Campaign for Better Transport

Fares and public spending on the railways in difficult economic times ~ a briefing from Campaign for Better Transport

The McNulty review of value for money in the rail industry has highlighted the thorny problem of high costs in the UK rail sector, and the Government's decision to raise the cap on regulated rail fares means that the equally thorny problem of who should pay these high costs continues to generate controversy.

Passengers remain highly dissatisfied with the value for money of train travel. Many have already suffered years of above-inflation fare rises without seeing any improvements to their particular journey. Regulated fares have already risen by 21% in the last five years.[1] However, this average masks much higher increases on some routes, such as Tonbridge to London, where a season ticket has risen by 35%, or nearly £1,000, since 2007.

Now, passengers face not only an average 28% increase in regulated fares by 2015 (again, with the with the potential for much higher rises on some routes), but also proposals to introduce even higher peak time fares to tackle overcrowding on London commuter routes, and substantially higher fares at all times on regional railways. Meanwhile, the industry has made no secret of its desire to see fewer regulated fares altogether, raising the prospect of the erosion of affordable, flexible tickets.

Fare regulation – initially established to protect passengers who have few alternatives to using the train, and to ensure that people could make longer distance journeys at an affordable price – has been turned on its head and is being used to generate revenue for the Government.

In anticipation of the upcoming review of fares policy, this briefing challenges the Government's justification for such high fare rises, and highlights the risks of pricing people off the railways, particularly in the current economic climate. It also questions whether enough revenue will be generated by raising the cap on regulated fares to justify the risks, and calls for greater transparency on how public money is raised and spent on the railways.

Pricing people off the railways: economic, environmental, social and political risks

In the 2010 Spending Review, the Government took the decision to raise the cap on regulated tickets from the retail price index (RPI) inflation rate +1% to RPI+3% for three years from January 2012. This will lead to regulated fares being 28% higher by the end of this Parliament in 2015,[2] which translates to £1,300 in additional costs for some season tickets. With living costs increasing across the board and the UK economy struggling to recover from the recession, the extra burden of rising rail fares, particularly for commuters, comes at a time when people can least afford it. The policy of RPI+3% runs the real risk of pricing people off the railways, which would have significant economic, social, environmental and political costs.

[1] Office of Rail Regulation, *National rail trends yearbook 2010-11*, July 2011
[2] Cumulative increase based on official inflation forecasts, taken from: Office for Budget Responsibility, *Economic and Fiscal Outlook,* March 2011

Reducing access to work

UK rail fares are the highest in Europe, and some season tickets now cost the equivalent of a fifth of the average UK salary. With inflation remaining stubbornly high while wages stagnate, the shift to RPI+3% means that rail fares will rise four to six times faster than average earnings next year. This raises serious questions about the affordability of getting to work, particularly for those on lower incomes, those with shift work or part-time jobs, and those who have moved further away from city centres to find more affordable housing.[3] Evidence also suggests that some parents are giving up work because the combined costs of commuting and childcare would leave them financially worse off.[4] By reducing access to work, raising the fares cap to RPI+3% undermines the Government's objectives of getting people back into jobs and making sure that work pays.

If fares increase I will have to stop working as I quite literally cannot afford to travel to work.

Vicki, Ashford

If they increase the fares any more, I've got to get a new job and move house.

Chris, Peterborough

We have not had a pay increase for three years. My travel costs are greater than my housing costs and comprise almost 20% of my net salary.

Sarah, Staplehurst

With increases everywhere else, this proposed increase will force me out of working in London and stands to threaten my whole livelihood.

Rob, Reading

I cannot afford to meet my basic needs with fares increasing so frequently.

Emma, Brighton

Damaging competitiveness

With UK fares already up to 30% higher than European rail prices,[5] and London commuters paying twice as much for their season tickets as their counterparts in other major European cities,[6] the policy also risks damaging the UK's competitiveness in the global marketplace. Thirty-five per cent of employers say rail travel is too expensive,[7] and this rapidly rising cost is particularly damaging for struggling small businesses which need flexible, affordable tickets.

