to another sector of transport.

Before deregulation, the quantity bus licensing system placed rail at an advantage over coach. British Rail could object to any coach initiative, such as reduced fares or an increase in services. If British Rail lodged an objection to the Central Government, it was up to the coach operator

to prove the need for the initiative. In order to fulfill the financial goals established by the government, British Rail even had the power to adopt discriminatory pricing policies which encroached on the coach operators' staple markets.[34]

In 1981, British Rail was forced to respond to the new competition by introducing the London Saver ticket, a low-cost, round-trip ticket for service between London and other major British cities. The fares for the London Saver ticket were initially low and represented a savings of 79% over pre-deregulation prices. The program was successful in bringing back the lost rail patronage without an overall loss in revenue. The deregulation of one portion of the transport industry had improved rates and service in another.[35]

Although fare prices increased after the intensity of competition between rail and bus service declined, fare prices for both rail and coach still remained below the pre-deregulation level. It is argued that although the express coach market remains dominated by the nationalized carriers, independent entrants did induce significant and lasting fare reductions and improvements in service quality. The entrance of independents into the newly opened express market further stimulated fierce competition between the nationalized coach and rail operators which improved the overall transport market. This directly benefited the

public without any additional cost to the government, while still allowing a margin of profit to the operators.[36]

The deregulation of the express bus market in the United Kingdom was deemed a success by the Conservative Government and is distinguished in that it was a deliberate attempt by the Thatcher Government to introduce competition to a nationalized industry. The move belonged to the relatively short period in the Thatcher Government when attention was focused on making public enterprises more efficient, short of privatising them.[37]

The success of the Transport Act of 1980 permitted the Conservatives to move ahead with further deregulation of the transport market. A 1984 White Paper entitled Buses stated that: "new measures are needed to urgently break out of the cycle of rising costs, rising fares, reduced services, so that public transport can win a bigger share of this market."[38] The paper claimed that competition would provide the opportunity for lower fares, new services and more passengers. It was felt that this could be accomplished within the essential framework of existing safety regulations and provisions for social needs. Another major goal of the White Paper was to reduce government subsidization of local bus services. Countrywide, bus revenue support (subsidies) rose from 10 million pounds in 1972 to 520 million pounds in 1982. Because the government was determined to reduce public expenditure, the situation

in the local bus industry could not be allowed to continue.[39]

The 1985 Transport Act would attempt to solve these problems by extending deregulation to the local bus market for all areas in Britain except London. The plan was similar to the 1980 Act in its removal of quantity licensing, but the 1985 Act also included the privatization of the National Bus Company. (In its experimental phase, the proposed plan would not deregulate London bus service "for the time being," and would not privatize the country's other public bus company, the Scottish Bus Group, until 1990.)[40]

In the initial stages following deregulation about 85 percent of the preexisting bus services were registered by operators as commercial services. The National Bus Company was privatised as 72 separate companies.[41] There were also many new entrants to the local bus market, to include the largest of the new operators, United Transport.[42]

The results of the 1985 Transport Act have been mixed. While competition has led to some improvements in Britain's local bus market, not all of the promises of the 1984 White Paper have been realized. Fares have not been reduced in all areas, and have increased substantially in some locations. The general opinion is that bus fares were largely unaffected by deregulation.[43] The failure of overall fare reduction, however, was due to competition not emerging throughout the market. In areas where on-the-road competition did emerge, fare reductions did occur, but this

was the exception rather than the rule.[44]

Privatization of the National Bus Company was successfully accomplished and the 72 successor companies have survived the initial deregulation period. Services in the deregulated local bus market were improved by the large-scale implementation of cost-efficient mini-buses, but the discontinuation of some of the less-traveled routes, along with the unstable period following the implementation of the Transport Act caused a drop in bus patronage. Even up to three years after the deregulation period ended, service patterns and timetables were still being changed, causing a loss of confidence of the users. Between 1985 and 1988, bus patronage fell by as much as 16.2 percent.[45] The drop in patronage is seen as an "unfortunate short-term consequence" which could be greatly increased by more effective marketing and education of the public.[46]

One primary objective of the bus policy which was achieved was the reduction of costs and subsidies through competition. The crippling bus subsidies were cut significantly through the privatization and deregulation of local buses. While the government still subsidized the fares of the elderly, the disabled and school children, and still subsidized certain bus routes which were deemed necessary, the privatization of the National Bus Company meant that the public was no longer directly financing unprofitable lines with millions of pounds. In English

non-metropolitan areas, local authorities spent 86 million pounds on bus revenues support in 1985-86. In 1987-88 the figure had dropped to 67 million pounds. In the metropolitan areas outside of London, bus revenue support went from 201 million pounds to 117 million pounds in two years.[47]

Although it is too early to record final conclusions, the 1985 Transport Act appears to only have been moderately successful. By May 1988 there had been a net increase of 465 operators of local service (30 percent) which should have caused an increase in service and a decrease in fare.[48] It is believed, however, that an overall lack of competition was the result of collusion between numerous operators. In November 1988 the Director General of Fair Trading announced that 115 operators had fixed fares and shared out timetables. The overall effect of such agreements was to undermine the drive for more competition in the bus industry.[49] It is ironic that the British Government now had to push a reluctant private sector into competition.

