Turnaround or Churnaround on the West Coast Line

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The Guardian on 20th June 2013 published an article by Richard Branson substantially repeating claims which he had previously made about the performance of Virgin Trains on the West Coast main line which CRESC researchers challenged in their report on the *Great Train Robbery*. When the Guardian's Editor C.P. Scott famously wrote "comment is free, but facts are sacred", he underestimated the difficulty of distinguishing between interpretation and empirics. But, in Richard Branson's case, it is very hard to reconcile his claims with the available empirics. And we have written this short rejoinder to lay out the facts so that our readers can make their own judgment.

The primary aim of the *Great Train Robbery* report was to criticise the rotten system created by rail privatisation and subsequent bad political decision making. The fundamental problem with our rail network is not enough money in the fares box, so that the state is now putting in near £10 billion a year in cash subsidy and bond guarantees so as to cover operating costs, debt interest and capital investment requirements; while quasi-public Network Rail has accumulated £30 billion of debt for which the taxpayer is liable. But we did criticise the franchising system (which directly results from HM Treasury and the Department for Transport decisions) because it offers train operating companies like Virgin a low investment option on profit; and our report argued that lobbying and agenda control by the train operating companies was hindering reform.

Many of the claims made in Richard Branson's article can be clarified by turning to the accounts of West Coast Trains. This special purpose vehicle has held the West Coast main line franchise since 1997 and is jointly owned by Stagecoach and a chain of Virgin companies which ends in the British Virgin Island registered Virgin Group Holdings. Sixteen years of accounts are now available and in the Great Train Robbery report we adjusted for inflation and presented real values; to remove any cause for dispute, the table below presents nominal figures as given in the original West Coast Trains accounts. They are slightly different from those in the Great Train Robbery report but that does not in any way change our story. If we consider Virgin Trains as a long term investment, over the life of the franchise since 1997, the company is directly subsidy dependent and does extract value rather than bring investment into the rail industry.

Table 1: West Coast Trains, direct subsidy, depreciation, profit, tax and dividends[1] (Nominal data)[2]

	Gross direct State subsidy £000	Premium payments £000	Net direct subsidy £000	Depreciation £000	Pre-tax profit £000	Tax £000	Net profit £000	Dividends £000
1997	72,250	0	72,250	152	-11,181	0	-11,181	0
1998 (11 months)	70,236	0	70,236	95	9,724	450	9,274	0
1999 (53 weeks)	71,913	0	71,913	274	38,042	15,415	22,627	0
2000	59,511	0	59,511	1,066	52,521	15,220	37,301	37,000
2001	93,241	0	93,241	1,681	38,539	13,488	25,051	24,000
2002	263,008	0	263,008	3,687	69,820	21,368	21,048	69,500
2003	360,496	0	360,496	4,745	66,782	21,845	44,937	0
2004	370,818	0	370,818	5,961	24,881	4,912	19,969	8,000
2005	212,061	0	212,061	11,756	30,135	9,769	20,366	25,800
2006	92,770	0	92,770	6,305	-13,276	-5,013	-8,263	20,000
2007	98,746	0	98,746	2,604	16,668	6,100	10,568	13,132
2008	161,905	0	161,905	425	81,254	24,799	56,455	64,000
2009	127,945	0	127,945	413	104,548	28,123	76,425	74,882
2010	77,518	0	77,518	1,587	69,440	18,808	50,632	67,000
2011	76,833	155,270	-78,437	2,665	55,712	15,764	39,948	30,500
2012 (56 weeks)	69,258	214,320	-145,062	2,128	40,775	10,989	29,786	26,000
Total 1997-2012	2,278,509	369,590	1,908,919	45,544	674,384	202,037	444,943	459,814

As table 1 shows, since 1997 West Coast Trains has benefited from a huge direct public subsidy which (after allowing for offsetting premium payments) amounts to £1.9 billion pounds. This company operates in a space of politically constructed profit because, without this direct subsidy, the £674 million of cumulative profit could not have been found over 16

[1] Source: West Coast Trains Limited 'Director's report and financial statements', various years. Company registration number 3007940.

[2] The presentation of the notes to the accounts mean that 1997-2010 gross subsidy is a net figure and include the net summation of items that reflect various arrangements including 'Revenue Adjustment' and other amendments. From 2011 the company explicitly state as a separate line 'Franchise (expense)/income'.

years; and the £202 million West Coast Trains then paid as corporation tax on profits could be understood as simply the recycling of a small part of the much larger state subsidy. In line with standard train operating company practice, all of the post-tax profit, some £460 million over sixteen years is extracted from the rail industry as dividends remitted to the corporate parents Stagecoach and Virgin Rail Group. The operating company's value extraction is not offset by investment which brings new funds into rail because any large investment by West Coast would result in depreciation charges much larger than the £46 million cumulatively taken.

