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Editor
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REPORTS OF MEETINGS

GLOBAL AIRPORT PRIVATISATION TRENDS

Michael Colella, The Portland Group

The speaker has spent the last two years with The Portland Group as their transport consultant and before that he was with the Port Authority of New York and New Jersey. His talk covered:

- Airports as a business
- Factors in privatisation
- Past and present airport privatisations, and
- The future

Airports as a Business

Historically, airports have been owned and operated by national or regional governments. While the airline industry world-wide is increasingly dominated by privately owned carriers, airports have until recently been bastions of state control. Even in the United States, there are no privately owned commercial airports, the majority being owned and operated by governments or public corporations.

In 1987, the UK Government sold seven airports to the private sector as BAA plc. Since then BAA has been transformed, with improved performance, reduced costs and increased profits to the benefit of customers, shareholders and government in the form of increased corporate tax proceeds. Other airports including Copenhagen, Vienna, Cardiff, Belfast and Liverpool have been partially or fully privatised with similar results.

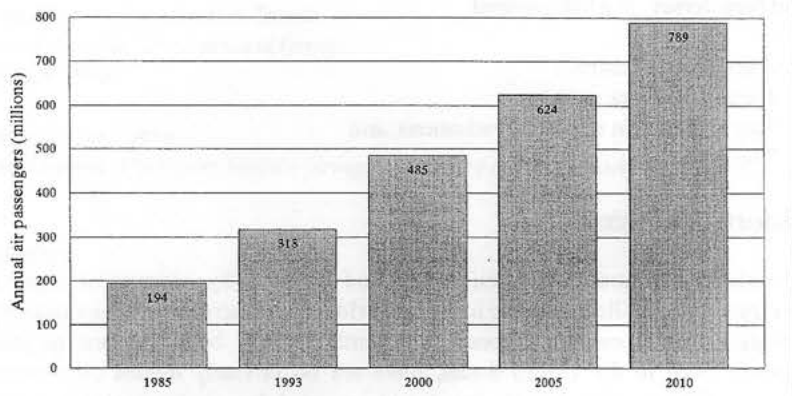
As a result of these successes, governments are increasingly willing to consider the partial or total sale of their airports.

What is an airport?

Airports are almost unique as they are both capital intensive and labour intensive. They are also seen as long-term investments similar to public utilities. The airports industry is characterised by long term growth and steady capital expenditure. It can be seen as a low risk industry which is far more resilient to economic cycles than airlines which operate on lower margins and are more sensitive to competitive forces. World airport traffic has been growing at over 7%

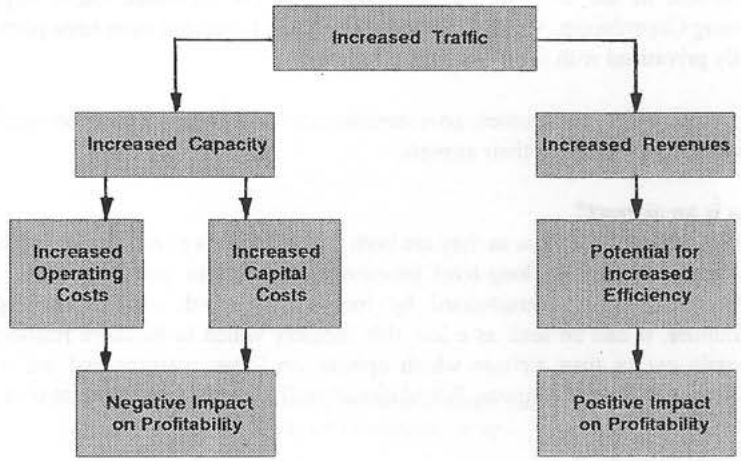
per year during the last twenty years. According to International Air Transport Association (IATA), demand for air travel will grow at an average annual rate of 6.3% over the next decade. The past and future trends are shown in figure 1 below.

Figure 1: World international air passengers per annum



Source: IATA Consultancy Services

Figure 2: Impact of traffic growth on airports



Impact of traffic growth on airports

Traffic growth can significantly increase revenues but can also significantly increase capital investment. The key is to manage the business so as to maximise the financial benefit to the airport while maintaining quality and minimising cost increases.

The airport industry

Some of the distinct factors which underline the attractiveness of the airports industry to private investors are:

- *Traffic growth is strong:* Figure 1 above showed the growth in demand to over 789 million passengers by 2010.
- *Most airports are natural monopolies* by nature of their geographical location and, although they may be subject to regulation, their strong market position reduces investment risk.
- *Airports are capital intensive* with stepped increases in expenditure as additional capacity is provided to meet demand. Airports Council International has estimated that European airports alone will have invested £22 billion from 1994 to 1997. Given public sector budgetary pressures, governments are increasingly willing to consider private sector financing and ownership.
- *Airports are labour intensive:* as traffic grows, value can be added by reducing costs per passenger significantly over time. Airports also offer the potential for efficiency gains and cost reduction by more effective management strategies. Measured in the number of passengers per employee, BAA has achieved increases of 45% between 1991 and 1995.
- *Airports have stable revenue sources:* around 60% of airport income comes from aeronautical sources such as aircraft landing and parking fees, and passenger charges. Historically, these change little from year to year even when a dominant airline substantially reduces its operations.
- *Airports have strong revenue growth potential:* commercial revenue sources are traditionally under-exploited due to the nature of current public airport ownership. There is an opportunity for considerable development of commercial revenue from non-aeronautical activities such as retailing, catering and property management activities at its airports, as illustrated by BAA in table 1.

Table 1: BAA revenue breakdown

BAA Revenue 1995/6	Revenue (£m)	%
Airport charges	434	34.6
Retail	556	44.4
Property	213	17.0
Other	50	4.0
Total	1,253	100

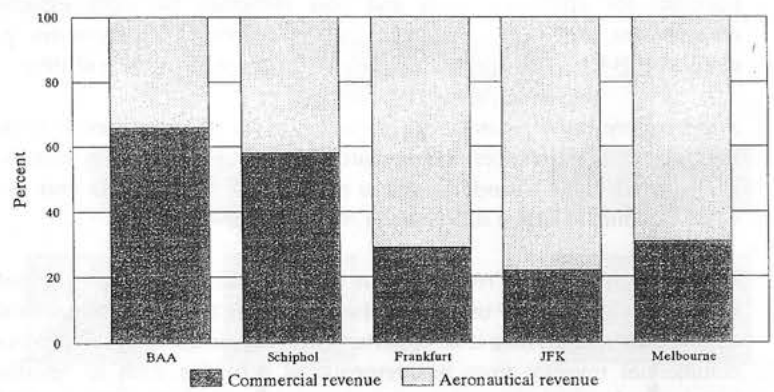
Importance of commercial revenues

A major factor in maximising returns for an airport is to increase commercial revenues. This can:

- help pay for new development;
- keep landing fees and other aeronautical charges down;
- improve the financial viability of the airport;
- reduce or eliminate the dependence of public sector funds; and
- improve the perceived quality of service to passengers.

A comparison of the income of five airports is illustrated in figure 3 below.

Figure 3: Comparison of revenue sources



Source: UBS research and various annual reports

There are several different sources of commercial revenues, including:

- Retail
  - duty free/tax-free shops: specialist operators selling traditional goods such as alcohol and tobacco and non-traditional items such as jewellery
  - catering: increasingly, specialist operators with competitive pricing and mix of branded products
  - specialist shops: increasingly, specialist operators selling clothing, shoes, etc.
  - local product shops selling cultural items as well as other gifts
  - service-oriented "traditional" shops (books, souvenirs, etc.).
- Advertising
- Property (offices and other rental properties)
- Other
  - car rental
  - car parking both for passengers and staff
  - telephone/communication services
  - fuel concessions, etc.

Airport commercial activities tend to differ according to traffic size and demographic characteristics. A 1997 report by Travers Morgan on air pricing showed that high commercial revenues lower airport charges which, in turn, attract airlines and increases congestion.