Ignoring the wider benefits of rail

Such dramatic fare rises also undermine the Department for Transport's objectives to cut road congestion and carbon, and to improve the quality of life of UK communities. Rail use helps to tackle climate change, and people should be encouraged to switch to the train rather than penalised with unaffordable fares. Evidence suggests that reducing public transport fares in real terms and increasing motoring and aviation taxation could cut carbon emissions by 13%.[8] The move to RPI+3% also suggests a lingering view within Government that rail travellers are wealthy and can afford

[3] Future fare increases compared to official wage inflation forecasts, taken from: Office for Budget Responsibility, *Economic and Fiscal Outlook,* March 2011
[4] Aviva, *The Aviva Family Finances Report*, August 2011
[5] The Rail Value for Money Study, *Realising the Potential of GB Rail*, May 2011
[6] Passenger Focus, *Fares and Ticketing Study Final Report*, February 2009
[7] Passenger Focus, *Employers' business travel needs from rail*, February 2009
[8] Steer Davies Gleave, *Transport costs and carbon emissions*, December 2008

whatever level of fare increases are meted out. However, not everyone who uses the train does so to get to a high paid job in London. Half of all rail users are not in social groups A or B, and this rises to 60% on regional services.[9] Twenty-five per cent of people in the UK don't have access to a car, and rely on rail to access the transport network and get to jobs, shops and services.[10] Fare rises will therefore disproportionately affect those who can least afford it: those on lower incomes and those without choices about how they get around.

This raises questions about what the railways are for. Railways help to deliver a range of Government objectives and provide a host of social, economic and environmental goods that do not simply benefit those who use them. In some cases, these can even be quantified, in terms of the economic 'agglomeration benefits' of rail services to a particular area, or the savings to businesses of reduced congestion. These benefits must be acknowledged when addressing the question of who should fund the railways – a fact which is recognised by many of our European counterparts, where state support has helped to create modern, efficient, affordable railways.

> *Even those who never set foot on a train derive as much benefit as those who do. For proof you need look no further than the chaos that descends whenever our trains don't run. You name it – any stoppage and it seems like the roof has fallen in.*
>
> *Nigel Harris, Rail Magazine, August 2011*

Courting a political backlash

Taken together, the challenges presented by sharply increasing fares raise the very real risk of a serious political backlash from passengers, and particularly from the powerful 'Thameslink voters' of the London commuter belt.[11] Around London and across the country, many of the most marginal seats are also key commuter areas, such as Watford, St. Albans, Enfield, Hove, the Medway towns, Shipley and Hazel Grove. A YouGov poll has found that rail fare rises were the single most unpopular policy announced in the Spending Review, opposed by eight out of 10 people;[12] and 74% of regular rail users in the South-East said that they could switch their support away from parties that raised fares by RPI+3%.[13] Given that the commuter vote could be so decisive in so many seats that any party must win to form the next Government, two key questions must surely be asked: are such unpopular fare rises necessary, and are they worth it?

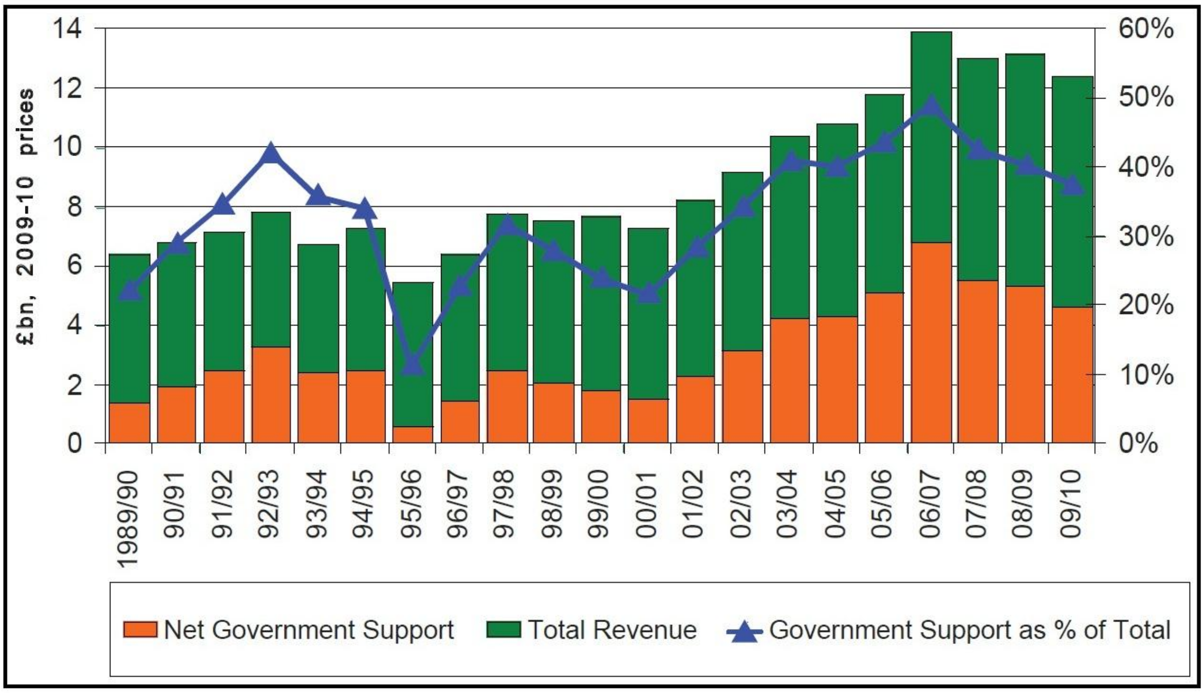
Public spending on rail: are fare rises necessary?

