RAILWAY REFORM

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April 1999

CHINTAN Policy paper No. 7a

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Any views expressed in this paper are those of the author and should not be attributed to the organization for which he works.

** Elements of these reforms were first proposed in 1993.

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1 INTRODUCTION

1. In the early days of development it was assumed that private entrepreneurs & firms were unwilling or unable to undertake investment in and production of many goods and services. This assumption has long since become invalid. The role of government must therefore change from being an entrepreneur, investor and producer of goods & services, to an enabler and facilitator of development. It must continue to fund the provision of Public goods and provide for the correction of externalities and the basic social safety net. It must catalyse the building of institutions & markets where these do not exist. But it need not produce all these services itself.
2. In this context the existence of the mammoth National Railways within the government as a departmental undertaking whose financial accounts are part of the National budget is a complete anachronism. The fiscal problems faced by the government also means that there not enough funds available for investment in crucial areas of safety and security.
3. The poor quality and relatively high cost of basic infrastructure services is the greatest source of competitive disadvantage to Indian agriculture, industry and services. It is also a major source of aggravation to the hapless consumer, who regularly faces the arrogance and arbitrariness of the employees & management of public monopolies. The nominal price is not a major issue save in exceptionally distorted cases. The effective cost of infrastructure services is far greater than the nominal price charged because of poor quality. For instance the appalling frequency of major railway accidents and inadequate signalling & safety equipment on railways. This disastrous situation is the result of five decades of absolute public monopoly and continuous interference in pricing by populist politicians.

2 POLICY FRAMEWORK

2.1 Price Controls

4. Prices of Railway services (as of all public utilities) must be de-controlled and subject to independent regulatory authorities whose objective would be to protect the long-term interests of consumers. The current consumers of power and other public utilities are now paying the cost imposed by price controls and public monopoly on new investment and the quality and quantity of production.

2.2 Regulator

5. The railway tracks along with signalling equipment constitutes (like all networks) a 'natural monopoly.' All infrastructure sectors, which have 'natural monopoly' segments, require a regulator. There must be a law for regulation of the railways that provides for an autonomous and independent railway regulatory authority (RRA). An independent regulatory regime would have to be set up expeditiously. The RRA must have full authority over pricing of 'natural monopoly' elements and over the conditions & quality of supply. The regulator should however refrain from setting prices in segments where there is scope for sufficient competition.

6. Prudential/ technical registration and licensing should be completely under the purview of such authorities. They should be made financially independent by allowing them to charge regulatory fees for running the regulatory system. Existing regulatory authorities should be brought to this level of autonomy by changing the law. Training should also be provided to staff to bring them up to global standards. Technical assistance and co-operation should be facilitated.

2.3 Network Access

7. The regulator must ensure interconnection & access to all new rail companies to the 'natural monopoly' rail track network. This access must be on the same terms and conditions as those available to the Owner Company. In particular it must be non-discriminatory vis-à-vis the historical monopolist.

2.4 Network Companies

8. Pricing of the 'natural monopoly' networks and ensuring fair access to this network by new competitors is the most difficult job for the regulator. This job is greatly facilitated if the natural monopoly network or segment is separated from other segments (e.g. generation) and the service provision functions. The two can be made into separate companies, with the former (network company) made a subsidiary of the latter (main company).

2.5 Investment De-licensing

9. Public utilities like Railways are vital for production, employment, growth and social welfare. The poor quality of our infrastructure is directly due to the public sector reservation policy, which has created unresponsive monopolies. This along with price controls has led to large supply gaps.

10. Complete investment de-licensing is necessary to ensure that the public users get the full benefits of competition. Global experience is that the monopoly provider, who has the incentive & the means, works to undermine competition. The regulator with the support of the users must actively thwart the monopolist in the interests of the public. Essentially competitive segments such as provision of railway service can then have level playing field and actualise their competitive potential.

11. Monopolistic inefficiency has imposed a heavy cost on the international competitiveness of our manufacturing and service industry. As a result manufactured exports have suffered and service exports are likely to be stunted unless urgent steps are taken. All these infrastructure services must be de-licensed, and a level playing field provided to encourage new private companies to compete in providing all infrastructure services.

2.6 User Charges

12. Many public monopoly services have been priced either on the principle of 'what the traffic will bear,' or on the assumption that the government will underwrite whatever losses are incurred. This approach is a recipe for disaster, as already exists in the power sector in terms of low & highly variable availability and equipment destroying quality. It is essential to move to cost based pricing of infrastructure services to generate sufficient resources for quality production. It is also critical for generating finances for the investment needed to reach and sustain an economic growth rate of 7% to 8%. Higher infrastructure growth is in the long term interests of the common man both as a consumer and as worker.

