Competitors Report 2015/2016: German rail sector's growth depends on competitors' development

1 Key facts and figures in a nutshell

Level of competition

Since the publication of the previous (2013/2014) edition of the Report on Competitors in the German Rail Sector, the level of competition on Germany's railways has intensified further. The number of players competing with state-owned enterprise Deutsche Bahn (DB) AG has continued to grow, the range of services offered by them has expanded, and the quality of these services has improved, although often DB with its virtual monopoly still dominates the scene. If policymakers really want to see more competition and a wider variety of providers operating on the German rail network, further – and in some cases more vigorous – efforts will need to be made by political decision-makers at European and domestic levels.

The market volume of operating performance rose in 2015 to an all-time high of some 672 million train-kilometres, equivalent to a 5% increase within the space of four years. In the course of 2015, the market share of the competing railway undertakings (RUs) grew from 27.1% last year to 29.3%. Meanwhile, the degree of market openness increased from 51.8% in 2014 to 60.2% – a percentage that rises still further to as much as around 73% if we also include all the services that have been awarded but not yet commissioned.

Notwithstanding the competing RUs' successes, they are not yet operating on a level playing field: in the most lucrative sub-segment, namely local rail passenger transport (i.e. the S-Bahn suburban railways), DB AG continues to rule the roost – as shown by the fact that passenger numbers are expected to go up precisely in those agglomerations where it is virtually the only operator. By contrast, in some rural areas where a lot of companies are competing for business, a decline in these numbers is forecast in the longer term despite an improved service offering.

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No progress has yet been achieved in the field of long-distance rail passenger transport, which has to be provided without receiving any subsidies. Here, DB Fernverkehr AG (the subsidiary of Deutsche Bahn specialising in long-distance rail services) still has a market share of more than 99%. Since the year 2000, there have been 10 attempts by other companies to join the market. Of these, only three services (the Berlin Night Express, the Harz-Berlin-Express and the Hamburg-Köln-Express (between Hamburg and Cologne)) are still running, while the InterConnex service, operating between Leipzig, Berlin and Warnemünde, has been suspended and the Vogtland-Express was switched to a coach service in October 2014.

Indeed, recently the only part of the long-distance public transport sector that has experienced strong growth in terms of both competitor and passenger numbers has been the long-distance coach market. In the first year of market liberalisation (2013) alone, 6.7 million passengers, many of whom might have taken the train in the past, used long-distance domestic coach lines. Following a rise to 16.7 million passengers in 2014, the BDO German coach operators' association is estimating that numbers will reach 30 million a year by 2020.

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However, the level of competition on the railways in terms of freight transport is on an upward curve. While DB's haulage capacity in this domain in 2014 did not even come to 2002 levels, from 2002 to 2014 the competing RUs managed to increase their haulage capacity from 3 billion to 37.8 billion train kilometres, i.e. by more than a factor of 10, meaning that one third of all goods trains in the German network are now operated by a rival to DB Schenker Rail. It is worth noting in this connection that in just one year the competing RUs succeeded in expanding their market share by as much as 4.5% to 33.6%.

Having said that, this development is no sure-fire success story. The non-state-owned rail operators too have to fight very hard in the face of intermodal transport competition. For some time now, the cost differential vis-à-vis road haulage has been growing. Low diesel prices combined with falling toll levels for trucks and increased levies applying only to rail transport so as to, for example, fund the energy revolution in the power generation sector are making it difficult to achieve the policy goal of shifting traffic onto the railways. In this context, the slight decrease in rail's market share of freight transport is a real wake-up call.

EU policy: Supporting the development of integrated RUs rather than increasing the level of fair competition

The EU's Fourth Railway Package once again does not question the existence of integrated state-owned undertakings. Yet the success of the regulatory system that has been put in place to act as a corrective mechanism to support the market relies on being able to fully identify and regulate company-internal dependencies and cash flows. In this light, significant improvements still need to be made to the Railway Regulation Act when it is discussed in both houses of the German federal parliament, so as to meet the goal of ensuring fair competition.