Factors in Privatisation

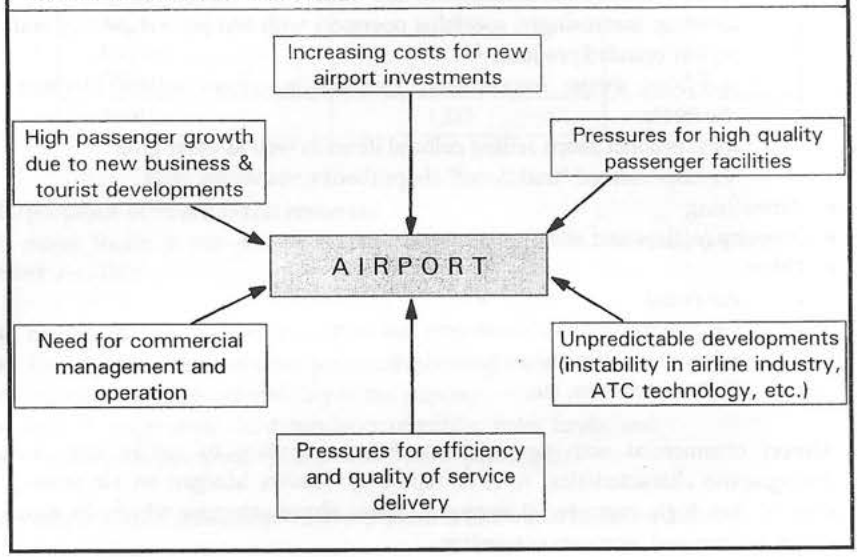
Governments are increasingly attracted to privatisation for commercial, financial and political reason. Airport privatisation is seen as an effective means of reducing substantial public capital expenditure commitments, whilst maintaining safeguards to protect airport as national assets. The form of privatisation will depend on a number of factors, including:

- political and policy stance on privatisation
- economic efficiency of existing airport operation
- scope for service improvements
- need for sales proceeds to the government
- requirement for major investment at airport.

There are a number of challenges affecting airports which are illustrated in figure 4. They involve high passenger growth with pressures for high quality facilities

that increase costs for new investment. At the same time there is a need for commercial operations and pressures for efficiency and quality service delivery.

Figure 4: Airport challenges



Forms of Privatisation

The type of privatisation implemented will vary depending on these factors. In many countries, there is historically a sensitivity to transferring outright ownership to the private sector for national security reasons, and so airport privatisation can take a number of different forms:

- *Total or partial sale of an airport through a public offering of shares* - BAA was publicly floated for £1.2 billion following more than 20 years of successful operation as a state owned corporation. More recently, both Copenhagen and Vienna airports have been partially sold off in order to commercialise the management and raise revenue while retaining overall government control.

- *Sale of an airport to the private sector through a private trade sale* - in the UK, a number of regional airports have been sold to private sector

companies through a competitive bid process based on value and promises to invest in new facilities.

- *A concession or lease to the private sector* transfers responsibility for airport operating and management in return for payments to the government which retain ultimate ownership. This form of privatisation is attractive to governments which want to retain some control of airport assets.

- *Management contract for the operation and maintenance of an airport* is popular in North America where government transfers responsibility for airport operation but retains investment decisions, paying the management company a fee which includes a performance related element. BAA's ten year contract at Indianapolis Airport in the United States is an example of this type of privatisation.

- *Private sector construction and/or operation of airport facilities* is popular in Australia and North America whereby an operator (usually an airline or group of airlines) design, construct, finance and operate facilities exclusively for a period of time (a Build, Operate and Transfer or BOT). The private sector company transfers the asset back to the airport operator after a period of time. A sharing of airport revenues and costs according to an agreed formula is also typical of this type of arrangement. The TOGA terminal under construction at New York's JFK Airport or Terminal 3 at Toronto's Pearson Airport are examples of this type of privatisation.

Each option implies different levels of involvement and risk transfer between the public and private sector. As the acceptance of more radical forms of privatisation grows, long-term leases and even outright sales are becoming more commonplace.

Regulatory Framework

The desire/need for regulation plays an important role in determining which option is chosen by the state. Regulatory issues include:

- formal versus informal regulation
- price versus commercial regulatory structure
- single till versus double till accounting
- cross ownership and foreign ownership needs
- monitoring requirements
- commitments to provide business development/investment strategies.

Past and Present Privatisations

United Kingdom

Since BAA's privatisation in 1987, the UK has continued with the privatisation of regional airports through a series of trade sales. This was encouraged by the UK Government's Private Finance Initiative which restricts access to capital funds for airports in the state sector, but allows airports which are more than 50% private to borrow and invest. As a consequence, local governments have been disposing of their interests in airports through a process of trade sales on a competitive bid basis. Seventeen out the UK's top 30 airports are now either in the private sector or in the final process of being privatised. Apart from Birmingham and Bristol, all seventeen airports privatised are now 100% owned by the private sector. The value of each airport has risen as illustrated with Belfast International which was sold by the UK Government to its management team in July 1994 for £32.75 million. It was re-sold in August 1996 to TBI plc for £100 million, representing a three-fold increase in value. Private sector airports in the UK are shown in table 2 below.

Table 2: UK Airport ownership

Airport	New owner
Heathrow, Gatwick, Stansted, Glasgow, Edinburgh, Aberdeen, Southampton	BAA plc
Prestwick, Liverpool	BAe plc
Belfast Aldergrove, Cardiff	TBI plc
East Midlands, Bournemouth	National Express
Belfast City	Bombardier/Shorts
London City	Consortium
Birmingham	45% stake sold to consortium of Aer Rianta/ Staff/Nat West Ventures

Europe

Denmark and Austria also introduced private capital into their airports. Copenhagen and Vienna airports have been partially privatised and have witnessed a similar increase in value as that experienced by the privatised airports in the UK. Copenhagen airport was floated beginning of March 1994 leaving the government with a majority shareholding of 51.3%. By October 1996, Copenhagen shares had increased by 100% over a period of two years. Vienna International Airport was partially privatised beginning of 1992 and has also increased in market value.

Australia

The federal government has begun the process of privatising, in three phases, the airports of the Federal Airports Corporation (FAC) which, as a wholly owned state corporation, operates 22 airports across Australia. Overall, there will be a transfer of airport ownership on the basis of an initial 50 year lease with a 49 year renewal option. There will be a 49% foreign ownership limit and a 5% airline ownership limit, and no one consortia can own more than one international airport. Along with airside facilities, the new private owners will operate the international terminals at Brisbane, Melbourne and Perth airports but not the domestic terminals which are on long leases to Qantas and Ansett airlines.

North America

North America accounts for half the world's throughput of air passengers. As yet, there is no significant privatisation beyond private sector involvement in the development of terminals for domestic carriers at major hub airports. However, in September 1996, the US President signed into law a bill allowing private operators to own and manage the country's airports. The law allows for a pilot programme of five airports to be privatised in which one can be a large hub (6 million plus passengers per year). The basis of the privatised environment will include regulatory oversight and approval function for the Federal Aviation Administration, and the permission of the new owners to retain many of the tax exempt provisions that currently exist in the public sector.

Airport Valuations

Airports have sold for increasingly higher values as financial institutions have become more comfortable. Moreover, all privatisations have seen the value of the company rise, sometimes significantly, after the sale. Table 3 below shows the financial performance of privatised airport companies.

Table 3: Financial performance of privatised airport companies

	EBDIT	Year	Enterprise value	Historic EBDIT multiple	Current EBDIT multiple
BAA (£m)	514	1995/6	6,500	12.7	11.5
Vienna (m Austrian sch)	1,090	1996	10,700	9.8	8.6
Copenhagen (m Kroner)	641	1996	7,200	11.2	10.1

There are a number of privatisations that are occurring now such as Harrisburg and Stewart in the United States and Hannover in Germany. In the UK, there are

currently three bidders for Luton. Further privatisations are likely to occur in the near future at:

- Leeds/Bradford)
- Newcastle) United Kingdom
- Jersey)
- Berlin)
- Munich) Germany
- Hamburg)
- Australia
- Italy
- Brazil

Future privatisations

A number of countries have declared an interest in privatising airports. Each country will tailor its privatisation programme according to its unique situation. Since most airports have limited experience in operating in a commercial manner, they will need assistance of external involvement to prepare them for the rigours of the private sector. As a result, a number of airport operators are considering the introduction of strategic investors through private trade sales or joint-venture consortia as their preferred privatisation option.