The core justification for fare rises is the need to reduce public spending on the railways, which currently sits at £4 billion annually.[14] Of this amount, £3.4 billion, or approximately 85%, went to Network Rail in 2010-11, with the majority of the remainder spent on subsidy payments to train companies and rail in the city regions.[15] It is therefore worth noting that, when we hear about the high levels of Government subsidy for the railways, this is in large part to finance Network Rail's track and

[9] Steer Davies Gleave, *The Case for Rail*, June 2002
[10] Department for Transport, National Travel Survey 2010, July 2011
[11] Kellner, Peter, ***Dave's New Best Friends,*** Prospect Magazine, March 2010
[12] YouGov, *More bouquets than brickbats for the spending cuts*, October 2010
[13] YouGov poll for Campaign for Better Transport, October 2010
[14] The remainder of the industry's total annual cost of £11 billion is met by £6.6 billion in revenue from fares and £377 million in private company investment. Office of Rail Regulation, *National rail trends yearbook 2010-11*, July 2011
[15] Office of Rail Regulation, *National rail trends yearbook 2010-11*, July 2011 and Department for Transport, *Business Plan Quarterly Data Summary*, July 2011

infrastructure operating costs and its significant debt – not to lay on trains in rural areas or reduce the cost of travel for particular vulnerable groups, as the common notion of 'subsidy' suggests.

Moreover, the level of Government support has been steadily declining since 2006/07, when it peaked at £6.8 billion following the wave of upgrades and improvements that were prompted by the Hatfield crash of 2000.[16]



Industry revenues and subsidy 1989/90 to 2009/10[17]

This chart shows that we are already on course to meet the target of fare-payers shouldering 75% of the costs of running the railways while taxpayers contribute 25% by 2014, as set out in the 2007 White Paper.[18] The Initial Industry Plan, meanwhile, suggests that the rail industry should cover its costs by 2023/24, with the London and South-East sector generating a surplus as early as 2018/19.[19] Unlike the nation's roads, which are expected to need to be subsidised in perpetuity, much of the rail network has the potential to be self-funding in the near future. In other words, the Government is already achieving its goal of reducing public spending on the railways, which undermines the most common justification for the need for RPI+3%. It also raises the question of what the Government's end goal might be on this front – and the possible consequences if this is to reduce taxpayers' contribution to running the railways to zero.

The other core justification for RPI+3% is the need to fund additional capacity and investment in major rail projects. Again, there is often a difference in how spending on road maintenance and additional road capacity funded through general taxation is regarded as investment, whilst spending on rail capacity and maintenance is regarded as subsidy. In fact, rail investment is catching up on decades of under-investment, which lagged well behind spending on new motorways, trunk roads and by-passes from the 1960s through to the early 1990s. It is also worth noting that additional revenue from fare increases is not ring-fenced for particular capital investments, nor does it anywhere near

[16] The Rail Value for Money Study, *Realising the Potential of GB Rail*, May 2011
[17] The Rail Value for Money Study, *Realising the Potential of GB Rail*, May 2011
[18] Department for Transport, *Delivering a Sustainable Railway*, July 2007
[19] Network Rail, *Initial Industry Plan England and Wales*, September 2011

compare to the billions required for major rail projects. This raises the issue of whether RPI+3% is really about investment, or whether it is more honestly a 'passenger tax' to bring in more money to the general public purse.

