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The Decentralisation of the Dutch Railways: Background and Policies anno 1995¹

Introduction

The Nederlandse Spoorwegen, ("Dutch Railways," hereafter referred to as NS) was formed in 1937-38 through the amalgamation of the two Dutch rail companies then still in existence: the Hollandsche IJzeren Spoorweg Maatschappij (Dutch Iron Railway Co.), established in 1937 as a private company, and the Maatschappij tot Exploitatie van Staatsspoorwegen (Company for the Operation of State Railways), founded in 1863 as a private enterprise that would rent publicly funded railroads - primarily in less congested areas of the country - and manage them on a commercial basis. The merger of 1937-38 was the logical culmination of a number of agreements (1890, 1911, 1916-17) which ensured high degrees of cooperation and coordination between the two companies and between the companies and the national government. All NS shares are held by the national government ("the State").² The company is the sole deliverer of passenger train services within the country and provides some connecting services in neighbouring countries on a complementary basis.

In accordance with Directive 91/440 of the European Community, the NS is currently undergoing a process of decentralisation, differentiation, commercialisation and possibly, in due course, privatisation. This development, which embodies a new relationship between the NS and the State, is based on various research and policy reports. Its main characteristics are:³

1. separation of passenger and freight activities into autonomous operations
2. transfer from the NS to the State of financial responsibility for rail infrastructure (investment, maintenance, innovation)
3. abolition of the State's loan guarantees
4. abolition of the State's operating subsidy
5. expanding capital works for the freight sector
6. separation of ownership, operation, and in principle allocation of infrastructure
7. optimisation of infrastructure capacity
8. contract arrangements for unprofitable but socially desirable services.

The many functions of the NS will be housed in various subsidiaries, each of which is expected to operate efficiently and, if possible, turn a profit.

The role of the European Community

It is the ultimate purpose of the European Community to create a common market in which competition is fair and opportunities are equally distributed.⁴ Unwarranted positions of economic power must be abolished. National regulations supporting domestic industries and companies are to be deleted in favour of community-wide rules.

The transportation sector is traditionally heavily regulated by national (and in some cases sub-national) authorities. The rationale is found in arguments of natural monopoly, externalities, working conditions, consumer protection etc., depending on the country and type of transport mode. The ruinous competition among private railway companies, at great private and public cost, led in most European countries to the establishment of state enterprises or, at least, state-sanctioned monopolies, with the prime mandate of providing efficient and fast rail traffic

for the passenger and freight sectors.

Shortly after the founding of the European Economic Community (EEC) in 1957, discussions began about the most efficient way in which railways could be integrated into a (semi)continental transportation sector on the same philosophical basis as other forms of economic production. During the 1960s much effort was directed at harmonising the terms of competition in the transport market and removal of a number of market constraints.⁵

The scope of EEC rail policy became broader during the 1970s and '80s, not least because of the growing "automobility" of an increasingly wealthy population and the emergence of a wide net of intra-Community short-haul air links - neither of which modes paid the full social cost of infrastructure and operation, particularly those costs that are shifted onto the State (e.g. policing) and the environment (air and noise pollution). Improved understanding of the nature of State support for rail transport became desirable in order to better identify the opportunities for equalising conditions among competing modes. With respect to railways the following principles were adopted for future EC policy:⁶

1. a framework of fair competition among all transport modes, including a non-distorting system of infrastructural changes
2. efficient and businesslike management autonomy, including corporate planning, financial discipline and compensation, within the general requirements of the owners and respecting any public service obligations such as maintaining unprofitable routes
3. transparent financial operations
4. enjoyment of State support only under Community-sanctioned conditions and limited servicing of the historic debts of railways
5. improved efficiency with a view to a lessening of general need of State support and discipline in the covering of railway deficits.

Possibly under the influence of a climate of distrust of public enterprise, the period after 1985

saw an increasing emphasis on the supposedly adverse role played by the national railway companies in the development of a competitive market. Moreover, rapid technological developments (traffic control, the TGV) made better trans-border coordination necessary. The Community wrote in 1989 in regard to the first consideration:⁷

The Commission would like a revision of the connection between railways and state authorities... It suggests a *clear separation between the public aspect and the commercial aspect*. The former are mostly involved with costs and choice of infrastructures, which would make up a "natural monopoly" by governments. Rail transport companies could function as *commercial companies that would sign contracts with the State for the use of these infrastructures*. In this case a German transport firm, for example, could obtain a contract and pay to be allowed to use the network of French railways without discrimination. The transport of goods in particular is not cut out to be a public service. This is why the Commission finds it absurd that transporters from one Member State are discriminated against in another Member State or that a producer wishing to transport goods from Copenhagen to Milan must deal with five different railways. Once this idea becomes accepted, many problems will remain to be resolved, such as the setting of rates, timetables, the subsidised price that the member States will have to contribute, etc.