Table 4 below lists the countries that are examining the potential of privatising airports.

Table 4: Future airport privatisations world-wide

Country	Airport	Date	% Sale to private sector	Type of sale
Netherlands	Schiphol	1998	Probably minority stake	Flotation
Portugal	ANA	1998	Probable minority or majority with foreign ownership limit	Trade sale or flotation
Spain	AENA	1999	Probable minority or majority with foreign ownership limit	Trade sale or flotation
Eastern Europe	Various	1998/9	Joint venture consortium with foreign ownership limit	BOT/Management contract
Chile	Santiago	1997/8	Joint venture consortium with Lan-Chile	BOT
Peru	Lima	1999	Joint venture consortium with foreign ownership limit	Trade Sales

Barbados	GAIA	1998	Joint venture consortium with foreign ownership limit	BOT/Management Contract
Malaysia	Various	1998/9	Joint venture consortium with foreign ownership limit	Trade sale
Indonesia	Bali Jakarta	1998/9	Joint venture consortium with foreign ownership limit	Trade sale
India	Various	1999	Joint venture consortium with foreign ownership limit	Trade sale

Europe

The trend of privatisation is beginning to accelerate. In 1995, the Italian parliament passed a law allowing private operators to manage the country's airports. It also eliminated the need for a state holding company, IRI, to retain a stake in the airports. The law allows the private operation of airports on contracts if up to 40 years. Naples airport has been partially sold to BAA. SEA Aeroporti di Milano and Aeroporti di Roma have been converted into a private company with the intention to sell a partial or full stake in the company by the end of 1998. Other airports in Italy are examining the potential of bringing in private management and capital to improve their operations. In Germany, airports in Frankfurt, Hamburg and the proposed new airport in Berlin are all looking into privatisation.

South Africa

The government commercialised the state owned airports in 1993 by transferring responsibility for operation and management to Airports Company Limited (ACL). The airports in South Africa currently handle 15 million passengers per year, of which two-thirds are domestic. Recently the South African State Airports Policy Review recommended that a minority shareholding in ACL be sold to a strategic investor who could offer foreign capital, technology and management skills.

Central and South America

Some experiments with private sector or BOTs for terminals in return for investment in both Colombia and Mexico. The Mexican government passed a law allowing private operators to manage the country's airports. While many airports in Mexico are likely to be sold off in the long term including Guadalajara, Tijuana and Mexico City, in the short term Puerto Vallarta and Cancun airports are likely to be privatised. In each case, both airside and terminal ownership and operations are likely to be included in the transfer.

Asia Pacific

Rapid growth coupled with lack of government funds is adding pressure to allow private sector involvement in airports in the Asia Pacific region. The Philippine government announced in August 1996, plans to privatise the country's airports in Manila, Cebu and Davao over the next few years. The intention is to partially privatise each airport on a 25 lease with a foreign ownership limit. In India, the government is proposing that new airports be constructed and operated by the private sector. Existing airports will remain with the state owned Airport Authority of India.

Discussion

Peter Gordon (Chiltern Railways) opened the discussion by seeking a view on the introduction of private capital in partial privatisations. The speaker said that in the case of Birmingham the banks had put in the necessary investment to build a new terminal. Investment by individual airlines into an airport can lead to monopolistic power by charging high prices to other airlines.

Dick Dunmow thought that particular governments had chosen different models of how airlines operate, for example in Australia there is a monopoly. He suggested that there was a strong airport owner that controlled all aspects of the airport.

Michael agreed, adding that people who use airlines however do not have the best interests of the region in which the airport lies at heart unlike airport operator - East Midlands run a strong community public relations and generate employment locally. Australia is a good example because the small population cannot support more than two airlines, and only a foreign airline could set up a new hub.

Peter Collins said that London and the South East has the greatest competitive environment. He asked if low landing charges result from regional competition from smaller airports.

The speaker that the reason they are lower is because there is a large amount of commercial income, increasing pressure from airlines and regulator and competition from Schiphol and Frankfurt.

Dick Dunmow opined that Heathrow has the advantage because it is at capacity and that German airports are stunningly uncommercial.

Peter White stated that from a transport efficiency point of view, Heathrow is poor because of the increased waiting time.

Michael Colella suggested that in terms of the process needed to go through, the passenger gets the benefit because of reduced charges.

Don Box asked if regulation is going to increase (to airline industry as a whole or to separate parts). Most of travel in the UK is international and, therefore, the end product must be to please the passenger and it does not seem possible to regulate to that end.

In answer, Michael Colella said that each country was taking a different approach, depending on the culture, and that there is no "right" answer. In Europe there is the possibility of a regulator on a continental basis, with Athens the first airport to be regulated by the EU.

Paul Krebs asked if environmental factors are going to constrain growth, for example with Terminal 5 at Heathrow.

Michael agreed that airports are not very environmentally-friendly but they have a unique ability to take people to far away places - the same people who object to noise, etc. People wish to travel more, and it is not clear when the cut-off point will be - at some point growth has to slow but it is not clear when that will occur.

Aircraft cause problems locally but people do not see global pollution between points (airports). Michael thinks that air travel will slow down because people will get sick of travelling!

Dick Dunmow remarked that a lot of people do not travel much by air, giving a great potential for growth.

Michael agreed, saying that air traffic will increase dramatically before it begins to slow down.

Michael was thanked for a very informative talk on the trends that are occurring in the privatisation of airports and the differing examples around the world.

Report by Laurie Baker

COMPANY CAR POLICY

Sinead Flavin, Transport Studies Group, University of Westminster

Introduction

Sinead suggested that company cars were a very topical issue because:

- government targets to reduce CO_2 require appropriate policy signals;
- company car mileage is out of proportion with the number of cars on the road, i.e. 10% of the car fleet do 20% of the car mileage;
- half of all new cars sold are company cars which transfer rapidly to the second hand market.

The talk was based on a study into company cars which was initiated by The Ashden Trust and London First and managed in partnership with the University of Westminster. The talk was divided into five themes:

- describe the current tax system
- identify the express concerns
- investigate these concerns
- identify the needs for reform
- develop recommendations.

The UK has a total national car fleet of 22 million cars of which 1.7 million are company cars used by employees for their own private use. A further 0.6 million company cars are estimated to be used solely for business use which are not subject to company car taxation. In total about 10% of cars are registered in a company name.

The current company car tax system

The issues of concern are the tendencies of the current system to increase both business costs and environmental damage. In particular, the ways the system:-

- creates incentives for additional and unnecessary mileage, and
- fails to encourage the use of more fuel-efficient cars.

There are two aspects of taxation on the employee:

(i) Company car benefit charge paid by employees: Employees are taxed at their marginal rate of income tax, on an amount based on 35% of the list price of the

car and its accessories (or pro rata for part years). This tax is called a benefit charge as it is intended to represent all the benefits that employees gain from the private usage of a company car.

Higher business mileage drivers are eligible for discounts on the calculated benefit charge. Employees whose annual business mileage exceeds a threshold of 2,500 miles receive a one third tax deduction and those exceeding 18,000 miles receive a discount of two thirds. For example a low business mileage employee, say 1,000 miles per annum, whose marginal income tax rate is 23%, with a company car priced at £15,000 (including price of accessories fitted) would be subject to taxation on the benefit of the company car on an amount of £1,208[1] per annum. If the same employee increased his mileage to above 2,500 miles, the amount, which would be subject to tax, would fall to £805[1]. Most company car drivers fall into the 2,500 to 17,999 mileage band.

(ii) Free fuel benefit charge paid by employees: About half of all company cars receive some 'free-fuel' benefit for private mileage (i.e. fuel used for domestic and commuting mileage that is paid for by the employer). Currently employees pay a flat rate charge for this benefit. The charge depends on the engine capacity of the car and the fuel type used rather than the number of miles driven. The charges range from £800 to £1,490 for petrol cars and £740 to £940 for diesel cars.