Part of the answer to this question lies in the flow of money between train operating companies (TOCs) and the Department for Transport (DfT) that occurs through franchise agreements. This is how public funding is provided for services that otherwise wouldn't be run commercially by the companies, and where negotiations are carried out that affect the balance of subsidy the TOC will receive from (or premium it will pay to) the DfT – and therefore, indirectly, what level of fares the operators charge. Since the RPI formula also works through franchise agreements, this is also how the DfT will increase its income by raising the cap to RPI+3%.

> *The DfT is unlikely to raise the revenue it expects from its RPI + 3 policy… and it is likely to be accompanied by a considerable reduction in rail patronage compared with what would be expected without the change in policy.*
> *Oxera, Agenda, June 2011*

However, a number of experts have questioned whether the DfT is likely to raise as much revenue as it expects through the new policy. In an in-depth study on behalf of the industry, the consultants Oxera and Arup have questioned the parameters of the models used to forecast this kind of revenue, suggesting that the elasticity – or price sensitivity – of season ticket holders in particular is up to 65% higher than previously thought.[20] In other words, more people are less likely to use the train if fares go up by as much as planned. City analysts have also expressed concerns that train companies are likely to face more pressure on their margins as they struggle to keep passengers despite the higher fares.[21] This is all on top of official DfT figures which predict 4% fewer rail journeys as a result of the move to RPI+3%.[22] It is therefore clear that raising fares will price some people off the railways – the question is how many, and how confident can the DfT be in its forecasts of the money it expects to raise.

Transparency: the need for a clearer contract with passengers

> *It is not at all clear to passengers where the money from increased fares has been spent.*
> *Public Accounts Committee, October 2010*

Arguments about the need for fare rises are made even more difficult to accept at face value because the facts to back them up are not in the public domain. Information on key questions is not available: where exactly does the money come from to meet the costs of running the railways? How important are regulated fares in covering the industry's costs? How is the money raised spent? For a vital part of our transport network that receives significant amounts of public money, the answers to such questions should be easily available to all. However, rail industry financing is a complex blend of public and private, the details of which are often deemed commercially confidential and therefore withheld from public access and scrutiny. Effectively, vital information about how public money is being raised (including how much and in whose interest) is being withheld from public access, which makes it very difficult to hold both public and private interests to account, and undermines the Government's commitment to greater transparency.

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[20] Oxera, *Fares Fair? The economics of setting ticket prices*, June 2011
[21] Jacobs, Rose, *Higher fares drive Go-Ahead revenues*, Financial Times, October 2011
[22] Hansard, 10 November 2010, c335W

For example, Campaign for Better Transport has been blocked from accessing data about how much revenue will be generated for the Government by the move to RPI+3%. We submitted a Freedom of Information Request asking for the background information which was used to inform the decision to raise the cap on fares as part of the Spending Review. Although we clearly stated that we were only seeking the information at aggregate level (ie. not broken down by operator, sector, year etc.), the information was withheld on the grounds of commercial sensitivity, in that it could prejudice franchise negotiations with the operators. Our subsequent request for an internal review also resulted in the information being denied, despite the DfT admitting that it was statistical information and a decision that was in the past, both of which should make the request more likely to be successful – particularly given the strong 'public interest' in releasing the information. We have had informal legal advice suggesting that the DfT are on shaky ground on this matter, and Transport Minister Norman Baker said publicly at the Liberal Democrat Party Conference that he thought the information should be released.

> *I am fed up with the rising tide of official duff data. It may be intended to mislead or confuse, or it may be down to incompetence…. It is a constant battle against the forces of obscurantism.*
>
> *Roger Ford, rail columnist, September 2011*

In carrying out research to estimate the forecast that has been withheld by the DfT, we have encountered numerous other 'data roadblocks'. Many of the inputs that are necessary for such calculations are only available to the Passenger Demand Forecasting Council – ie. the industry, the DfT and those consultants paid to work confidentially on their behalf. LENNON, EDGE, RIFF, MOIRA – these models and databases are what govern fares and ticketing, revenue and forecasting; each is built on top of the other, and at their core is data that is owned rather than public. Even very basic information such as how many season tickets are sold each year is deemed commercially confidential, and – although held by the public Office of Rail Regulation – was prevented from being released to us by its ultimate data 'owner', ATOC.