In short, national governments should decide on the rail infrastructure to be installed and maintained, but they must allow any carrier who satisfies objective criteria to bid on the use of the infrastructure. This has been the situation in the airline industry for as long as anyone can recall.

The commission tied this institutional aspect to the issue of technical development and

harmonisation:

Traffic control systems are becoming more and more sophisticated. In the case of the TGV, for example, the system is completely automated and computerised. Satellites are also beginning to be used. Science has perfected the techniques of tomorrow, which must now be implemented... The Commission's fear is that in a few years Member States might adopt different control systems (American, Japanese or European) which will be incompatible. It is thus important to harmonise control methods among Member States from the beginning, without which there will never be a community rail network.

By the end of that year European Transport Commissioner Karel van Miert's plans for modernisation (high speed trains, combined transport), technical harmonisation, and liberalisation were approved by the European Commission:⁸

The commission proposes to keep the control of infrastructures in the hands of existing railway companies, while at the same time developing the access possibilities in these infrastructures. Companies established in a Member State are authorised to provide rail services on the national railway network and control operating rights on it. These operating rights are paid through a set fee or a tax based on the non-discriminatory allocation of costs among users. Accounting methods must make a distinction between the infrastructure and the other sectors in order to avoid any "crossed" subsidies.

Hence the allocation of trackage rights may be made by the national railway company, yet the trackage fee must be neutral between its own operations and those of potential competitors. In fact, in most if not all countries, the allocation prerogative has remained with the State enterprises.

The new policy was debated by the Council in March 1991, examining in particular the following objectives:⁹

1. opening of national networks to railway carriers other than existing public undertakings
2. financial restructuring of the existing public railway undertakings through the introduction of arrangements for absorbing debts incurred in the past in order to create a sound financial situation
3. legal autonomy of railway undertakings and reinforcement of their operational independence
4. distinction between the operation of the infrastructure and the provision of transport services
5. the right for international groupings of railway undertakings to have access to the infrastructure of the Member States in which the grouped undertakings are established and to transit via the infrastructure of the other Member Countries.

These principles were embodied in a Council Directive of 20 July 1991 (91/440/EEC),¹⁰ to which all member countries are expected to adhere.

The EC does not require the decentralisation (actually the breakup) or privatisation of national railway companies.¹¹ However, by insisting on an open access rule, it encourages the breakup of the companies in so far as other carriers may have access to their own suppliers at lower cost. Open access leads de facto to commercialisation of the State enterprise, first in the form of devolution of tasks to newly created subsidiaries, and then by marketisation of the subsidiaries' activities. This, incidentally, might be a two-way process. Nothing keeps subsidiaries of Railway A from bidding on work to be done for Railway B.

On the other hand, one should not underestimate the power of national governments to impose standards on the services to be provided by other carriers or through outsourcing. Council Directive 1893/91 of 20 June 1991 implicitly recognises the

need for "Public Service Obligations" whereby contracts are based on the needs of the "home country" (or region, in the case of geographically decentralised transport systems) in terms of, inter alia, social, environmental or spatial planning factors.¹² But such conditions, if attached, must be imposed on all potential bidders because of the requirements of free competition. Subsequent documents lay out the rules under which railway infrastructure capacity can be allocated and the corresponding fees charged.¹³

While the EC policy attempts to establish competitive conditions within the railway industry, it does not address the issue of competition between segments of the transport sector. Drawing attention to the fact that rail infrastructure pricing makes the rail sector pay for all carrying costs (capital and operating), Etienne Schouppe, speaking on behalf of the Community of European Railways, has stated that "European railways are opposed to the introduction of *rail infrastructure pricing* until a similar measure is applied to road transport" (emphasis in original). Moreover, according to Schouppe,¹⁴

The CER is critical of the fact that the Member States could choose their charging system on a national basis... This would... produce a wide range of different systems [and] risk leading to distortive effects for rail operators in competition with the road.

Thus the CER calls for a pricing mechanism under which "all users of all means of transport are obliged to pay their full costs - infrastructure and environmental."