Taxes which apply to the employer. Employers providing company cars are subject to National Insurance Contributions, which are in proportion to the personal benefit charge and the fuel scale charge paid by employees. It is currently set at 10% of the employee's total benefit charge and fuel scale charge. VAT must also be paid on the purchase of a car, on most of the maintenance costs and also on the fuel scale charge where fuel is provided for private use.

The main concerns are:

- tax discounts encourage additional business mileage,
- flat rate taxes encourage additional commuting and other private use,
- purchase of fuel-efficient cars is not encouraged.

The study

This was divided into two-stages:

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(1) 0.23 (marginal tax rate) x 0.35 x 15000

(2) 0.23 (marginal income tax rate) x 0.35 (of list price of car) x 15,000 x 0.67

(i) collecting and analysing data, and
(ii) developing corrective policy options.

To test the validity of the concerns expressed about the current taxation system the study collected and analysed data from six different sources. These were:

- A new analysis of the National Travel Survey.
- Two surveys, of company car drivers and company car fleet managers, conducted by MORI for Lex Service PLC. These are annual surveys. In 1997, these surveys included a number of questions specifically for the study.
- A specially commissioned survey to investigate the behaviour of company car drivers and their attitudes towards possible future changes in the system.
- Business company car database records, obtained from a sample of five companies, to examine reported business mileage for evidence of clustering around taxation mileage bands.

Company Car Mileage Concerns

The National Travel Survey reveals that the total mileage of company cars is out of proportion to their proportion of the national car fleet, since on average a company car does around two and a half times the annual mileage of a privately owned car (23,500 versus 9,500 miles). Thus 7.7% of the total car fleet does about 20% of total mileage.

The concerns addressed by the study about the current UK company car taxation system are:

(i) that company car drivers have incentives to drive additional mileage, in order to become eligible for tax discounts.

(ii) the flat rate charge to those receiving 'free-fuel' is unrelated to the private mileage driven. With no additional fuel costs, drivers have incentives to use as much fuel as possible to get the best value out of the flat rate paid. Furthermore, 'free fuel' drivers are largely insulated from the effects of the fuel duty strategy, which is designed to encourage fuel-efficient driving style.

The effect of the mileage banding system on business mileage

(i) Anecdotal Evidence of mileage distortion: The STRS Survey[1] of company car drivers commissioned by the study provides anecdotal evidence that the business mileage thresholds do lead to some distortions in the mileage declared. Two-thirds of those surveyed believe that the mileage bands encourage drivers to make business trips which are not strictly necessary, while only 15% admitted that they personally do so. However almost one in five drivers in the middle tax band did admit to doing additional business mileage. With regard to declaring private mileage as business mileage, one third of those interviewed believed that this is encouraged but again a much smaller proportion admitted doing so.

While the proportion of drivers distorting their reported business mileage is not clear from these responses, they do suggest that the main distorting effect of the banding system is of direct environmental and economic significance, since it involves drivers actually undertaking additional mileage rather than simply misreporting mileage.

(ii) Empirical evidence that the mileage banding system is causing a distortion in the number of miles driven. The study revealed that company car drivers do drive extra business mileage as a result of the taxation system. The evidence is found from business company car data base records from five nationally based companies (comprising of almost 14,000 cars). Most company car drivers fall into the middle mileage tax band, i.e. between 2,500 and 18,000 business miles. There is evidence that suggests a significant proportion of drivers tend to "overshoot" the mileage thresholds: there is a two-fold increase in the proportion of drivers doing up to 500 mile above the 2,500 mile threshold compared to those 500 miles below (see figure 1). The number of drivers doing between 18,000 and 18,500 miles is comparable to the number in the much lower group doing 14,500 to 15,000 miles (see figure 2).

To estimate the average increment of additional business miles driven resulting from the current system, a calculation was made of the likely spread of drivers in each band if the mileage banding system was not in place[1]. **The result suggests that reported business mileage may, on average, be 6% higher than if there were no tax thresholds.**

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[3] The Social & Transport Research Services survey questioned 2,250 company car drivers from eight companies that are scattered nationally with some bias towards London.

[4] Calculated using regression analysis to generate a smoothed curve producing an 'expected trend line'.

Figure 1: Annual business mileage distribution (low end)

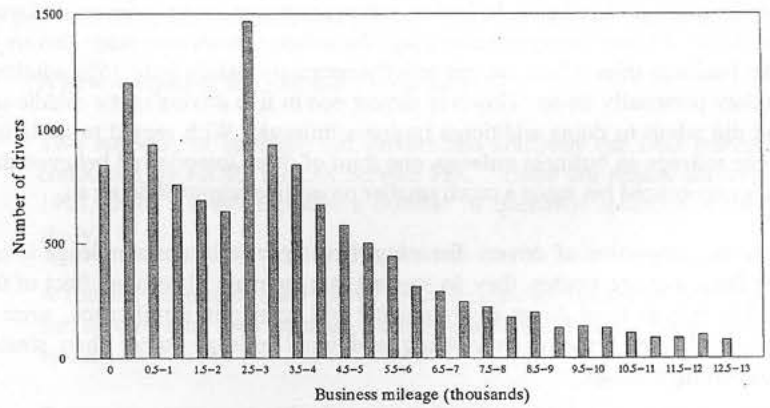
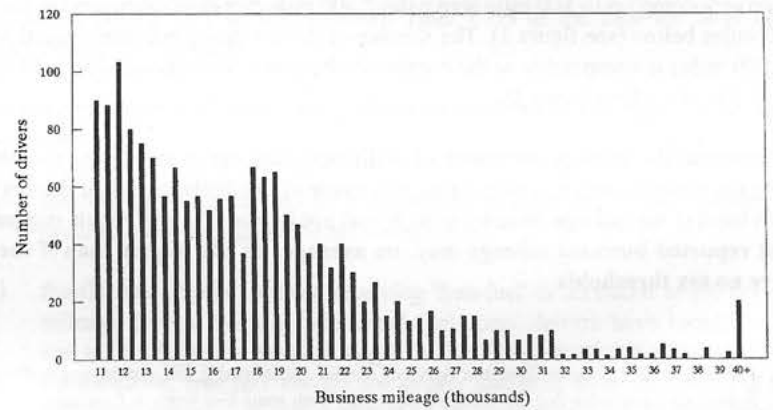


Figure 2: Annual business mileage distribution (high end)



The conclusion that business mileage driven increases as a direct result of the banding system is supported by findings from drivers' responses and company car data base records. These indicate that current reported business mileage is around 5% higher than if there were no tax mileage thresholds. The drivers' responses suggest that about 60% of this additional reported mileage is extra business mileage actually driven (adding around 1 billion business miles).

(iii) Does the banding system reflect the personal benefit of the company car? As already noted, the taxation of the company car is called a benefit charge and is therefore intended to reflect the personal benefit gained by the driver. The theory behind this is that the business mileage thresholds differentiate 'perk' (or 'status') cars (i.e. cars provided more as an award or a bonus) from 'job need' cars (cars considered essential for the job). Table 1 shows the annual mileage and geographical coverage for five companies that provided detailed data base records.

Table 1 below suggests that the theory is at best questionable: the average business mileage is more closely related to the type of business, its location and geographical coverage of the company than to whether the majority of company cars are 'job-need' or 'perk'.

Table 1: Average annual business mileage and geographical coverage

Company	Business mileage	Coverage	Type of fleet
A	16,974	National	mixed fleet
B	2,483	Mainly London area	mostly 'status' cars
C	4,062	National (HQ in London)	mostly 'status' cars
D	4,162	Mainly London	Mostly 'job need' cars
E	5,559	National	mostly 'status' cars
Weighted Average	5,470		

Source: Business company car data base records (total of 13,936 company cars)

One of the five firms, which supplied detailed database records, designated each of its cars into the two categories of 'perk' (or 'status') and 'job-need' company cars. The two categories of car show a high degree of overlap in terms of business mileage providing evidence that the banding system does not necessarily reflect the 'perk'/'job-need' company car split. These findings reinforce the expressed concerns about using business mileage as the basis for company car

taxation and further challenge its suitability as a tax that reflects the personal benefit of the car.