One fear that was never realized in the deregulation of the local bus market was a decrease in safety standards. It was alleged by some critics that competition would lead to the neglect of vehicle maintenance and personnel training. There were no increases in bus accidents following the deregulation, only a steady continuation of the previous decline in injuries and deaths per passenger mile. It

seems, therefore, that the quality regulation has been sufficient so far.[50]

### TRANSFERRING THE EXPERIENCES TO OTHER SECTORS

The successes of the British deregulation efforts have not gone unnoticed in other countries and in the other sectors of the transport industry. While the experiences of truck and bus deregulation cannot be directly translated to all countries and areas of transport due to differing situations and infrastructures, the general concept that increased competition will reduce fares and increase service has been examined throughout the European Continent.

One area where this theory can be adopted and is being put into practice is the European airline industry. The current trend of European aviation is liberalization, but the process is much slower than the deregulation which occurred in the United States airline industry beginning in 1978. There are several reasons for a slow transition to a deregulated aviation market in Europe.

Most European countries have a tradition of heavily regulating both entry and fares in the airline industry. This degree of regulation has frequently been justified by governments in terms of serving the public interest by ensuring market stability, maintaining safety standards, protecting the public from monopoly exploitation and providing a comprehensive network of services. The heavily

regulated market also protects the national interest by maintaining flag carriers which meet wider economic and military criteria.[51] Most important, perhaps, is the fact that the majority of airlines operating within Europe are state monopolies which can set their own rates and services. Open competition would threaten their secure position in the airline market.

The success of the United State's Airline Deregulation Act of 1978 has made a great impression on the world airline market and serves as a model of how the airline industry can be competitive and still serve the public interest with reliable service and overall lower fares. Whether the U.S. experience can be imported to Europe is still in question.

There have been many benefits from the deregulation of the U.S. airline industry. The deregulation gave passengers a greater choice in routes, fares and airlines. There was a 28 percent increase in the number of scheduled flights in the United States between 1978 and 1986 with a greater choice of flight times and more direct flights. 85 percent of passengers traveling in 1986 experienced fare reductions of up to 50 percent. The safety record in U.S. aviation has also improved in spite of the increase in air traffic.

It is not the benefits but the downside of the U.S. deregulation experience which worry the European airlines. While the public experienced fare reductions over long-haul routes, they experienced price increases in the less

profitable short-haul routes. What made the U.S. market successful was the replacement of linear direct services with a hub-and-spoke system in which economies were achieved and costs reduced by employing key hub cities as consolidation points for flights with routes radiating out from them. Since most flights are long hauls between major airline hub cities, passengers have benefited (although some journey times have increased due to the necessity of changing planes). This might not be the case in Europe, where the average route length is 750 kilometers versus the 1300 kilometer average in the United States.[52] The great time savings over long-distance flights is the airlines major competitive advantage. If flights are short then there is much less scope for hubbing because any time spent changing planes during a trip takes a relatively long time, time which could be made up by alternate means of travel such as high-speed rail or road transportation.

Another major problem with importing the U.S. experience is that Europe may not have the airport capacity to introduce more airline traffic. The U.S. experience shows that deregulation will lead to an increase in traffic, but of the 46 largest airports in Europe, 10 are operating at or around capacity and it is predicted that a further 13 will join the list by 1995.[53] This lack of infrastructure is currently under consideration by most European countries and plans are slowly being made to remedy the problem.

The fact remains that European air fares are 45-74 percent above those in the U.S., and this differential cannot be explained by reference to factors other than the absence of competition. European civil aviation is regulated by a set of of bilateral treaties known as Air Service Agreements entered into by governments which control market entry, tariffs, routes and capacity. These agreements produce a highly regulated market which restricts entry into routes between the two countries involved. This arrangement produces a duopoly which eliminates competition from the European skies.[54]

While the European Community's progress with aviation policy has been painfully slow, the Commission's aim is to liberalize the skies over Europe. For now, in the absence of an aviation policy, the Commission will apply the competition rules of the Treaty of Rome. In April 1986 the Court of Justice delivered a judgment confirming that the competition rules of the Treaty of Rome apply to air transport. In July 1986 the Commission sent a letter to ten European airlines giving them two months to provide evidence that they do not participate in cartel practices and sharing arrangements.[55]

Although it appears that deregulation of European airlines will eventually take place (most likely under the watchful eyes of the European Commission), it is clear that the transformation will not take place overnight. One

country, however, is not waiting for the rest of Europe. The United Kingdom's Civil Aviation Act of 1980 was a major step in the Conservative Government's efforts to increase competition within British airlines. Domestic airfares were effectively deregulated in 1985. From that point on, carriers were free to set their own fares provided they did not engage in predatory pricing. Liberalization of the British air market has led to growing competition on domestic routes and has led to significantly lower fares (the London to Edinburgh excursion and stand-by fares are now one-third less than before liberalization). The quality of service has also improved considerably in the wake of liberalization.[56]

The United Kingdom has also been the prime mover in bilateral airline agreement liberalization. In June 1984 it negotiated an agreement with the Netherlands whereby any carrier designated by either government would be allowed to fly any route between the two countries. The carriers themselves would decide on frequency and capacity of services. The new bilateral agreement appears to have been successful with a capacity growth of 24 percent in the first year. By 1986 the London-Amsterdam route alone was served by seven airlines, an increase of three airlines in three years. The market had grown to 1.4 million passengers, an increase of 30 percent over 1983. Similar agreements have been reached with Germany, Luxembourg, Italy and Spain.[57]

The rest of Europe will once again watch the British experiment to see if deregulation and competition can improve another sector of the transport market.