Shortly before this call by the CER, Jacques Duchemin had elaborated on this contradiction, listing a number of matters which the European Commission was said to be considering in order to "stem the decline in the rail market share and to allow it to be competitive in relation to rival modes:"¹⁵

1. application of the principle of unrestricted provision of services (part of the Treaty of

Rome)

2. open access to Community infrastructure applied across the board (the concept of deregulation)
3. essential harmonisation of interface with customers (as in the airline industry)
4. technical integration (interoperability and interconnection of national railways - Treaty of Maastricht)
5. equal conditions of intermodal competition (including external costs)
6. unification of operating rules (as in the airline industry)
7. equipment procurement in terms of requirements and performance (and not in relation to observance of national descriptive specifications).

The Dutch reaction to EC directives

Successive governments of varying political stripes have produced a number of analyses of the proper place of and support for the Nederlandse Spoorwegen. In a country with the highest population density of the Western world, public transit is of the essence to allow sufficient mobility for productive and consumptive purposes. Government assistance for public transit (national rail, regional bus, local bus and streetcar) has traditionally been considered a matter of course.

Like so many public transit systems, the NS has not always been able to satisfy the highly differentiated types of demand for its services. Greater use of private automobiles (higher "automobility") did not pass the Netherlands by. This was accommodated by the authorities during the late 1960s and the '70s, when large investments were made in highways, bridges, tunnels etc. Because traffic follows the sometimes (perversely) dubbed micro-economic version of Say's Law ("supply creates its own demand"), the new and/or expanded roads quickly became congested. Thus a more pro-active policy was needed if a significant portion of the car-owning public were going to return to using public transit. The national government embarked on a course of expanded support for the rail system. Doubling of

rail tracks (with a target of four tracks between the major cities: Amsterdam, The Hague, Rotterdam, Utrecht), construction of new stations and acquisition of new rolling stock have taken off in the last fifteen years.

EC Directive 91/440 thus found the NS well prepared for the challenges of a more open market. Moreover, the political climate (and the traditional docility of the Dutch when collective interests are at stake) ensured that The Hague would respond quickly and positively to the common market regime. Given the need for improved market penetration, and in the context of European unification, a survey of NS activities was conducted and a blueprint for a revamped "empire" was drawn up. The results can be found in the Wijffels Report,¹⁶ submitted to the Minister of Transport and Waterworks in June 1992. The report dealt with the following issues:¹⁷

1. determination of the necessary rail infrastructure, in connection with desirable developments in related policy fields (road and waterway systems, spatial planning)
2. setting a pricing policy for road traffic and public transit that would reduce the growth rate of mobility, and which would stimulate a shift from road transport to other modes
3. securing the policy-oriented, socially desirable provision of transport by government purchase (on a contract basis) of specific services wherever and whenever the market cannot sustain them
4. following a policy to support the preceding ones, using other instruments, e.g. location permits for business,¹⁸ accessibility of city centres, space availability and parking rates.

Wijffels et al. not only recommended a policy structure compatible with EC Directive 91/440, they also advocated a structural separation of the key NS functions: operation of passenger travel, operation of freight transport, investment in and maintenance of infrastructure, and capacity management (the assignment of scarce infrastructure capacity among the various users). As is already the case with a number of side activities, these four key functions should be

placed in separate subsidiaries of the NS (which would become a holding company only). Moreover, Wijffels recommended that during a five-year transition period the following measures be taken:

1. the NS must realise improvements in efficiency
2. the NS must investigate which rail lines are candidates for a complete shutdown or for a request to the central government for a "public service contract"
3. the NS should implement real increases in fares, i.e. increases exceeding the level of inflation as measured by the Consumer Price Index.

The report was well received by a substantial portion of those affected, in particular the business world. Criticism came from ROVER (Vereniging reizigers openbaar vervoer - Association of public transit users):

1. the Wijffels plan can only succeed if all its components are carried out; any failure to obtain State support for infrastructure programmes or for the maintenance (through contracts) of traffic on unprofitable lines will endanger accessibility, and one cannot easily turn the clock back on institutional reform of this kind
2. the report does not prove in concrete terms that a decentralised, broken-up railway system is more consumer-friendly than the present system
3. such a new system might make it more difficult to achieve a fully balanced ("integrated") public transit network
4. Wijffels' recommendation of real increases in fares during the transition period might well mean the death knell for parts of the network.

The largest railway labour union (the Vervoersbond FNV), although not unsympathetic toward the report, agreed with some of ROVER's concerns. Moreover, it insisted on the need to have contract and working conditions apply throughout the rail sector, even if certain parts were to be removed from the NS.¹⁹

The government announced in February 1993 that it would accept most of Wijffels's recommendations.²⁰ During a six-year period beginning in 1994, the treasury's contribution to rail operation was to be removed, fares had to increase annually 3% faster than the cost of living, non-profitable lines were to be assessed on their social importance and the availability of acceptable inter-city bus options,²¹ and the separation of the various functions of the NS should proceed.