Effect on private mileage of the flat rate charge on free-fuel benefit

About half of all company cars (i.e. about 850,000) receive some private use 'free-fuel' benefit[1]. As already noted, the taxation rate is independent of mileage or the actual amount of fuel used. The following looks at the effect of the flat rate system on (i) domestic mileage and (ii) commuting mileage.

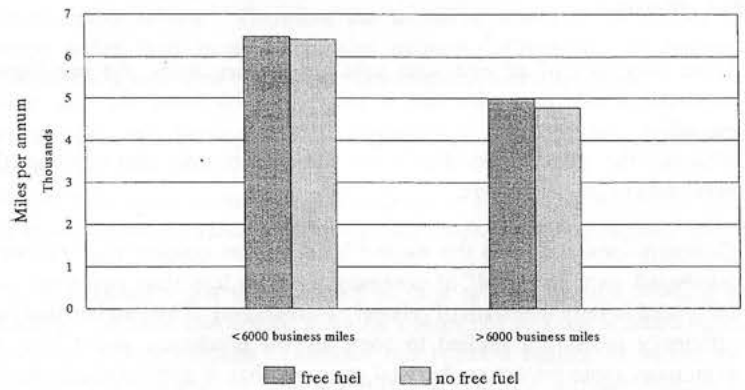
(i) Is there empirical evidence that the 'free-fuel' charge influences the number of domestic miles driven? In general, company cars do the same annual domestic mileage as private cars used for work and, contrary to what might be expected, the provision of free-fuel has no significant effect on this mileage (figure 3 below). However, the graph below does show that lower business mileage company cars record significantly more domestic mileage than higher business mileage company cars (by on average 15-20%), irrespective of whether fuel is free.[1]

(ii) Empirical evidence that the 'free-fuel' charge influences the number of commuting miles driven: The study found that the free-fuel benefit has a significant effect on commuting mileage. Figure 4 below shows that those company car drivers receiving free fuel do 20% more mileage than their counterparts paying for their own fuel and also that the effect of free fuel provision is stronger among 'no business mileage drivers' than 'higher business mileage drivers'. In the 'no business mileage' category, those receiving the benefit do 35% more commuting miles than those who do not. It is also apparent from the graph below that high business mileage drivers record lower commuting mileage, irrespective of whether they receive 'free-fuel'. This is probably mainly due to the fact that a journey straight from home to a business appointment or visa versa is recorded as business, and as a result drivers of a peripatetic business nature such as salespersons will have a lower commuting mileage, by definition.

(5) The Inland Revenue

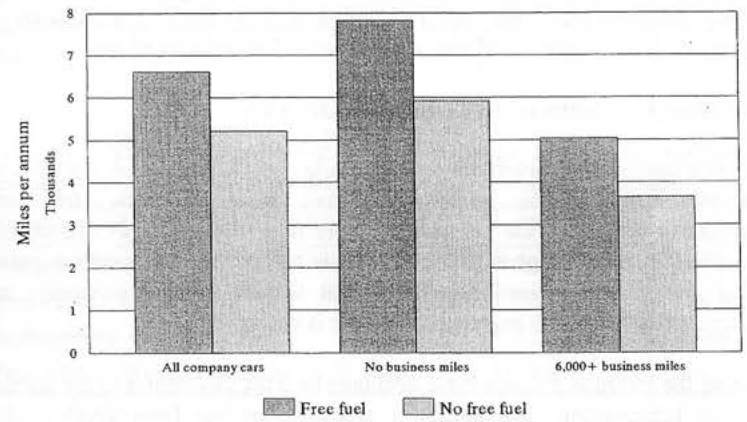
(6) Reduced leisure time, or the desire for a rest from the road are factors that may contribute to the low domestic mileage of higher business mileage drivers.

Figure 3: Domestic mileage by category of company cars



Source: National travel survey

Figure 4: Commuting mileage by category of company car



The lack of incentives for fuel efficiency under the current system

There is a case for direct fiscal incentives to encourage companies to purchase more fuel-efficient cars, which would also stimulate manufacturers to design more fuel-efficient cars:

- Since over half of all new cars sold are to companies, the purchasing preferences of companies are a prime consideration for the motor manufacturing industry. Companies therefore have the potential to influence the specification of new cars and consequently also influence the purchases of private buyers.

- Company cars pass into the second hand market quicker than privately purchased cars (over half of company cars are less than two years old compared to only one sixth of privately owned cars). This implies that fuel efficiency incentives applied to company car purchases would have an even more rapid impact on the total car stock than if applied to private car purchases.

- The fuel efficiency of newly registered vehicles grew steadily from the mid-seventies to the late eighties, increasing on average from 30 mpg to 35 mpg. However, since then it has deteriorated slightly[1]. Hence the market requires additional stimulation to further improve fuel efficiency, which the present price based taxation system does not provide.

For these reasons it would be beneficial on both environmental and business efficiency grounds to incorporate fuel efficiency signals in the taxation of company car ownership and fuel use. At present such signals are absent.

Encouraging Environmental and Business Efficiency

There are a number of taxation options that could remove the current stimulus for unnecessary business miles, to encourage fuel efficiency among "free fuel" drivers and to encourage the purchase of more fuel-efficient cars. The current mileage banding system gives contrary signals to government transport policy thinking and change towards a system that fosters a more economic and environmentally-conscious approach to car use is warranted.

Replacing the business mileage band discounts by a tax that relates to the number of private (commuting and domestic) miles driven has been given widely

[1] *Transport Statistics for Great Britain*

supported. This would more directly reflect the 'perk' value of a company car than the current system. The tax paid by a company car driver would increase with the number of private miles driven, rather than reduce in line with the business miles driven. Therefore the incentive would be to reduce private mileage rather than increase business mileage. Company car drivers were questioned to gauge their reaction to the introduction of this option:

27% said they would *'drive less private mileage (including commuting) in the company car'*,
12% said they would *'conceal private mileage as business mileage'*,
64% would *'drive the same amount of private mileage in the company car'*.

A concern raised about the introduction of a private mileage banding system pertains to the need that would arise for companies to keep accurate records of employees' private mileage. However this is not a significant barrier as most companies keep records of total and business mileage. Private mileage can be directly calculated from this, so there would be very little additional compliance cost. The Lex fleet manager survey found that three quarters of companies already keep accurate records of total mileage of some or all of their fleet.

A key question that may be politically important is "what percentage of company car drivers would change tax position?". National Travel Survey data were used to select three private mileage bands that would have the same proportion of drivers in each as the current business mileage bands. Thus under current driving patterns, the introduction of this system would be revenue neutral compared to that currently operating. Table 2 below shows the three private mileage tax bands chosen to have equivalent proportions of drivers to the business mileage bands.

Table 2: The formulation of Private Mileage Bands to replicate the distribution of drivers across the current Business Mileage Bands.

Taxation level	High tax	Medium tax	Low tax
Business Mileage Bands	<2,500	2,500-18,000	18,000 +
Proportion of drivers in each band	26%	50%	24%
Equivalent Private Mileage Bands	>14,000	5,000-14,000	<5,000
Proportion of drivers in each band	26%	53%	21%

The proportions of company car drivers who would pay more or less tax under this new (but revenue neutral) system were calculated. Table 3 shows that overall, there would be no tax change for 46% of company car drivers, an increase for 28% and a reduction for 26%.

Table 3: The proportion of drivers who would change tax positions

Business Mile Bands		Private Mile Bands		
		high tax >14,000	middle tax 5,000-14,000	low tax <5,000
high tax	<2,500	**10%**	14%	3%
middle tax	2,500-18,000	14%	**27%**	9%
Low tax	>18,000	2%	12%	**9%**

Note: The figures in bold are the percentage of drivers in each band found to be in a no change tax position, therefore the sum of these (46%) is the total percentage that will remain in the same tax position.

Only 2% would move from the lowest tax band to the highest, and 3% would move from the highest to lowest. The analysis also found that in the middle tax band, in which the majority of company car drivers fall, 53% would remain in the same taxation band: 29% would pay more and 18% less. Almost two thirds of those in the low business mileage band would pay less, and around 60% of those in the high business mileage band would pay more.