In looking at the European transport market it is clear that, where tried, deregulation led to competition and competition has improved services and/or lowered fares. It is also clear that the trend in European transportation is towards liberalization, but a slow and clearly planned liberalization. While Great Britain, and other like-minded countries, have demonstrated the desire to liberalize their transport markets through deregulation, other countries, such as France and Germany, have been reluctant to take similar steps. The result is that Britain and the other market-oriented countries will have already adjusted to free-market competition in the transport industry, when open competition spreads across a united Europe. The reluctant countries will have to simultaneously adjust to a deregulated internal transport market as they are dealing with competition from other European countries.

The age of economic regulation appears to be ending. While economic regulations were once required and desired, it is clear that as long as social regulations are enforced the public interest will be served in the transport sector. The removal of economic regulations will encourage competition. Competition will ensure that fares will be

kept near the cost margin, and will also force the improvement of services. Government anti-trust laws will prevent the creation of monopolies, oligopolies and collusion. Though simplistic, the deregulation model has been effectively proven in Great Britain and the United States. Even when it didn't work as well as expected, it was due to a lack of competition, not too much competition!

## Chapter III: Privatization of the European Transport Market

"Privatization may not exactly have 'swept the world' - the claim of a British Finance Minister - but it is certainly true that throughout Western Europe governments are pursuing, with varying degrees of enthusiasm, policies under the banner of 'privatization'."[1] While the most committed have been the conservative governments of Thatcher in Britain and Chirac in France, even the coalition governments and Socialist-led governments in Europe have sold or intend to sell at least some state assets.

As mentioned in the previous chapter, the extreme form of economic regulation in the transport sector is direct ownership by the state. Just as this is true, so is it true that the extreme form of deregulation is the privatization of state-owned transport systems. While European countries are busy deregulating certain sectors of the transport market, such as road haulage, coach transport and commercial air operations, they are now exploring the possibilities of selling off their state-owned transport industries. This step in the deregulation process will primarily involve the state-owned railways and, to a lesser extent, the state-owned airlines.

Before examining the transfer of these national transportation assets to the private sector, it is necessary to define exactly what the term 'privatization' means and

how it applies to the transport sector. It is also necessary to explore the aims behind the privatization of the transport sector.

## DEFINING PRIVATIZATION

Interpreted broadly, privatization is "that wide range of policies designed to reduce the scope, limit the functions and generally weaken the influence of the public sector."[2] Traditionally, privatization means "transferring to the private sector all or part of an activity (or activities), hitherto the bailiwick of the public sector."[3] It is therefore the exact opposite of nationalization. Privatization is sometimes further defined as "real" privatization and "legal" privatization. In both real and legal privatization "the body responsible for the particular activity is conferred legal status enabling it to operate under the same conditions as a private business." They must also "be endowed with adequate forms and amounts of working capital, irrespective of who owns this capital."[4] While both forms of privatization are legal, in real privatization ownership is transferred to the private sector. In legal privatization, ownership may remain with the state in the form of a public or joint-stock company.[5]

"Real" privatization can occur to differing degrees: partial or total. With partial privatization, the state maintains an important stake in the capital, a stake large

enough to have a say in the definition of corporate objectives. In such a case the state will have private sector partners with boardroom representation. The result is a structure with a mixture of public and private sector capital.[6]

In total privatization, the state yields its entire holdings to private shareholders, legal entities or private individuals. This can occur through the sale of the industry in whole, or in parts, or the sale of shares on the open market to the general public or private sector.

Whatever its degree, privatization clearly conveys an important implication not necessarily found in the public sector: there must be a minimum level of profitability built into corporate objectives. If this does not occur, the privatised entity will fail to attract the private investors.[7]

The difference between partial and total privatization can be quite substantial, however, in terms of management criteria and objectives. In partial privatization, the primary goal is to increase efficiency in the operation in order to reduce the burden of cost on the taxpayer. In this case the exercise consists of introducing private sector management, believed by many to be more efficient, and, in order to please the stock exchange and money market, ensuring a minimum profitability margin.[8]

With total privatization, the activity is no longer

protected by the state and therefore must be profitable in order to survive. The principle of the activity will then be based on establishing maximum profitability. In the case of some natural monopoly privatizations, however, the state has interfered by establishing a price cap on the goods or services offered to the public. This occurred when the British government established a price cap on British Telecom prices following privatization of the telecommunications giant.[9]

Another form of privatization consists of the selling-off of ancillary parts of an enterprise. This is called sectorial privatization and consists of singling out one or several segments of the business for transfer to the private sector. This occurs as a part of a stable contractual pact with a public sector operator, with the latter continuing to control the main part of the business.[10]

Sectorial privatization is often viewed as an interim solution to privatization, allowing the results of the privatization of a lessor part of a business to be examined before continuing the process with the main part. It is conceivable that if the initial steps in sectorial privatization achieve the state's goals of increasing efficiency, the main part of the enterprise will remain in public hands.

The breaking up of an enterprise into sectors, whether privatised or not, also serves the purpose of restructuring

the enterprise into more visible and manageable sectors. By allowing each sector managerial autonomy, and holding it responsible for its own costs and actions, it becomes possible to identify where public funds are being spent (or misspent). At present, considerable funds are allocated to the centrally managed railways without it always being possible to identify where the funds go and what they are used for. Sectorial privatization and management autonomy creates a better environment for cost transparency. With managers carefully watching the funds in their sectors and being held responsible for them, waste can be better identified and eliminated. This, in turn, helps reduce government subsidies.