2.7 Fees, Taxation & Subsidy

13. License fees are a disguised form of taxation and should be replaced by an explicit tax. These can then be set in the context of the overall tax system so as to minimise distortion and optimise revenue collection. The regulator may also charge nominal (regulatory) fees to generate funds for its maintenance and functioning. These should be viewed as charges paid for the provision of regulatory service.

14. Prices must reflect the full cost of production if investment, growth and quality are to be maintained. This must be supplemented by moderate taxes as in the case of other goods and services. The levy of license fees

either in addition to this or in lieu of full cost pricing distorts the system. There should not be any other license fees or revenue share requirements on private railway companies.

15. A cross tax-subsidy mechanism can be used to fulfil minimal social objectives. “Subsidy auctions” can be used as a mechanism for servicing remote and sparsely populated areas such as the North-East.

3 INDIAN NATIONAL RAILWAY

3.1 UNBUNDLE

16. The production and service provision functions carried out by government departments such as Railways, need to be removed from government. Governmental rules and procedures (including CAG audit) are not conducive to quick decision making and commercial risk taking. Departmental enterprises should therefore be converted into public companies with professional boards. Technological developments over the last two decades have made it possible to un-bundle the ‘natural monopoly’ segments of infrastructure from the rest. In general there are three parts to an infrastructure department enterprise, namely production of goods used in the sector, the ‘natural monopoly’ segment (e.g. rail track, telephone/telegraph line) and provision of services. Each of these segments should be dealt with separately.

3.2 NON-CORE ACTIVITIES

17. The production units of infrastructure departments and the defence production units producing civil goods should be sold to the private sector. Telecom and Railways should focus on their core business by selling to the highest bidder, captive units producing equipment and parts.

This will ensure full exploitation of economies of scale, while imports provide potential competition in supply. Peripheral services, not related to the core infrastructure service, could also be privatised.

18. In many countries across the world railway-stations are an attractive and profitable commercial hub with retail outlets, restaurants, entertainment and department stores. Our metropolitan stations are more likely to be dirty and stinking with nooks and crannies used as urinals or garbage dumps. The only way to achieve international standards under the current circumstances in India seems to be by giving out stations in metros and large cities to the private sector on long lease or other methods such as BOLT and BOOT.

3.2.1 Communication Network

19. The railways also run a long distance communication network. With the opening of long distance communication to competition in 2000, this could either be sold to the private sector or be spun-off into an independent company with 26% government holding. This company would then be unshackled to exploit economies of scale, and supply communications services to other organisations besides the railways.

4 NETWORK & SERVICE COMPANY

20. The 'natural monopoly' segments and service provision should be converted into separate companies, which can be termed the 'Network Company' and the 'Service Provider' respectively. The network companies must operate on the 'public carrier' principle, subject to independent regulatory supervision, which ensures that all 'service providers' especially new entrants have equal and fair access to the 'natural monopoly' network at non-discriminatory prices. Over time, up

to 74% of the equity in ‘network companies’ and up to 100% of the equity in ‘service providers’ should be sold to the public. Investment must be fully de-licensed, with no artificial barriers. It is only through free private entry and competition in providing all services that the gains from technological change, economies of scope and productivity improvement can accrue to the public.

4.1 RAIL TRACK CORPORATION

21. In the case of the railways it is the railway lines and related signalling equipment, which constitute the ‘natural monopoly’ network. These could be converted either into a single Railway track corporation or into four regional and one trunk line (inter-metro) corporation. The service functions could correspondingly be constituted into either two transport companies (for goods and passengers), or into four regional and one inter-metro transport company. If five companies are formed each track corporation could be a subsidiary of the corresponding service-company.

5 RAILWAY REGULATORY AUTHORITY

22. An autonomous and independent railway regulatory body must be formed so as to ensure the public interest including passenger safety, and to ensure that new entrants have access to the railway tracks on the same terms and conditions as the government railway transport companies. Entry of private companies into the provision of railway transport services would be freed. The laying of new tracks would also be freed from investment licensing. All companies would have to register with the regulator so that it can ensure that they follow the safety, interconnection and other rules.

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** Copies of these papers can be obtained by sending an e-mail to DrAVirmani@hotmail.com.

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