Encouraging fuel-efficient driving behaviour particularly among free fuel drivers may be brought about by a move away from the flat rate charge to a mileage dependent charge. The study looked at two options:

(i) Using the actual cost of the fuel purchased by the employer for employees' private use as the basis for setting "free fuel" tax rates.

(ii) Using a pence per private mile charge as the basis for assessing the benefit to employees.

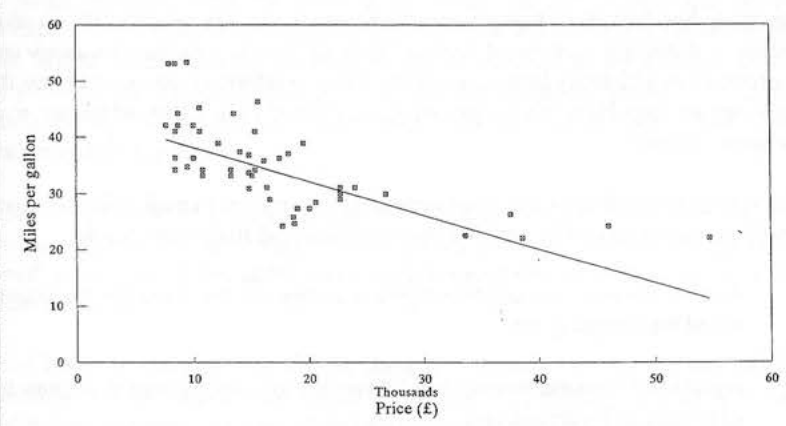
Both of these would serve to discourage high private mileage since those doing lower private mileage would pay less tax. The first option is preferable because it directly reflects the cost of fuel and therefore would encourage both more fuel-efficient driving behaviour (in terms of mileage and driving style) and the purchase of more fuel-efficient cars.

Concern has been expressed about record keeping requirements with regard to both options. In the case of the first option, the cost of fuel for private mileage provided to employees would have to be recorded. Employees could record the cost of fuel for private mileage in a logbook or alternatively using a fuel swipe card, such as those used for fuel purchases in parts of the USA. A pence per private mile charge, would require private mileage records to be kept. However, this is readily achievable without serious complication.

Incentives to encourage more fuel efficient cars

Analysis found that the relationship between the list price and the fuel efficiency of cars is weak (R^2=0.46). Therefore, using the list price as the basis for taxation does not provide incentives for company car drivers to use more fuel-efficient vehicles. Figure 5 illustrates the broad range of fuel efficiency values (MPG values) for lower priced cars: for example, cars that are priced around £10,000 range from 35 mpg to 55 mpg. It is also apparent that a car priced over £50,000 may have a fuel consumption value similar to a car priced less than £20,000.

Figure 5: Fuel efficiency against list price



The engine capacity of the car, an alternative that has been used in the past for determining taxation rates, also correlates poorly with fuel efficiency. (The R^2 between engine capacity and fuel efficiency, determined in the study, was only 0.47).

The study team and steering group both thought that to foster fuel-efficiency through company car taxation was to use the fuel consumption figure for each make and model as the basis for the taxation of company cars. This could be introduced either as a factor applied in conjunction with the list price, or instead of the list price.

A survey of fleet managers[8] found that seven out of ten fleet 'would adopt a policy of buying more fuel efficient vehicles' and one third of managers said they would support such a measure. Drivers were also surveyed[9], and interestingly, seven out of ten drivers said they would 'be happy to exchange their current company car for a more fuel efficient' model if the tax liability was directly related to fuel efficiency.

It should be noted that any system of taxation based on published fuel efficiency figures should also take into account the emissions from different types of fuel. Thus, rates on diesel engines would need to be set at a higher level than for petrol engines, and gaseous powered vehicles and other low emission fuel powered engines would be set at a lower level.

Recommended Reforms

The study has provided strong empirical evidence that the current UK taxation system is distorting patterns of use and fails to provide adequate business and environmental efficiency incentives. Therefore the reforms recommended by the study are an important component of an integrated policy that addresses road transport concerns.

The system deemed to be the most beneficial in terms of overall efficiency, and therefore recommended by both the steering group and study team would:

- employ the fuel consumption figure (i.e. mpg) as the basis for the benefit tax of the company car,
- replace the business mileage band discounts by a tax relating to the number of private miles driven, and
- tax the 'free-fuel' benefit at the actual cost of the fuel purchased by employers for employees' private use, rather than on a flat rate basis.

(8) The Lex survey of fleet managers
(9) STRS survey of company car drivers

These recommendations were submitted to the Government and are currently being considered for the Government White Paper on Transport Policy due out in the spring.

Discussion

Peter Gordon (Chiltern Railways) opened the discussion by asking how easy it would be to administer these reforms. Sinead said that this was an important issue, log books would need to be kept or the use of a fuel switch card as in the U.S.. Peter Jones added that companies know the total annual mileage but have a policy of getting their drivers to declare use so it is open to abuse.

Peter Collins (London Transport) thought that this is an issue that is of interest to the Chancellor. The speaker that it is also of political interest with winners and losers, and the issue of equity.

Peter Jones added that although the Chancellor has control of the instruments, transport is a policy issue.

K. Seigo enquired about the meaning of "status" car and thought that private mileage is very difficult to differentiate from business mileage. Sinead replied that "status" means that the car is given to the employee as a bonus and do not truly need a car. On the second point he said that bigger companies were tightly monitored but smaller companies are much more difficult to police. She added that no system is perfect!

Peter Gordon followed this by asking if the number of "status" cars was known. The answer was no! since very few companies give a breakdown of "status" or "need" cars. Peter Jones added that companies probably know subjectively but it is not recorded.

Peter Jones commented that if there were no company cars the number of cars would be less and engine sizes would be smaller, but generally they are very well maintained and newer cars get taken into the private market sooner.

Peter White asked if people taking substitutes was looked at? Although the issue was raised by the Steering Group it was not explicitly looked at. Companies seem to be moving towards team working and, therefore, encouraging people to either add in more money to buy bigger cars or smaller cars with a cash supplement.

Sinead Flavin was thanked for a very informative talk on a topical subject that should be reflected in the forthcoming White Paper on Transport.

Report by Laurie Baker

Postscript

The Government's Transport White Paper, **A New Deal for Transport: Better for Everyone**, published in July 1998 included the following:

"Company cars

4.128 Company cars account for almost 20% of car mileage and over half of new cars are first registered in a company name. Company policy on the purchase and use of company car fleets is therefore important for the environment. Company cars are generally much newer and better maintained than the average private car and therefore less polluting per unit of fuel consumed. However, they tend to have larger engine sizes than the average private car and as they account for a high proportion of the new vehicle fleet, they contribute to higher overall average fuel consumption both directly and through their influence on the stock of cars in the second hand market. Around 1.65 million company cars are available for private use. These drivers also tend to drive significantly further to and from work and those who receive free fuel drive further still.

4.129 We recognise that some drivers have to use a car because of the nature of their work. However, the existing system for taxing company cars has been criticised as providing a perverse incentive to drive further in order to reach the business mileage thresholds which attract significant reductions in the tax liability. In the March 1998 Budget, the Chancellor announced that he would be considering the case for replacing the existing business mileage discounts with discounts for driving fewer private miles in company cars, and invited people to send comments to the Inland Revenue. So far, a wide range of organisations and individuals have responded.

4.130 The current tax system for employees who receive free fuel from their employers for private use (about half of all company car drivers) has given them little incentive to reduce their private mileage, as the employee pays the same

amount of tax whatever the amount of private mileage driven. It is important to send consistent messages about the need to reduce unnecessary journeys and improve fuel efficiency. We therefore announced in the March 1998 Budget that we will increase the scale charges for employees provided with free fuel for private use by 20% each year over and above normal increases up to 2002/3 to discourage employers from providing free fuel."

REVIEWS

Two personal views on the "Big Issues" in transport economics are presented below. The idea is to foster debate among members of the **Transport Economists' Group**. You are invited to comment on the issues set out below, and add your own thoughts and solutions to what you see as "Big Issues". Contributions will be published in future issues of *The Transport Economist*.