## THE AIMS BEHIND PRIVATIZATION

There seem to be almost as many reasons for privatising government owned transport enterprises as there are definitions for the term "privatization." One excuse for the transformation is that privatization will result in extensive strategic management autonomy in transport industries and this, in turn, will make the industries more customer-oriented and market responsive in a continuously changing environment as regards to user requirements and competitive conditions.[11]

While guaranteeing a transport industry autonomy in strategic decision making may increase efficiency through

profit-oriented motivation, privatization may also cause management to disregard the public service aspect of transport. Although public service is not necessarily incompatible with management discipline, it may not be compatible with the logic of "hard and fast" private sector management. This threat to the public service aspect of transport can be kept in check by establishing regulations and contracts which will maintain the necessary services for the public.[12]

Some experts also consider that private shareholding and a private sector structure are a better guarantee of quality than a public sector structure. It can be argued, however, that threats of bankruptcy or of dismissal cannot in themselves constitute sufficient motivations for managers to perform better. Examples of sound and bad management can be found in both sectors.

Perhaps the most important reason for privatization is to relieve the financial strain on government coffers. Full privatization can sometimes be developed to meet financial objectives set by the state. If a public sector enterprise is thriving, its sale to the private sector can release substantial funds for the state which can be used to relieve the public debt burden or finance other public investments.

If the enterprise is not thriving, however, the sale may be engineered to eliminate further deficit spending to support a losing enterprise. It is necessary to question

the social benefit of maintaining a loss making enterprise. It is quite legitimate for the state to argue that in some cases the amount of its financial contributions is far too high in relation to the social value-for-money of services provided by the industry.

Another motive for privatization is that it is part of the ideology of some conservative European political parties. For the right, especially in Britain and France, privatization is part of the "general strategy to shift the boundary between public and private in favor of the latter."[13] In these countries, privatization is nourished by deep-rooted anti-state sentiment. The pursuit of privatization is also echoed in some other European conservative parties, but this sentiment is not as strong in Italy, Germany or the Benelux.

For some European governments, a motive for privatization is that it facilitates the adoption of tough labor policies by distancing governments from unpalatable political choices. Private management, which is not concerned with retaining political loyalties, is more likely to tackle the unions which protect inefficient work practices and employment levels.[14]

The theory of popular capitalism, the selling of public sector shares to the "common man", has been another motive for privatization. In theory, the government would sell shares of a public sector enterprise at a discounted rate to

the middle-class, thus creating a nation of small shareholders. When tried in Britain, France and West Germany, the public was less than enthusiastic and the purchasers usually turned a quick profit by immediately selling their shares to a few large shareholders. This defeated the purpose of the plan. In France, those who did not immediately sell their shares lost them in an ensuing market crash.

## EUROPEAN ATTITUDES TOWARDS PRIVATIZATION

The tide of privatization in Europe, which began in the 1980s has been strongest in Britain and France. In Britain, beginning in 1983 with the Thatcher government, and from 1986 to 1988 in France with the Chirac government, the programs were ideologically inspired. Elsewhere in Europe, privatization is more of a pragmatic response to problems in the public sector.

In Britain, no nationalized enterprise was safe from the threat of privatization. The only condition required was that the state-owned firm be saleable. The Conservative government transferred to private ownership not only firms in the competitive sector but also monopolies such as British Gas and British Telecom. Even major strategic industries such as British Aerospace, British Petroleum and Britoil, and British Airways, the national flag-carrier, have been completely denationalized.[15] The British program

of privatization, while based on the theory that private industry was more efficient, was more for the sake of accomplishing ideological goals than for any other reason. Public sector enterprises which already exhibited efficiency were just as vulnerable to privatization as inefficient operations, perhaps even more so if profitable.

The privatization plans of France's Chirac government were outlined in a 1986 act and was passed by the cohabitation government. This plan was considered very ambitious and listed 65 companies (with 755,000 employees) as targets for privatization. The French program, however, contained no provision for the transfer of public monopolies to the private sector. Gas, electricity, and telecommunications all were to remain under state ownership. Also, there was no question of selling Air France, the French national flag-carrier, or any aerospace industry.[16]

Elsewhere in Europe the ambitions of the privatisers have been relatively modest. For example, the German government, which in 1982 held at least a 25 percent stake in 958 companies (controlling 102 of them directly), planned on privatising only a few major firms. This is primarily because most of the public sector has been relatively successful in West Germany and little need has been seen to change the public-private relationship (It remains to be seen, however, how much of the public sector holdings of the former East German government will be placed on the

market).[17]

Another reason for the German lack of enthusiasm for privatization is that no nationalization took place in the Federal Republic of Germany after the Second World War. Only companies which were nationalized before the end of the war and considered vital to economic policy or defense were left in the German public sector. Furthermore, as a matter of principle, the West German government did not take over any financially ailing private companies. The West German State, therefore, held on to a smaller share of the nation's businesses than some other European states. The businesses which were in the public sector were considered necessary and most politicians, on the left and the right, felt that they should remain that way. Even if there were a desire to privatize, there would be some difficulties in disposing of the public monopolies. The German Basic Law provides constitutional protection for the public monopolies. Privatization of the railways and the postal service would require a two-thirds majority in the Bundestag to pass the necessary constitutional amendment.[18]

Other European countries, while not experiencing as much success as Germany with their public sector holdings, were even less ambitious in privatising. Privatization plans in Austria were limited to selling minority holdings in state enterprises. Belgium's plan was similar in that only parts of three state-owned companies would be sold to

the private sector. Also, the country was more interested in partial privatization for the purpose of raising capital than in the outright sale of its enterprises. Italy's privatization plan was limited to the disposal of loss-making and peripheral activities.