To ensure orderly implementation, a working group called MOVER²² was established with the task of formulating detailed rules of conduct and division of responsibility between the national government and the NS. In accordance with the Wijffels report and the government reaction, MOVER identified eight subprojects:

- for business units: passengers, freight, infrastructure, capacity management;
- for structural units (composite and level-connections): capital attribution and finance, legal, communication, and safety.

Major restructuring of the NS has by now occurred. An army of "change managers" is working out an array of business plans, and the disappearance of some 4800 jobs (out of 28,000) appears inevitable. The reorganisation is proving very costly: 103 million guilders in 1993 alone, which is 2.2% of the overall NS expenditures in that year.

The structure of the NS in 1995

The "new NS" is a holding company consisting of a myriad of semi-independent business units and administrative bodies. The most important (with a brief indication of their functions and tasks) are:²³

1. NS Reizigers: in charge of passenger transport; considers questions of service, fares (including possible differentiation according to train type and time of travel), and special services offered on various route networks;

has as subsidiaries NS Reisburo (travel agency), BV Trans (vacation trips and accommodation), Biljettencentrale (produces tickets and forms), Treintaxi VOF (taxi service to and from train stations at reduced rates), and NV HST-VEM (operation of the future TGV; it is also a shareholder in the international conglomerate in charge of the Paris-Brussels-Cologne-Amsterdam network)

2. NS Cargo: freight shipping; owns all box cars, all diesel locomotives and one-third of the electric locomotives (it services the other two-thirds as well); works in close cooperation with foreign freight carriers and arranges transnational shuttle trains for containers; owns Holland Rail Container BV
3. NS Stations: manages property at or near stations; serves as landlord for NS Reizigers (wickets for ticket sales) and an increasing number of unrelated enterprises from flower shops to dry cleaners
4. NS Vastgoed: manages NS-owned properties, some of which are not needed for the actual rail sector; determines internal allocation and charges on other business units of NS. BV Nemeog is a full subsidiary which develops and manages real estate projects
5. NS Materieel: production, service and maintenance of rolling stock and other capital goods (most of which are owned by NS Reizigers and NS Cargo)
6. Railinfra: maintains, renews and expands the national rail network
7. NS Verkeersleiding: operational control of all train movements.

Apart from these business units, there are a number of independent agencies connected with the NS. In principle they are all supposed to serve the concern from within and also seek markets elsewhere. As indicated earlier in this article, further breakup and eventual privatisation may be a logical course of development. No business unit has special legal standing within the NS - although the ability to deliver the contracted goods is probably better than that of outsiders in the long run. Whether they can overcome other units' temptation to "outsource" more cheaply remains to be seen.

Finally, there is Railned, the independent, neutrally operating group within the NS, with the dual task of improving and innovating rail capacity on the one hand, and on the other, allocating infrastructure capacity to carriers within the NS family and without. It is one of the EC's main concessions to the national railway companies that they have been allowed to "internalise" the very function designed to open up their system.

It is as yet impossible to assess the impact of the policies and measures described above. Things to watch are, among others:

1. government actions in the area of infrastructure
2. the success of the "public service contract" concept
3. the level and structure of fares
4. the quantity and quality of inter-unit service provision, complementarity and fine tuning²⁴
5. the development of an informational structure among the various business units, subsidiaries and departments that are expected to operate in some form of self-serving isolation from each other
6. development of cost levels and their relation to the increased need to gather, coordinate and disseminate information²⁵
7. the accuracy with which the business units, whether major players or minor actors, target their markets
8. the internal and external pressures to cut costs, corners and staff
9. the ability of Railned to fulfil its dual role of domestic builder and international arbiter (and the reaction of the EC if it fails in the latter task).

We shall know more by 2000.

NOTES

¹ The original text of this article was completed in March 1995, based on notes prepared for presentation at a two-day workshop on privatisation, organised by the Department of Economics, University of Manitoba, in the fall of 1994. The present text contains

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² The history of the Dutch railway system may be found in J.H. Jonckers Nieboer, *Geschiedenis der Nederlandsche Spoorwegen 1832-1938*, Rotterdam 1938, and J.A. Faber, ed., *Het spoor, 150 jaar spoorwegen in Nederland*, Meulenhoff & Nederlandse Spoorwegen, 1989.

³ Nederlandse Spoorwegen, *Annual Report 1993* (English version), p.11

⁴ A "common market" lies between a "free trade area" (no internal tariffs) and a "customs union" (free trade area with common external tariffs) on one side, and an "economic union" (common market with coordinated economic policies) on the other side. In a common market, capital and labour are in principle fully mobile between participating countries.