Others have expressed similar concerns about the secrecy surrounding rail industry financing. For example, criticisms have been made about the "financial sleight-of-hand" involved in the rule which permits fares to be 'flexed' by up to 5% above RPI+3%, with some claiming that this allows operators to game the system and impose the largest rises on the busiest routes.[23] Challenges also exist around determining how much the existing policy of RPI+1% is generating for the Government.[24] We do know the net amount each TOC has received or paid to the DfT in previous years,[25] and in the past the DfT published forecasts for subsidy/premium profiles into the future, with the most recently available being from 2009.[26] However, when rail columnist Roger Ford recently pressed the DfT for a more up to date version, he was told that the data was not available.[27]

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[23] Harris, Nigel, *The fares farrago – again… it's smoke and mirrors time again on fare rises*, Rail Magazine 677, August 24 – September 6 2011

[24] The earlier franchises were let under a 'no net gain/loss' financial model and therefore the change from RPI-1% to RPI+1% in 2004 would have resulted in the additional revenue going directly to the DfT. Those let since 2004 use a different financial model, but would have had the RPI+1% assumption built into the franchise agreement, and therefore would have agreed to less subsidy/more premium due to the higher revenue expected from RPI+1%.

[25] Office of Rail Regulation, *National rail trends yearbook 2010-11*, July 2011

[26] Department for Transport, *Guidance to regions on delivering a sustainable transport strategy*, July 2009

[27] Ford, Roger, *Informed Sources e-preview*, September 2011

> *For too long those in power made decisions behind closed doors, released information behind a veil of jargon and denied people the power to hold them to account. This coalition is driving a wrecking ball through that culture – and it's called transparency.*
> *David Cameron, The Observer, September 2010*

Clearly, some commercial interests do need to be protected in a privatised industry. However, the overall picture that is emerging is of a secretive sector, with both Government and industry going to great lengths to obscure even the most basic data from public view. Given the amounts of public money involved, and the agenda to make this Government a transparent one, the DfT has a responsibility to begin to address these major transparency failings on rail industry funding. In the meantime, passengers may justifiably wonder exactly what they are getting in return for being asked to pay ever more for the price of their tickets – in particular since many have seen no improvements to their particular journey despite the past year-on-year fare rises they have experienced, nor are they promised any future investment despite the new fare rises.

Are fare rises worth the risk?

In the absence of the official forecast being made public, Campaign for Better Transport has done our own research to estimate how much revenue will be generated for the DfT by raising the cap on fares to RPI+3%. Given that some inputs to these calculations (such as the figures currently being used for market growth and specific elasticities for the combination of tickets that make up regulated revenue) are also unavailable to the public, these by necessity can only yield an approximation. However, this does provide a yardstick with which to begin to measure whether the policy is necessary and worth the risks, and what the alternatives might be.

Our figures suggest that in 2012, an additional £26 million would be generated for the DfT by the move to RPI+3%, rising to an additional £81 million in 2015. This figure is based on the difference between predicted future regulated revenue at RPI+1% and at RPI+3%.[28] It is worth noting that this is in addition to revenue already being generated for the Government by RPI+1% through existing franchise agreements, as discussed above; that the policy would continue to yield benefits in the years following, even if it is assumed that the cap drops back to RPI+1% in 2015, due to compounding effects; and that exact amounts recovered will depend on negotiations with TOCs.

Considering other areas of public spending on transport and indeed on rail, this figure is relatively small, and it would be possible to find other sources of income of this order of magnitude which would avoid the need for such a price rise. For example, charging a fuel tax on domestic aviation at the same rate as petrol could generate up to £413 million each year.[29] The comparatively small sums of additional revenue raised by the move to RPI+3% also suggest that the economic, environmental, social and political risks of the policy are disproportionately large in comparison to the benefits accrued to the Government.