Most of Spain and Portugal's public sector enterprises are protected constitutionally. In Portugal, for example, the Law of 8 July 1977 forbid private enterprise in banking, insurance, air, rail and urban transport, electricity production and distribution, post and telecommunications, petroleum refining, basic petrochemicals, and arms industries. This law, however, was amended in 1983 to allow the private sector to compete in banking and insurance, and for joint public-private ventures in steel, petroleum, chemical and arms industries. While the resistance to private competition weakened somewhat, these public sector industries still solidly remain in the public sector.[19]

With the exception of the United Kingdom and France, European governments appear satisfied with maintaining a mostly status quo position with public sector enterprises. Only limited privatization efforts have been witnessed and mostly for the sake of strengthening the position of public sector holdings. The pro-privatization constituency outside of Britain and France appears to be limited to a small group of neo-liberal intellectuals and those investors and bankers

who would benefit financially from denationalization of certain industries. Certainly, the privatization efforts tried in all countries have raised much-needed funds for hard-pressed finance ministries, but nowhere outside of Britain and France have they significantly altered the balance between public and private industry.

It must be noted that while Britain and France are actively privatising much of their public holdings, both governments still retain the power to intervene in the affairs of their old possessions. While many public industries may have been transferred to the private sector, the states are still watching and influencing these businesses through a myriad of policies and regulations. These policies and regulations, which ensure that industry does not operate against the best interests of the public, include competition policies, regional policies, trade policies and regulations, policies for high technology industries, price control regulations, employment and training policies, and industrial relations policies, just to name a few.

### PRIVATIZING THE RAILWAYS

Following ten years of deregulation and privatization, the Thatcher government had succeeded in denationalizing much of the nation's bus and coach services, the national flag-carrier British Airways, Sealink ferry service, and

Associated British Ports. At the same time, the government extended its privatization plans from potentially competitive industries to natural monopolies such as gas, water and electricity. The British government believed that a regulated private sector monopoly would be more efficient, provide better service and carry out more innovation than a publicly owned one. The leading deregulating and denationalizing country in Europe, however, was slow to see privatization as the way forward for the rail industry.

The impact of recession and increased competition from other transport sectors led to a severe financial crisis for British Rail. In 1982 a committee set up to investigate railway finances concluded that there should not be any increase in government rail subsidies. It further decided that the only way to reduce future subsidy bills for the ailing rail system was through increased efficiency and major cuts to the rail network. While a major reorganization of the industry and adherence to strict financial targets led to a halving of subsidies in less than a decade, a number of academic authors and right wing think-tanks were pressing for privatization of British Rail.

Why, after more than a decade of denationalization, is British Rail still in the hands of the British public sector? Why hasn't Britain's rail system gone the same route as British Air and the other privatised industries? Former transportation secretary Lord Ridley, an ardent

right-winger and supporter of privatization, summed up the central argument for leaving railways in the hands of the government: "I myself never believed it was really possible to do very much with railways, if anything at all, basically because they are loss-making. They are not an industry; they're a service."[20]

There are several issues which separate the privatization of rail from the privatization of other industries or natural monopolies; issues which require special handling. The railway is an inflexible and costly means of transport. The infrastructure of rail cannot easily be moved and while it costs billions to build a rail line, the scrap value of the materials is minimal.[21] Unlike an airline's aircraft, a railway's rolling stock is specifically built for that nation's rail system and cannot easily be transferred to another railway. With several different track gauges and vehicle gauges, and four different European catenary traction systems (overhead electrical wire systems which supply electricity to the engines) currently in use, transferability of rolling stock within Europe is limited. With transferability limited and infrastructure inflexible, the prospect of attracting investors to an enterprise with fixed capital is also limited. There are many other obstacles which discourage privatizers from the rail industry.

European railways are subject to an even greater amount

of interference from politicians and trade unions than most other forms of transport. This is primarily because of a decades-old association with the public sector and the long held belief that rail is a service and not an industry. Railways require a massive amount of public funding to finance infrastructure building and repairs, as well as the funding of unprofitable, but socially necessary, lines, therefore finance ministers and many other government personnel take a great interest in them. Governments also intervene extensively in the range of fares and services provided by railways for social reasons.

One of the social reasons for government intervention in rail service and prices is that rail causes fewer external costs than other modes of transportation. Diverting traffic from road to rail may reduce road congestion, accidents, noise and air pollution. By encouraging use of rail, the government can also reduce the pressures for funding the building of new roads.

Thus, with this extraordinary amount of government involvement in the railways, it has generally been accepted throughout most of the world by both the private and public sector that railways are a natural monopoly and that they require unitary ownership at the network level and either public control or ownership.[22] The private sector also felt that the rail industry, unlike other forms of transport, has too many entry barriers. Access to infrastructure is even

more limited in the rail industry than in other forms of transport. Even innocent barriers, such as experience in rail management, staff knowledge and training may give existing operators a strategic advantage.[23]

It has only been in the last twenty years that this view, along with the belief that natural monopolies automatically belong in the public sector, has been challenged. Experiences of privatization in other sectors and other countries have demonstrated that the private sector, working together with the public sector, can overcome the barriers in the rail industry and provide necessary social services, while still improving efficiency.

