NERA
Economic Consulting

Project Profile

The Finances and State Funding of European Railways

In this project for the European Commission (EC), NERA undertook a detailed review of the financial position of European railways over the period 1995 to 2001. We also considered the various forms of public budget payments that they received. The project covered 27 European countries, with a closer examination of the 15 Member States of the European Union (EU), Norway and Switzerland. We also reviewed the main institutional changes which occurred over the period, the operating performance of the railways and progress being made in the implementation of Directive 2001/12, which required separation of finances for passenger, freight and infrastructure activities.

This project builds on earlier work by NERA's sister company, Mercer Management Consulting, which examined the financial position of EU railways over the period 1990 to 1995.

Project outputs:

- Report presenting general patterns and trends, and recommendations.
- Database of activity data, income statements and balance sheet data, 1995 to 2001, for major railways in 27 European countries.
- Detailed commentary and analysis of finances and funding of railways for each of the countries studied.

Background

In the 1990s the EC identified the poor financial health of many European railways as a major obstacle to revitalising the sector. By 1990, the Community's railways were heavily indebted, impairing their ability to operate on a commercial basis. The sometimes-opaque systems of public subsidy could reduce managers' incentives to operate efficiently and acted as barriers to competition.

EC Directive 91/440 established a framework to change this position: EU Member States were required to relieve railways of historic debt and establish the railways on a sound financial basis. Major debt restructuring followed, and in 1997 the Commission prepared a Communication reporting on Member States' progress.

NERA's project has provided the EC with detailed information about the current position with respect to railways' finances, to allow the Commission to continue to monitor progress and hence determine the next steps in its rail industry strategy.

NERA's Approach

Our economists collected financial data from a range of sources. We used railways' annual reports, publications of the International Union of Railways (UIC), submissions to the EC on railways state aid, certain government publications and data direct from the railways.

As part of the study we carried out a programme of interviews with the railway operators and ministry officials. For several countries we used questionnaires to collect and confirm information.

We made some adjustments to the data to improve its comparability from one year to the next—in several cases, major changes in accounting practice result in substantial discontinuities in the data over the period we studied—and to improve comparability between railways.

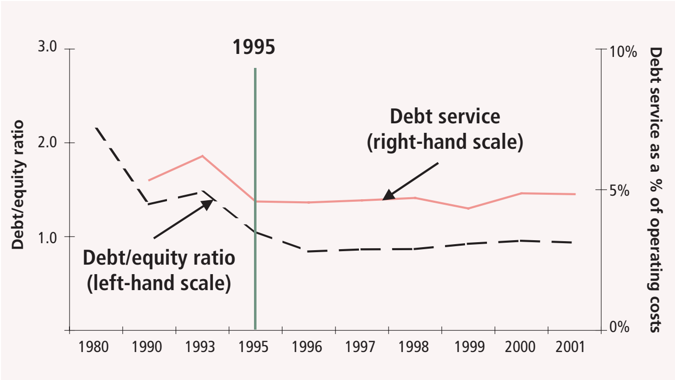
The Results

Operational Performance

From 1995 to 2001, the operational performance of EU railways has improved considerably, supported by strong economic growth. Commercial traffic revenue increased by 13 per cent (passenger revenues growing by 27 per cent, freight falling by 12 per cent). Operating costs did not change overall, so that the viability ratio of operating income (excluding public budget contributions) to operating costs improved substantially (from 61 per cent in 1995 to 71 per cent in 2001).

Finances

Debt levels fell sharply in the early 1990s as a result of financial restructuring, and have subsequently been broadly stable. Many EU railways now have sound finances. Some railways still have high debt levels, however, that would require restructuring for them to move further toward commercialisation.



Railways' finances continue to be put under strain by levels of capital intensity, which are historically high and continue to increase (the ratio of total assets to operating costs was 1.9 in 1980, 2.9 in 1990, and 3.5 in 2001). In part, this reflects a catch-up of past under-investment, as well as asset revaluation; it also reflects increased investment in high-speed services and improvements in safety standards.

Subsidies and Other Government Payments

Governments have contributed more to railways' funding requirements, both operational (so that losses after subsidy were 5 per cent of operating costs over the period compared to 10 per cent over the previous 15 years), and in terms of capital. Total government payments were broadly similar in 1995 and 2001, though there was a shift over the period from support for restructuring to payments for infrastructure, particularly in the form of capital grants for infrastructure investment.

Public budget contributions have become more transparent, with payments often made under contracts spanning several years, with only minimal funding for freight, identification of contributions in the accounts of railways and treatment to normalise accounts with respect to these payments. An important trend has been devolution of responsibility for service funding and specification to local government.

State Payments to EU National Railways, 2001

Form of Payment	Euro millions	%
PSO - Passenger services	11,541	30
Freight/combined transport	275	1
Infrastructure maintenance and operations	8,689	23
Payments for capital investment	9,657	25
Staff and pension obligations	2,690	7
Debt service	1,617	4
Restructuring	1,036	3
Other	2,783	7
Total	38,288	100

The majority of state payments to the railways consist of payments for services, under contract, or for maintenance and investment in the railway infrastructure. A number of other payments remain.

Many state railways also benefit from implicit support that commercial companies do not enjoy. In particular, they benefit from government backing for debt so that they are able to borrow more cheaply; and their shareholders—governments—do not require a commercial return on equity. This implicit support is very large: the shortfall in return on equity alone amounted to around 11 billion euros in 2001, or 30 per cent of identified government payments.

Central and Eastern European Countries

In the candidate countries, many of which become full EU members in May 2004, some progress has been made in instigating the reforms prescribed by the EU rail legislation. But the railways in the candidate countries are displaying many of the characteristics of EU railways one or two decades ago: they appear to be inadequately funded, their commercial revenue is falling and cost savings have been insufficient to compensate for the losses in revenue. Large operating losses are contributing to increased debt (rising from 10 per cent of liabilities in 1995 to 54 per cent in 2002), so that the financial position in most of the countries' railways is not sustainable.

Benefits of NERA's Analysis

This work is important as a detailed briefing document for the European Commission and Member States. It has also proved to be ground breaking in the breadth and depth of analysis of public support and finances to the railways. It forms a strong basis for making comparisons of public support, finances and performance between countries, as well as providing a framework for future monitoring.

About NERA

NERA Economic Consulting is an international firm of economists who understand how markets work. Our more than 45 years of experience creating strategies, studies, reports, expert testimony, and policy recommendations reflects our specialisation in industrial and financial economics. Our global team of more than 600 professionals operates in over 20 offices across North and South America, Europe, and Asia Pacific.

NERA Economic Consulting (**www.nera.com**), founded in 1961 as National Economic Research Associates, is a unit of the Oliver Wyman Group, an MMC company.

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