[28] For an example of a similar exercise in estimating revenue generated by the move to RPI+3% see: Steer Davies Gleave, *Research project on fares for the Rail Value for Money Study*, February 2011

[29] Campaign for Better Transport calculation applying current rate of fuel duty for cars to domestic aviation fuel usage, taken from: Department of Energy and Climate Change, *Digest of United Kingdom Energy Statistics 2011*, July 2011

Conclusion

There are serious questions as to whether the policy of RPI+3% is necessary, justifiable or worth the risks. Given that the taxpayer contribution is already falling and the rail sector is on course to cover its costs, these new fare rises can be seen to be not a necessity but a political choice – and one that is coming at the worst possible time for families struggling to make ends meet and to afford the cost of getting to work. Clearly, the rail industry needs to get its costs down, and the benefits of this effort should accrue to fare-payers and taxpayers. However, the vast bulk of public spending on the railways goes to Network Rail, which is already succeeding at getting its costs down, and is likely to achieve more following the McNulty review. The subsidy payments to TOCs are marginal by comparison – as is the amount likely to be raised from three years of RPI+3%. As anecdotal evidence from passengers tells us, the same is not true for squeezed commuters, for whom finding an extra £500 for their annual season ticket next year could make the difference between staying in work and being forced to quit their job.

> *There is a limit to how much should be squeezed in the short term out of rail users, particularly commuters, at a time when living standards are under strain… until the mismanagement of the railways is tackled, ministers should trim back fare increases so that they rise by not more than the rate of inflation.*
> *Adam Raphael, Transport Times, September 2011*

The Government also needs to do better on its commitment to transparency and come clean about revenue and spending in the rail industry – and in particular, what the RPI+3% policy will raise and be put towards. Is it a tax on passengers to fill the hole in the public finances? If so, it is comparatively small and, given the political will, the revenue could be found elsewhere – as is suggested by the current possible moves towards cancelling the planned increases in fuel duty (which generates significantly more annual income than would be raised by RPI+3%) to help motorists struggling with high petrol prices. Or is it part of a strategy that eventually seeks to fund long term capital investment in rail solely through the fare-box – a strategy that would be considered preposterous if it were to be proposed for roads, and is not pursued by our competitor countries in Europe and elsewhere.

There are certainly lessons we could learn from these other countries, in terms of the value that is ascribed to the social, economic and environmental non-user benefits of public transport, and the according recognition of the importance of Government support. Our European competitors have also found ways to encourage innovative forms of financing rail investment that do not simply rely on fare-payers or taxpayers. These include payroll and sales taxes, parking levies, and tariffs for developers. Some of these are already in use in the UK, such as the business rate supplement for Crossrail, and the Nottingham workplace parking levy scheme – both of which recognise that businesses also benefit from the railways and should therefore contribute to it. It could also be made much easier for third parties such as developers, local authorities, leisure operators and other businesses to fund and develop rail stations and schemes.

Government, industry and third sector organisations must all take responsibility for ensuring that ill-timed decisions do not price passengers off the railway, and that rail can continue to play its role as a key engine of the UK economy.

Recommendations

Improving fairness

- Reconsider the decision to raise the cap on regulated fares to RPI+3%, and set a date by which the commitment to allow fares to rise by no more than inflation should come into effect.
- As part of the fares review, implement changes to the ticketing system that do not involve changing the overall RPI formula, but would help to improve passengers' experience and reduce their costs – such as introducing season tickets to benefit the growing number of part-time workers. Example policies are proposed in Campaign for Better Transport's Fair Fares Charter.
- Research and trial the full range of alternative forms of revenue and capital funding, including business, developer and employer funding.

Improving transparency

- Scrutiny bodies such as the Transport Select Committee and the Public Accounts Committee should investigate the secrecy surrounding rail industry funding, and challenge Government and industry to embrace a culture of transparency.
- The fares review should involve high quality public consultation, including roadshows, online surveys, the use of social media, and involvement from the official watchdog Passenger Focus.

November 2011

Alexandra Woodsworth
Campaign for Better Transport

Campaign for Better Transport's vision is a country where communities have affordable transport that improves quality of life and protects the environment. Achieving our vision requires substantial changes to UK transport policy which we aim to achieve by providing well-researched, practical solutions that gain support from both decision-makers and the public.

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