The first modern examples of successful rail privatization occurred during the 1980s in the United States, Japan, Sweden and Switzerland. In the case of the United States, the privatization began in the mid-1970s when the government intervened to bail-out seven bankrupt railroads in the Northeast and Midwest. These railroads carried nearly half of all rail traffic in the regions they served, and their bankruptcies threatened the economic health of the regional economies. Through the Regional Rail Reorganization Act of 1973, the United States Congress authorized the creation of the Consolidated Rail Corporation (Conrail), a private, for-profit railroad company. The Act also established the United States Railroad Association (USRA), a government corporation which would fund and

oversee Conrail's operation.[24]

The main purpose of the government's nationalization of the seven bankrupt rail systems was to identify a rail system which would provide adequate and efficient rail service in the Northeast and Midwest and to reorganize the region into an economically viable system that could provide that service.[25] The USRA's intention was to make Conrail economically viable over a period of several years, then to transfer Conrail intact to the private sector. This would make the "legal" privatization of Conrail "real". They would accomplish this by improving Conrail's infrastructure and operating efficiency, and by infusing federal funds into the rail system.

The process, however, proved difficult. While infrastructure and rolling stock were greatly improved, Conrail was doing worse than expected, as was the entire U.S. rail industry. At that point, it became clear that simply throwing money at the problem was not going to improve the rail system. If Conrail was going to survive, Congress would have to turn its attention to the fundamental regulatory and structural problems that had driven the seven railroads into bankruptcy in the first place - and which were threatening to do the same to Conrail.[26]

The result was that Congress passed the Staggers Act in 1980, an act which significantly reduced the government's regulation of pricing and marketing activities for all

railroads. Changes made by the act enabled railroads to restructure rates and services in order to improve their profits. Railroads were also allowed much more flexibility to abandon their unprofitable routes and services.[27]

The Staggers Act enabled Conrail to compete more effectively against other forms of transport and also helped to reduce the amount of funding required from the federal government. Another piece of legislation, the Northeast Rail Service Act of 1981 (NERSA), helped to turn Conrail into a profit making industry. This act permitted Conrail to eliminate its passenger service operations and to restructure its labor agreements (to include terminating the lifetime job protection benefits).[28] By doing so, Conrail was able to reduce its operating costs.

The act also challenged the management and workers of Conrail by imposing a deadline on reaching profitability. NERSA required Conrail to show by 1983 that it could be a profitable railroad. If Conrail was unable to do this, the Department of Transportation would be required to sell the railroad piecemeal to other carriers.

The result of the new regulations was that by the end of 1981 Conrail was operating in the black. Conrail continued to operate in the black over the next few years and was finally privatised in March of 1987 through a public stock offering. The overall cost of the Conrail experience was about $7.8 billion before the privatization sale, which

netted $2 billion.[29]

Today, Conrail is a healthy and economically viable freight railway which is able to compete successfully in the private sector without public support. The main cause for the rail system's financial turn-around was the regulatory changes which occurred during the federal wardship. The elimination of passenger traffic responsibilities allowed Conrail to concentrate solely on the potentially profitable segment of freight traffic. The Conrail experiment demonstrated that certain sectors of rail can be profitable and not a drain on taxpayers.

Although the U.S. government allowed Conrail to eliminate its passenger service, it did not shun its social obligation of ensuring passenger rail service. The federal government created Amtrak in 1971 to assume the responsibility and financial burden for providing intercity rail passenger service. Amtrak was conceived of as a for-profit corporation but is wholly owned by the federal government. While costing the federal government about $19 billion since its founding, the creation of Amtrak has achieved its objective of lifting the burden of passenger losses from the freight railways. By operating on other companies' rail lines on a contractual basis, Amtrak is not burdened with the additional costs of track maintenance and can keep the social costs to a minimum.[30]

Transparency was also achieved by separating the two rail sector, thus making accountability of costs possible. The social cost of providing intercity passenger rail service to the American public could now be clearly identified. The technique of separating rail sectors allows for maximizing efficiency in both profitable and unprofitable sectors and allows for the identification of waste. This technique was also successfully implemented in Japan.

On 1 April 1987 the Japanese National Railways (JNR) was privatised and split into six regional passenger companies and one nation-wide freight company. The purpose of this restructuring was to eliminate JNR's large operating deficit and to create competitive rail undertakings in order to regain the railways declining market. Prior to its restructuring, JNR was losing more than 1 trillion yen a year and had long-term debt amounting to more than 23.5 trillion yen (equivalent to almost half the Japanese annual national budget), a problem common to most national European rail services.[31]

JNR's restructuring plan called for "legal" privatization, with each of the seven new rail segments responsible for its own management. The six regional passenger services would own and operate their infrastructure while the nation-wide freight company would use the tracks of the passenger companies for a marginal

cost. The separation of freight operations from passenger operations, and the breaking down of passenger service into regions, would allow managers to concentrate their efforts on one particular segment. This would also allow for greater transparency in the industry.

The elimination of JNR's enormous debt and industrial relocation of excess personnel was managed by the newly-created JNR Settlement Corporation. The JNR Settlement Corporation was given the task of finding new employment for 61,000 excess employees and reducing the 25.6 trillion yen debt through the sale of excess JNR land. A debt of 6 trillion yen was divided among the seven rail companies, to be made up through austerity measures and an increase in profitability.[32]

The legal privatization of JNR, along with the restructuring plan, appears to have reversed the decline in passenger and freight transport volume. Within the first year, increases in passenger transport in the six regional markets ranged from 0.8 percent to 4.7 percent. This trend continued the following year with an overall increase of 9.1 percent. Freight transport went from an annual 9.7 percent loss in volume to and increase of 6.5 percent. This is attributed to better management and service on each of the seven lines.[33]

By working with both the public and private sector, the JNR Settlement Corporation has been successful in finding

employment for all but 3,700 of the 61,000 former JNR employees. Elimination of debt remains to be the biggest challenge for the Corporation. The partial sale of JNR land has only succeeded in keeping the debt at a steady level. It is anticipated, however, that the future public sale of company shares will help to eliminate much of this debt.[34] The example of Japanese National Railways demonstrates that the division of a railroad into manageable sectors, combined with the application of market-oriented management, can help to make a railroad more cost efficient.