⁵ Decision 65/271/EEC: Harmonisation of certain provisions affecting competition in transport by rail, road and inland waterway. Regulation 1191/69: Action by Member States concerning the obligations inherent in the concept of a public service in rail, road and inland waterway. Regulation 1192/69: Common rules for the normalisation of the accounts of railway undertakings. Regulation 1107/70: Granting of aid for transport by rail, road and inland waterway.

⁶ Consolidated from Presse 203, 11296e/86, dated 15/16.XII.86, p.8-9.

⁷ *Europe*, 6 October 1989, no. 5105 (n.s.) All emphases in the original.

⁸ *Europe*, 1 December 1989, no.5143 (n.s.)

⁹ Presse 40-G, 5395/91, dated 27.III.91, pp.6-7.

¹⁰ Published in the *Official Journal of the European Communities*, 24.8.91, no. L237, pp.25-28; for some corrections to this text, see the issue of 6.11.91, no. L305, p.22.

¹¹ Karel van Miert: "As for certain *national privatisation plans... the Commission has no authority* in this regard. Such plans fall entirely under the responsibility of national governments" (*Europe*, 16 October 1992, no.5837 (n.s.), p.15; emphases in original).

¹² *Official Journal of the European Communities*, 26.6.91, no. 169, pp.1-3 (Dutch version, translation mine)

¹³ Council Directive proposal 448 and 490, COM(93) 678, 15 December 1993; see also the amendments, COM(94) 316, 14.07.1994, and the "Opinion" of the Economic and Social committee, TRA/268, 14 September 1994. The present state of discussion of policy is reflected in *Presse 193-G*, 9405-94, dated 26.IX.94, pp.9-11.

¹⁴ *Europe*, 6 April 1994, no. 6204 (n.s.), p.14

¹⁵ Jack Duchemin, "The Commission of the European Communities and the railways: the lines of a misunderstanding..." *Rail International*, August-September 1993, p.7-10. Duchemin worked for many years with the Office for Research and Experiments (now the European Rail Research Institute) and later at the Commission of the European Communities.

¹⁶ H.H.F. Wijffels, R.J. in 't Veld and J.F.A. de Soet (1992), "Sporen voor straks: Advies over de toekomstige relatie tussen overheid en Nederlandse Spoorwegen" (Rails for tomorrow: Advice on the future relationship between government and the Dutch Railways). Dutch text. No commercial edition available. No ISBN. Various paginations.

¹⁷ pp.2-3

¹⁸ Often such permits are only issued when public transit is nearby.

¹⁹ Although most Dutch collective bargaining is done either centrally in a tripartite structure or on an industry-wide basis, the NS has its own contract with the unions. The national government has the power to declare any collective agreement applicable throughout an entire sector of the economy, but it is unclear

whether that option would exist (and be used) in a decentralised NS.

²⁰ Government document DGV/CPF/V321150

²¹ The Netherlands has a dense bus network. On weekdays most towns and major villages can be reached on at least an hourly basis. Until recently many of these bus companies were owned by the NS. Smaller communities may have volunteer buses and bus-on-demand service.

²² "Markt, Overheid en Railvervoer" - Market, Government and Rail Traffic. First report, dated March 1993 (vwdh072.rap), prepared by the consulting firm of Twijnstra Gudde.

²³ Sources: NS Annual Report 1993, NS-wijzer (information booklet), and W.H.G. Radstake, "De reorganisatie bij de N.V. Nederlandse Spoorwegen" (The reorganisation of the Dutch Railways Inc.), *Op de rails*, 62:9, September 1994, pp.316-320.

²⁴ These include timetable coordination. Because "route devolution" is part of the decentralisation exercise, route managers have been appointed who are expected to do the best job possible for the route(s) under their jurisdiction. While some of the initiatives are strictly internal (e.g., the provision of refreshments on the trains, introduction or expansion of the "train taxi"), others may have a bearing on the connecting system. For example, the manager of the Zeeland route (Roosendaal-Vlissingen, in the southwest of the country) had plans to replace the half-hourly service with a twenty-minute service. However, this would have upset the balance of the half-hourly connecting trains in Roosendaal, north to Rotterdam, east to Breda, and south to Antwerp.

²⁵ Economists like to support competition on the basis of the perceived optimal efficiency of resource allocation thus created. However, in the presence of so-called transaction costs (ranging from information needs to enforcement of contracts), such optimality cannot be assured. Indeed, the complexity of outsourcing has been a major contributor to the failure of previously self-sustaining enterprises to survive in an increasingly competitive output market.