Infrastructure: Appropriate priorities and stable funding

In a welcome development, a basic pillar of infrastructure funding, namely the Performance and Financing Agreement II (LuFV II), has been conceptually refined and its resources beefed up by €8 billion to €28 billion for 2015-2019. However, there is no cast-iron funding guarantee, as substantial DB profits are included in this total but it is unclear whether these will actually materialise, given that for the most part they can only be realised by further significantly raising train-path prices, a move that would be counterproductive in terms of the attractiveness of rail transport.

According to the 2015 German Federal Transport Infrastructure Plan (BVWP) which is currently in preparation, the construction and extension of railway infrastructure will rightly focus on existing bottlenecks. Unfortunately, there are too few high-priority projects which could benefit both rail passenger and rail freight transport and which are set to be realised on schedule. This also applies to third-party infrastructure, including shippers' connections and combined transport, for which insufficient funding is currently available.

The expected increases in engineering works will have an adverse effect on both performance and quality of service, but there is no alternative. As a result, the RUs must be protected from losing traffic by means of more effective coordination and communication of the plans for these works and a lower burden of charges on the part of the network operator.

Need for the train-path pricing system to become a lever for more rail traffic

The draft new train-path pricing system (TPS 2017) is based in principle on the absorbed costs of the rail network. In the final analysis, the prices applying from the start of 2017 will be equivalent on average to the current train-path price level plus an annual increase of around 2.5%. The federal government would like to see a link being established between the future development of train-path prices in local rail passenger transport and the development of regionalisation funds (meaning probably a 1.8% increase per year). This could cause the train-path prices for long-distance rail passenger transport and freight transport to rise disproportionately so as to avoid hitting the financial results of DB Netz.

From an economic perspective, objections could be raised to the fact that the train-path prices adopt an absorbed-cost approach, rather than being based on marginal costs (a possibility that arose in the recast legislation). Lower train-path prices would boost intermodal transport competition.

Improving noise control – competing RUs doing their bit

The target of halving railway noise by 2020 is a key goal in terms of noise control and increasing the public's tolerance of rail transport. The competing RUs are now fitting their rolling stock with silent brakes – a measure they will gradually be extending further. It is also vital that the federal government plays its part in the drive to control noise levels and takes action to ensure that the infrastructure on lines with a high level of noise pollution provides active noise control. Measures such as bans on certain trains running and speed restrictions make no sense if the appropriate adjustments are not made to the rolling stock at the right time, as such changes have a damaging impact on rail freight transport in general and reduced speeds also affect RUs that already adhere to the relevant requirements.

Traction power: Non-discriminatory access not yet a reality

Again, regrettable delays have been encountered in providing non-discriminatory and efficient access to traction power to other power suppliers. As a result, the non-state-owned rail transport companies have had to once more report the former monopoly holder DB Energie GmbH, which was only forced to open up its power grid as late as 2014, to the Federal Network Agency.

Overhaul of regionalisation funds: A case of a glass half full or half empty?

On 15-16 October 2015, the two houses of the German federal parliament adopted the third law amending the Regionalisation Act, representing the first step to resolving the protracted impasse the competent authorities, RUs and customers have been facing. The regionalisation funds of the federal government will be raised from €7.4 billion in 2014 to €8.0 billion in 2016 and will continue to be maintained from 2017 onwards with a moderate increase of 1.8% per year. Both these values are below the required level calculated by the federal states and the federal government expert. As a consequence, whereas some degree of expansion in the local rail passenger transport service offering as an alternative to road transport is conceivable, at least in a few western German states, the eastern German states in particular will have a fight on their hands to even keep the existing services.