As we pointed out in the Great Train Robbery report, train operating companies are inherently value extractive, low investment operations because the infrastructure is provided by quasi-public Network Rail and the trains are supplied by leasing companies. The dividend extracted is then a kind of 'fee for service'. We doubt whether the fee is necessary when the state owned Directly Operated Rail achieves high operating standards without dividend extraction on the East Coast main line. But Richard Branson's argument is that the taxpayer gets something in return. His story is one of corporate "turnaround" achieved by West Coast Trains which inherited a loss making, problem operation which is now making profits thanks to the "hard work" of the operating company. And, in support, he can point to how the steady profits in recent years are accompanied by a dramatic reduction in direct state subsidy (it has fallen hugely from the crisis peak after the collapse of Railtrack) so that West Coast is now paying more in premiums than it obtains as direct subsidy..

The problem with Richard Branson's operating company turnaround story is that it does not engage with our rather different and well evidenced subsidy 'churnaround' story. As the Great Train Robbery report explained, after 2004 as direct state subsidies in the form of cash grants to West Coast Trains and other operating companies declined, so the indirect subsidies in the form of low track access charges levied by Network Rail have increased. The rise of indirect subsidy is elliptically dealt with in Richard Branson's article which accepts that national track access charges for use of infrastructure by train operating companies have declined from £3 to £1.5 billion. West Coast Trains track is a beneficiary of lower track access charges despite the fact that the company is running more trains with more passengers along a West Coast track that has been upgraded and renewed at cost of nearly £10 billion which was substantially charged to the taxpayer.

Table 2: West Coast Trains time-series comparison of track access charges and direct subsidy[3] (Nominal data)

	Track access costs £000s	KM miles KM mill.	Cost per KM £	Direct State subsidies £000s	KM miles KM mill.	Cost per KM £
1997	130,160			72,250		
(11 months) 1998	120,779			70,236		
(53 weeks) 1999	133,712			71,913		
2000	131,923			59,511		
2001	116,275			93,241		
2002	239,051			263,008		
2003	261,133			360,496		
2004	279,964	18.19	15.39	370,818	18.19	20.39
2005	136,495	20.02	6.82	212,061	20.02	10.59
2006	158,832	22.46	7.07	92,770	22.46	4.13
2007	210,247	22.68	9.27	98,746	22.68	4.35
2008	257,384	24.25	10.61	161,905	24.25	6.68
2009	152,752	30.01	5.09	127,945	30.01	4.26
2010	170,552	35.55	4.80	77,518	35.55	2.18
2011	136,700	35.59	3.84	76,833	35.59	2.16
(56 weeks) 2012	161,175	35.88	4.49	69,258	35.88	1.93
Total 1997-2012	2,797,134	244.63	11.43	1,287,854	244.63	5.26

Again, some time series empirics are helpful and table 2 above pieces together the fragments of available evidence from West Coast Trains' annual reports and Office of Rail Regulation sources. This shows how, since 2004 on the West Coast line, the number of timetabled train kilometres has doubled to 36 million but track access charges have been nearly halved since the 2004 peak of £280 million so that West Coast which paid £10 per train kilometre travelled as recently as 2008 is now paying less than £5. Richard Branson's defence of this huge hidden subsidy is that track access charges "are set by the government,

[3] West Coast Trains Limited 'Director's report and financial statements', various years and 'National Rail Trends' (NRT), Office of Rail Regulation.

and the west coast charges reflect a reduction in costs after the renewal and upgrade work."

Richard Branson's defence of the hidden subsidy is completely unconvincing. The Great Train Robbery report explains how lower track access charges suited the Treasury because they kept the costs of rail subvention out of the PSBR. But, a subsidy is a subsidy regardless of how it is decided and, if government sets charges below economic costs, then it will make any operating business look good. As for lower track access charges reflecting a reduction in operating costs, the economic charge for track access should include an element to recover the cost of nearly £10 billion of improvement. Without that cost recovery, lower track access charges cast Network Rail in the role of the philanthropic landlord who improves your flat at his expense and then reduces the rent so you can keep more of your income.

If subsidy dependence through low track access charges is irrefutable, the rest of Richard Branson's claims are dubious in that they assert or imply relationships between variables which we have disputed in a reasoned way. Thus, all the train operating companies publicly claim the credit for increasing passenger numbers through clever marketing and good service. Against this, the Great Train Robbery report argues that passenger numbers were increasing before privatisation under the secular influence of GDP growth, more recently reinforced by a rise in South East commuting driven partly by property prices. Train operating companies accept our account of the key relations insofar as they have, for example, lobbied to include GDP related compensation mechanisms in franchise contracts.

We need to set the record straight because privatised rail is a completely dysfunctional system which creates politically constructed profit opportunities in a chronically loss making sector which is a machine for generating public liabilities that fall upon the taxpayer. The self-justifying narratives of the private train operators about "turnaround" are simply distracting us from discussing the basic issues about how we fund rail at public expense in a way that is socially equitable, politically accountable and financially transparent.

24th June 2013