Both the U.S. and Japanese privatizations separated freight operations from passenger operations, leaving one segment responsible for maintaining infrastructure. While this is proving effective, European transportation planners are urging the total separation of infrastructure from rail operation, leaving responsibility for infrastructure in the hands of the public sector. Separation is already effective on the partially-privatised Swedish and Swiss rail systems, where the operators' accounts show that the fee paid by the operator is equivalent to respectively 16 and 4 percent of the infrastructure cost. The balance of infrastructure cost is paid for by the public. To increase the infrastructure user fee could jeopardize the financial stability of the operators or deter rail patronage through increased fares.

The covering of infrastructure costs by public moneys can be justified as necessary. Some argue that the external

benefits of rail use, such as less pollution, greater fuel efficiency and reduced congestion, are worth the public expense of financing infrastructure. Others compare it with the government financing of highways or dredging inland waterways.

The placing of infrastructure into government hands has another benefit besides cost transparency. With the government acting as an impartial manager of infrastructure, private rail companies can compete freely without the fear of one rail company preventing another from using the rail line. Limited rail competition on government infrastructure can already be seen in Sweden and Switzerland and demonstrate that there is potential for rail competition with an increase in inter-EC rail traffic.

The first country to privatize its railway within the European Community will probably be Great Britain. After observing the results of the privatization efforts of the United States, Japan and other countries, the British government finally proposed plans for the privatization of British Rail which borrow different aspects of each country's plan. The White Paper on British Rail has already passed a second reading in Parliament and is now in committee stage. Barring a huge public outcry, the bill is expected to pass by the end of 1993, with implementation to follow by the summer of 1994. Full privatization of British Rail is expected to take up to twelve years. [35]

In following the basic principles of privatization, the government plans first to sell off the profitable sectors of British Rail. It will then franchise its unprofitable passenger services on individual or groups of routes to private rail companies. Borrowing from the Swedish and Swiss experiences, the government will turn the responsibility for track and signaling over to a separate independent authority. Eventually, the single rail system will be owned and operated by numerous independent companies, monitored by three government agencies.[36]

The plan calls for a triad of government bureaucracies that will attempt to hold the formerly single rail system together. Railtrack will manage the infrastructure and allocate slots to private operators. A Franchise Director will be responsible for which companies get what lines, and Rail Regulator will referee relations between Railtrack and the operators over such matters as track charges.[37]

The major public fear over the proposed privatization of British Rail is that rail service will disappear on certain lines. With the railway sold off to numerous private operators, the rail lines will no longer be able to cross-subsidize unprofitable routes with funding from profitable ones. The government has offered to subsidize private franchisees on the unprofitable lines, but the Department of Transport admitted that financial support for unprofitable lines will not last indefinitely. Roger

Freeman, the Minister of State for Public Transport, also conceded that franchised operators will have the right to cut back on evening and weekend services.[38]

Britain's transportation community is not convinced that the benefits of privatization outweigh the bureaucracy of the proposed program. Opposition has been growing from both sides of the Parliament and there has been a deafening absence of support from the business community as well as from most sectors outside of the government.[39]

The success of British Rail's privatization will determine whether other European governments will go forward with similar projects. Other European countries, such as Germany, are carefully watching to see if privatization is the answer to debt-ridden national railways.

A commission was set up in Germany to suggest ways of improving German Rail's situation. Currently Germany's two rail networks, the eastern and western, have a debt of over DM 65 billion and about 150,000 too many employees.[40] A proposal was put forward to raise gasoline taxes in order to pay off part of the railway's debt. The most important measure proposed was to transform the railway into a joint-stock company, thus partially privatising the industry.

Under the new arrangement, infrastructure would be separated from operation and financed by the state. Public service obligations to provide service on unprofitable lines

would be replaced by government contracts. It is expected that a more creative management operating under the proposed system, along with the better-adjusted subsidies, would yield savings of about DM 105 billion over the first eight years of operation. It must be remembered, however, that the German Basic Law protects public monopolies and that privatization of German Rail would require a two-thirds majority in the Bundestag.[41]

Italy has already begun privatization of its rail system. The Italian rail system is heavily in debt and has been heavily handicapped by its dependence on politicians and unions. To deal with this situation, Italian Rail has been transformed into a public company. This privatization, however, is purely legal (like the privatization of the Japanese National Railway) since the state remains the owner. Interestingly, Italian Rail will run a commercial rail network which will be separate from lines that meet a social need. This commercial network will be run without any public subsidy in return for the freedom to set its own tariffs (hints of the Staggers Act).[42]

France, the one EC country other than Britain to fully embrace the principles of privatization, has no intention of privatising its railway. France's railway system suffers similar woes as other European systems, but the government currently plans on fighting its railway deficits with increased patronage aboard its new high speed rail network.

While the introduction of the TGV (Trans a Grande Vitesse) high speed trains won back declining patronage from air and bus services, it remains to be seen whether the TGV will be able to bring French National Rail into the black.