BIG ISSUES IN TRANSPORT ECONOMICS

The issue of the Government's White Paper on transport policy, while setting out a number of aspirations and objectives for the future, does not, in many cases, give leads as to how these might be realised in a practical way. There are also many structural difficulties in the privatised transport industries, particularly in the railways, to tackle. The following is an attempt to particularise some of the questions of means to employ which hang over the broad concepts of the White Paper and privatisation and suggest areas of research and debate which could help towards the resolution of these practical problems.

Railways

There have been several examples recently of TOC's bargaining for an extension of their franchise in return for investment in rolling stock (both renewal and 'new' investment). This largely arises from the shortness of franchises compared with the life of rolling stock. Obviously it will arise again once the end of the now extended franchise is approached. The long-term consequence will be fits and starts in the building of new rolling stock instead of the steady stream of timorous replacement and investment in additional trains which are desirable. Is there some way in which a return on the residual value of investment could be assured to the funder of such investment once the franchise has expired, and the financing/leasing cost of rolling stock made proportionate to the full commercial life of the asset rather than that of the franchise?

The Strategic Rail Authority is to be, *inter alia*, a planning mechanism for the railway industry. Currently, each part of the industry plans in its own interest. Corporate planning in an industry so complex and interrelated as the railways implies a strong probability of gain for some parts at the expense of others. What can be done about the internal relationships, financial and physical, of the various parts of the industry, and the subsidy payment mechanisms, to fairly compensate the losers?

Currently there are several 'layers' to the railway industry, each of which wishes to make its own profit. Fares are, in part, regulated by OPRAF, Railtrack charges are, in part, regulated by the Rail Regulator. Other parts are unregulated, competition being relied upon to keep charges down (largely unsuccessfully in the case of the ROSCO's). What needs to be done to ensure that the profits of the rail industry as a whole are divided fairly between the ultimate consumer, the taxpayer and the shareholders of the constituent parts of the industry?

The Regulator is currently reviewing infrastructure access charges. Infrastructure costs are about half of the total costs of the railway industry and the major part of these infrastructure costs are, in reality, paid for by the taxpayer through the intermediaries of the TOC's. Therefore, the way in which charges for the use of infrastructure are raised can have a significant effect upon the success or otherwise of government transport policy, and there is a need to structure and regulate access charges to forward the Government's avowed objective of carrying more traffic by rail. But, how can this best be done and what role could the structure of subsidy payments and their application to various parts of the industry play in this?

Local Transport

A previous government favoured a policy of subsidising stage 'bus services and non-intercity train services only. Interurban passenger services and rail freight services were ostensibly deprived of subsidy. (Privatisation ditched this policy so far as InterCity train services were concerned.) Road congestion is predominantly a local and localised burden. Are the present methods of subsidy to public transport and payment for infrastructure - road or rail - sufficiently discriminatory and what should be done to these arrangements to make them more effective in tackling road congestion?

Local authorities are expected to play a big role in forwarding the Government's transport policy. Which local authorities ? Regional authorities, unitary authorities, more PTE's ?

Inter-Modal Competition

The separation of rail infrastructure from operations gives the opportunity to devise a (more) level playing field for road and rail, public and private competition. The role of infrastructure charges in this has already been mentioned. Can social costs be brought into the equation? The EEC tried in the

1970's, but failed, largely through member states demanding 'balanced budgets' for the (publicly owned) public transport industries.

The company car is responsible for a major part of the uneven playing field between public and private transport. Could company car taxation be changed so that companies are (financially) encouraged to substitute public transport provision for company car provision?

We are promised a Strategic Rail Authority to re-integrate the railways, but only a vague sort of commission to integrate transport of all modes. What sort of powers should such a commission have ? How does one compensate those parts of the (largely private) public transport industry which might suffer from pursuing a corporate good?

Don Box

RAILWAYS

by Stephen Bennett

There have been a number of publications concerning mainline railways since the last issue of the Journal that will be of interest to transport economists.

The Government's White Paper: *A New Deal for Transport*, the first major review of transport policy since 1977, was published in July 1998. The paper contains proposals for the creation of a Commission for Integrated Transport and a Strategic Rail Authority (SRA), which is to tidy up the overlaps between the Rail Regulator and the Franchising Director. The Office of Passenger Rail Franchising (OPRAF) will be absorbed into the SRA and the role of the Rail Regulator will be reduced as the SRA will take over his consumer protection functions. The new authority will advise on policy and, in addition to administration of the OPRAF grants, will have access to public funds to increase freight on rail and invest in additional capacity for passenger rail services.

Progress in implementing these proposals has not been impressive. It is now unlikely that time will be provided in the 1998/9 Parliamentary session for legislation to create the new structure set out in the White Paper. Meanwhile, the Deputy Prime Minister has invited industry leaders to a meeting at the end of November to see what can be done in the interim. His decision not to renew the contracts of the Rail Regulator, the Franchising Director and the Chairman of the British Railways Board has compounded uncertainty upon indecision. The above needs to be put into context. Professor Bradshaw reminded members earlier in the year (see the Summer edition of the Journal) that the biggest opportunity for change will not be until 2003 or 2004, when passenger franchises are due for renewal and new criteria could be considered.

The Government's *Transport Statistics Great Britain* was published at the end of September 1998. There was also a new sister publication, *Transport Trends*, but this gives little or no insights into railways. The tables for public subsidies and grants to railways show significant changes:-

£ million	1993/4	1994/5	1995/6	1996/7	1997/8
Passenger	1,092	2,161	2,074	2,100	1,804
Freight	4	3	4	15	29

Passenger grants, having risen in 1994/5 to accommodate the new industry structure, show for the first time the effect of the gradual halving of grant over five years accepted by bidders when franchises were let. In the case of freight, financial support enabled by the 1993 Railways Act, does appear to be coming through at last at a meaningful level.

Demand for passenger services has increased and has nearly reached the 1988/9 peak of 34.3 billion passenger kilometres. Passenger receipts before grant have increased in real terms, but the policy objective of progressive real pricing under the previous Government can now be seen to have been moderated by the Franchising Director:

PASSENGER	1993/4	1994/5	1995/6	1996/7	1997/8
Demand Passenger/kilometres (billion)	30.4	28.7	30.0	32.1	34.2
Receipts 1997/8 prices (£ billion)	2.42	2.35	2.52	2.64	2.85
Unit Prices Receipts/Demand (£)	0.80	0.82	0.84	0.82	0.83

In consequence rail registered its first increase in national modal share for passengers, up from 5% in the years 1993 to 1996, to 6% for the year 1997. In March 1998, OPRAF announced that five of the ten London commuter operators were at or over the Passengers in Excess of Capacity (PIXC) limit, which has triggered negotiations to agree action plans to ameliorate official overcrowding.

Freight volume has also improved, although the product mix has changed with a move out of traditional traffics such as coal, often conveyed over relatively short distances, to other commodities, some new to rail:-

FREIGHT	1993/4	1994/5	1995/6	1996/7	1997/8
Freight Tonnes (million)	103.2	97.3	100.7	101.7	105.4
Tonne/Kilometres (billion)	13.8	13.0	13.3	15.1	16.9

An indication of the improved prospects for freight has been the profitability of Freightliner, which transports containers on rail. The company reported a pre-tax profit of £2m in 1997/8 compared to a loss of £5m in 1996/7 and a loss of £20m in 1995/6, the last year in public ownership.

In July 1998, the Franchising Director published the *OPRAF Annual Report for 1997/8*. This was the first report to cover a full year with all passenger franchises in the private sector. The report contains detailed appendices about each of the 25 franchises as well as tables covering grant payments and performance statistics.

In the year 1997/8, OPRAF paid out £26m in incentive payments and received £13m in penalty payments: a net payment of £13m under the terms of the performance regimes operated by OPRAF. Critics have suggested that franchise holders are insufficiently incentivised to improve performance. The above figures on a combined operator turnover of £4,650m (£2,846m receipts plus £1,804m grant) are indeed very small.