A problem that remains unresolved for the time being is the wrangling that goes on between the states when it comes to deciding on the distribution of these resources: a matter which is meant to be governed by the so-called "Kiel key" and which currently has to be settled by means of an ordinance that has to be passed by the upper house of the federal parliament, the *Bundesrat*. A bone of contention here relates to situations where there is a breach of the agreed ratchet mechanism (a minimum annual increase of 1.25% for each state) from the relevant decision by the Conference of Transport Ministers (VMK) held on 1 and 2 October 2014, with this being linked to €8.5 billion in funding and a dynamism rate of 2.8%. It is hoped that the old federal states will back down, as if they adhere to the ratchet mechanism, they clearly stand to gain – and are also in principle entitled to – €12.7 billion in any case, thereby sparing the new states cutbacks and averting hard times for the RUs in eastern Germany.

To what extent the increased nationwide resources will bring about lasting success will depend on whether and how an effective brake is put on the rise in infrastructure charges – a challenge that the declarations of intent to date have been completely inadequate in addressing.

The forced transfer of personnel – a financial buffer for DB AG under a social-policy pretence

Recently, DB AG has been trying, in conjunction with the EVG trade union, to pressure the competent authorities and political decision-makers into making the transfer of its personnel in the event of a change of operator a legal requirement, on the grounds that DB Regio suffers from a disadvantage of more than 10% when it comes to personnel costs in comparison with its competitors.

The results of many tendering procedures demonstrate that this claim does not hold water. Nor could this be plausible either, considering the substantial hedges in the sectoral and company collective agreements. In fact, the market leader's cost issues lie elsewhere, e.g. in its overheads.

Ultimately, we find ourselves in agreement with the Verkehrsverbund Rhein-Ruhr (VRR), an authority that is competent for local transport, when it says that DB Regio's demand for the transfer of personnel to another operator to be made a legal requirement aims *"to provide a way of offloading its personnel costs onto the RU that has won the contract and preventing fair competition, under the pretence of social responsibility"* or, as one competitor pithily put it, to use this situation as a way of slimming down. By contrast, the competing RUs are open to transfers of personnel among themselves as the costs of their staff are similar.

Healthy pressure from the coach sector forces the long-distance rail passenger transport industry to place more focus on competition

In 2014, the coach sector increased its market share of domestic long-distance public transport by around 10%. What competitors within the long-distance rail passenger transport industry had failed to do in 20 years, the coach sector managed within two years of market liberalisation. DB AG's long-distance transport division has come under pressure and needs to undertake a radical overhaul of its price/performance package.

DB AG has announced its intention to respond to this challenge with "the biggest customer relations offensive in the company's history". Its plan is to increase the frequency of ICE trains between the agglomerations to one every half-hour and restore better connections within "areas" (meaning smallish regional centres and attractive medium-sized cities). However, what can be made out of the plans so far leaves a lot of questions unanswered, for example in terms of the time-scale involved, as their rollout is only meant to be completed by 2032. Any such effort would, however, be pointless if there were to be a continued requirement that performance targets be based on a 14% return on investment.

The impression that the Board of Management's masterplan may be founded on a desire to socialise the costs of the unprofitable part of the long-distance transport business arouses scepticism. Such subsidy-based models are already being used for various routes (Bremen – Norddeich; Rostock – Stralsund) or a decision has been taken to apply them (Stuttgart – Zurich; Erfurt – Gera). One uncontroversial idea is to redraw the line between local and long-distance transport or to do away with this distinction altogether and where appropriate expand the socioeconomic share if the resources were tailored accordingly. What is unacceptable though are DB AG's attempts to get subsidies introduced for existing long-distance rail passenger transport services that have not received them up to now, while ruling out competition in this area.

The report is available from the associations both in printed form and online at the following addresses:

- www.netzwerk-bahnen.de;
- www.mofair.de

The Network of European Railways (Netzwerk Europäischer Eisenbahnen e.V.) and mofair e.V. represent the interests of competing transport companies in relation to passenger and freight transport by road and rail. Their main goals are to establish fair conditions for competition and to ensure the provision of high-quality transport services.

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