### THE CASE FOR AIRLINES

While the majority of European countries are still reviewing deregulation of air transportation, some are already looking at privatising their government-owned fleets. Several observers of the European airline industry have suggested that privatization could, in fact, occur very rapidly. The United Kingdom has already privatised its flag-carrier, British Airways, and many other European airlines are already partially privatised. This list includes Alitalia, Lufthansa, Sabena, SAS, Finnair and Swissair, all with majority government ownership. Partial privatization is being considered for Air Portugal and Iberia Airlines.

One major factor affecting privatization of European airlines is that the air carriers are going to need access to substantial financial capital for massive fleet renewal, as well as for expansion to accommodate growth in this period of cabotage and opening markets. If governments are to finance this renewal and expansion without additional taxpayer funds, they will need to raise capital through the private sector. As forces of competition express themselves

within Europe, the need for financial capital is likely to place significant pressures on governments to privatize their carriers.[43]

There is still much resistance to any additional privatization of airlines. Discussions about the partial sale of Lufthansa gave rise to serious conflicts between the Bavarian CSU state government and the conservative-liberal federal government. The Bavarian state government argued that the federal government had to keep its influence over Lufthansa in order to protect it against foreign investors. Strategic defense arguments were also invoked. Behind these arguments, however, stood the real opposition to privatization. The state of Bavaria is the center of the German aerospace industry and also the location of the European Airbus program. Partial privatization could undermine the traditional close-knit network between Lufthansa, Airbus and the aerospace industry. To fight off the threat of any additional privatization, and a possible loss of jobs in Bavaria, the state government is in the process of acquiring an additional five percent interest in Lufthansa.[44]

The threat of foreign investment that the CSU feared, is, in fact, real. In 1987, the Thatcher government blocked a bid by Scandinavian Air Services to buy controlling interest in British Caledonian, a privately-owned airlines. At the same time, KLM and British Airways each proposed

purchasing twenty percent stakes in Belgium's Sabena Airlines.

Mergers of European airlines is a distinct possibility in the future. It is an alternative to bankruptcy and allows for a national airline to stay competitive in an increasingly competitive market. While this occurred in the American airline industry following deregulation, the question still arises as to whether the European governments will allow their national flag-carriers, airlines which embody the egos of their countries, to merge with or be partially owned by a foreign airline. Would Germany allow Lufthansa to be purchased by Air France, and for the Lufthansa identity to completely disappear and be replaced by the identity of Air France? This question is even more relevant for the smaller EC flag-carriers which face increasing competition from the larger carriers.[45]

The days of propping-up a failing state airline is shortly coming to an end. The Treaty of Rome imposes severe constraints on the ability of a government to subsidize one of its industries. State aid is not allowed, in general, except for purposes such as regional development. Belgian subsidies for its ailing Sabena Airlines were questioned by the European Community, but the action was finally allowed under the condition that the airline would be restructured.[46] Tolerance for such actions, however, may not be so great in the future. The solution to future airline difficulties may

likely lie in the merging of airlines through buy-outs or partnerships, thus ending the era of European flag-carriers and starting an era of international corporations controlling the skies of Europe.

In the meantime, European countries are studying the effects of privatization on the first-movers. Should British Railways and British Airlines succeed under privatization, the other European national rail and air services may move forward with similar solutions to their financially ailing transport systems.

## **CONCLUSION:** What the Future Holds

It is clear that the current trend in European transport is deregulation and a return to competition in the transport sector. Europe's main incentive, however, is not to create large profits for the private sector, but to take the burden of transport subsidies and massive public debt off the back of the taxpayers. A return to market-oriented management in the transport system, and the partial or full privatization of transport system, will increase efficiency and help to identify where social cost is necessary.

With the shifting of transport responsibilities to the private sector, the role of the state will change. The state's role, as seen in road haulage, rail infrastructure, and the airlines, will become that of watchdog and arbitrator, ensuring that transport is fair, safe and in keeping with the best interest of the public. The state will contract with the private sector to provide necessary social services. The state will relax economic regulations as long as social regulations are adhered to by the private sector.

The role of the EC Commission is increasing in European transport. The Common Transportation Policy, while not complete, is still influencing community transport. So are the competition clauses of the Treaty of Rome. As long as the European Community is advocating the use of market

forces in transport, the trend towards competition and deregulation will continue.

The European Community is currently attempting to become the negotiator of air services for its member nations. Should this occur, the EC would negotiate agreements for the community as a whole and would be solely responsible for negotiating agreements with all non-EC countries. EC air transport policies will greatly effect all other European countries. Non-EC countries, such as Austria and Switzerland, are literally sandwiched between the EC member nations. In order to survive economically, it will be necessary for these nations to adopt the ways of the EC. This same rationale will also apply to rail and road transport. Simply put: "If you can't beat them, join them."

It remains to be seen how far Europe will move towards a market-oriented transport system. Many in Europe still consider transport to be a public service and not an industry. But, if profitability can be attained while still providing necessary social services, these opinions may change.

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**VITAE**

**CRAIG R. REISTAD**

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|---|---|
| BORN: | February 14, 1962, Northvale, New Jersey |
| EDUCATION: | Indiana University<br>Bloomington, Indiana<br>Master of Arts in West European Studies |
| | Boston University<br>Boston, Massachusetts<br>B.S. in Public Relations, 1984 |
| PROFESSIONAL: | Captain, Infantry, United States Army |