In comparison, Railtrack received £99m net from customers and paid out £48m net to suppliers on a turnover of £2,467m in 1997/8 under the terms of its performance regime. It is no surprise, therefore, that the largest share of improvements in performance since privatisation have been attributable to Railtrack.

OPRAF now publish quarterly details of train performance, the latest of which covers the second quarter (summer 1998) to mid-September. Sixty-four groups of services are monitored. Compared with the summer of 1997, punctuality declined on 43, was unchanged on three and improved on nineteen. This lack of progress was on top of the 1997/8 annual result, which, compared to 1996/7, showed a fall in punctuality on 35 groups and improvement in only seventeen. It appears that the dramatic improvements achieved in 1996/7 upon 1995/6 and earlier years might have faltered.

The OPRAF annual report provides a useful analysis of the seasonal characteristics of train performance, whereby the majority of penalty payments fall in the autumn and net bonuses are paid in the other three-quarters. This suggests that there is an opportunity for the industry, in the short term, to capitalise upon Railtrack's investment in equipment, to make improvements in the third quarter.

In the longer term investment in new rolling stock is seen by the industry (Ivor Warburton, Chairman of the Association of Train Operating Companies (ATOC), *Financial Times*, 4 November 1998) as the best strategy to deliver better performance. The Franchising Director, in his annual report, comments that commitment exists to procure new vehicles amounting to 20% of the current fleet at a cost of around £2 billion and to refurbish a further 40%.

In some instances commitments have been made in exchange for franchise extension, although it is unclear if the Government is prepared to continue with this policy. A proposal by Connex Rail was rejected and a new one is being prepared by Great North Eastern Railway and Railtrack (*Guardian*, 6 November, 1998). These developments illustrate the problems created by the award of short-term franchises, some as short as seven years, where assets have much longer economic lives.

In July 1998, the *Rail Regulator's Annual Report for 1997/8* was published. The Regulator found that accurate and impartial retailing of the rail product (passenger fares and journey information) was only being achieved on average 90% of the time, but he has yet to impose standards or enforce improvements upon the industry. On the other hand he imposed fines of £350,000 upon the telephone enquiry service run by ATOC and is currently considering fines of up to £500,000 in this financial year.

The Office of the Rail Regulator (ORR) has concluded that a balance has to be drawn between the potential benefits of innovation and pricing from on-rail competition and the potential dis-benefits of cherry-picking and price-wars. The result is that limited competition was initiated from April 1998 for introduction in the winter 1999 timetable, subject to the regulatory test of an overall benefit to passengers.

The future role of the Rail Regulator will be heavily weighted to the economic regulation of the sole owner of the rail network, Railtrack. ORR began the periodic review of Railtrack's access charges in December 1997 with the publication of its *First Consultation Document*, which is going to be a long drawn out affair given that the new prices are not due to come in until April 2001. This was followed in July 1998 by publication of the *Second Consultation Document*, where it was decided to regulate Railtrack following standard UK utility methodology and to concentrate upon corporate finance issues first (rate of return and evaluation of the regulatory asset base).

Railtrack published its *Response to the Regulator* to consultees at the end of September 1998. A possible result might be that there could be agreement to a cost of capital close to the current 7.5% real, although the treatment of taxation is proving a technical problem. The major difficulty, however, is in reaching agreement on the value to be assigned to the asset base. There is agreement that market rather than accounting values should prevail, but share prices have not stood still and give a valuation from £2 billion to over £8 billion.

In September 1998 Railtrack issued details of a *Proposed Acquisition of Section 1 of the Channel Tunnel Rail Link* to shareholders so that it could be approved at an Extraordinary General Meeting on 28 September. Approval was given to purchase Section 1 for £1.7 billion (£1.5 billion plus £0.2 billion LCR debt). This was a particularly attractive offer to shareholders as there was substantial underwriting from Government and access charges for the new line are not to be subject to regulation by the Rail Regulator under the Railways Act.

This development is linked to the valuation of the regulatory asset base (RAB), which now has to exclude the Channel Tunnel Rail Link (CTRL). It is likely that share prices in 1998 will have reflected potential unregulated activities such as the CTRL, so the RAB will probably be settled at around the £4 billion level. This assumes that ORR move from their opening offer of £2.5 billion, which contended that political uncertainty ended at the close of the first day's trading in May 1996. This is very unlikely given that Railtrack alone amongst privatised utilities had the benefit of a periodic price review before privatisation: political risk, therefore, is the only remaining major factor at play in price movements in the first year.

The Rail Regulator is also consulting the industry about the possibility of restructuring passenger track access charges so that a larger proportion than the current 8% should be variable with output and a smaller proportion fixed. Railtrack sees potential benefits from taking a larger share of risk in the success of the industry, although some shareholders might be a little nervous about the timing of this initiative.

Throughout much of 1997 and 1998 the Rail Regulator has been concerned about the level of expenditure upon renewal and investment in the rail network. In the absence of comprehensive agreed output measures, expenditure has been adopted as a proxy measure. In July 1998 the *Railtrack Annual Report and Accounts for 1997/8* provided the facts. These were contained in the supplementary regulatory information (not provided at Interim), which are free of the accounting provisions endemic to the main accounts. Key figures were:-

£ millions	1995/6	1996/7	1997/8
Maintenance	725	732	702
Renewal	600	821	1,038
Backlog	8	28	63
Enhancements	202	170	243
Total	1,535	1,751	2,046

The reduction in maintenance costs has arisen from in-built productivity measures in existing contracts and re-tendering of contracts as they come up for renewal. Maintenance expenditure in 1997/8 was about £60m lower than forecast when the Regulator set access charges in January 1995 and renewal expenditure some £370m higher (order of magnitude estimates by the reviewer). Backlog expenditure upon stations, however, left £351m of the 1994 provision of £450m still unutilised. Overall, though, Railtrack is in the unusual position of a utility facing a periodic price review having spent more, not less, than allowed for when prices were last set.

However, it is unlikely that track access charges will be considered the most important issue for the industry as a whole, if for no other reason than the results of the periodic review will go straight to the tax payer via a cost pass-through mechanism in the franchise agreements.

The major issue for the industry remains that franchise bids were predicated upon strategies of growth, which will be difficult to sustain if the prospects for the national economy deteriorate. Problems are compounded by the fact that operators have only some 38% of their costs under their direct control (the balance is made up of track access charges and rolling stock lease hire charges). Their freedom with regard to pricing is heavily constrained by OPRAF and the level of subsidy is reducing by about 10% a year, although those with revenue sharing arrangements with Passenger Transport Authorities might find the going a little less difficult than others. By the time the Strategic Rail Authority is established the task might not be, as currently envisioned, how to attract more customers to rail, but how to keep the industry afloat in times of difficulty.

TEG NEWS

MEETINGS 1998/9

Meetings will be held at 5.30 for 6pm in room 205 of the Transport Studies Group at the University of Westminster, located at 35 Marylebone Road, London NW1 5LS. The building is on the south side of Marylebone Road, close to Baker Street Underground Station and is passed by numerous buses.

December 16 **Highway Capacity Reduction: a draft guide to best practice**
Peter Bonsall, Institute of Transport Studies, University of Leeds

January 27 **Setting Road Traffic Reduction Targets in London**
Michèle Dix, Director, Halcrow Fox

March 4 *NOTE: CHANGE OF DATE AND VENUE*
A joint meeting with the Institution of Civil Engineers, London Association to be held at 1 Great George Street, London SW1:

How schemes on Red Routes are evaluated
Martin Lawrence, Senior Consultant, Oscar Faber

March 24 Returning to University of Westminster
5pm: ANNUAL GENERAL MEETING

6pm: **Bus Quality**
Malcolm Roberts, Colin Buchanan & Partners

April 28 to be confirmed

May 26 **London River Services**
Andy Griffiths

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ADDENDUM

Please note that the talk on Company Car Policy given in May was based on a paper presented by Sinead Flavin to the Universities Transport Study Group Annual Conference in January 1998.

IMPORTANT - PLEASE NOTE:
Details of December 16 meeting on page 39
Highway Capacity Reduction: a draft guide to best practice
Peter Bonsall, Institute of Transport Studies, University of Leeds