SPECIAL REPORT: MARKET PRICING

‘Live with complexity - enjoy it’

Sir Roy McNulty wants the government to look at making fares more simple, but Michael Schabas uses international comparisons to argue that we should embrace complexity. Robert Jack reports.

A common complaint is that rail fares in Britain have become too complex. And Sir Roy McNulty, author of the influential study on rail value for money, has added his voice to those calling on the government to look at how they can be simplified. He also believes that steps have to be taken to increase train utilisation in Britain, pointing that load factors here are much lower than elsewhere in Europe.

But Michael Schabas, an economist and a transport entrepreneur, takes a different view. He told a conference on rail fares last month of his belief that on fares, pricing and efficiency, McNulty has got it “very wrong”.

While Sir Roy was carrying out his study for the British government, Schabas, a Canadian, was also advising a government on how to get the most out of its railway - the Chinese government. The Chinese were concerned about flagging revenues on their high speed trains and Schabas was asked to look at what they could learn from European fare pricing models. What he discovered cemented his opinion that the often malign British system actually works rather well.

“The first thing you have to ask is: what's the point of having fares? And I'm not sure McNulty has actually thought that through very carefully,” said Schabas told delegates at the Passenger Transport-sponsored Regulation in Rail freight: Rail Freight at a Crossroads? conference in London, organised by First Class Partnerships and Waterfront.

“[McNulty] comes from industries where you have a fixed output - air traffic control - or totally market-driven - manufacturing airplanes - and I don't think he really understands that in the rail industry you have to think a bit more about why you charge fares.”

In China, a socialist country, the fares and the output are set by the central planning organisation, the National Development and Reform Council. But their preferred tariff-pricing model, where all travellers pay the same price, based on average cost, tries to please everyone but fails to appeal to huge swathes of the population.

In terms of quality, the Chinese high speed rail network is as good as any in the world, and services now link all major cities, but loadings are poor and the lines are not being used intensively. At 600 miles in length, the high speed line between Shanghai and Beijing is the world's longest high speed railway. The first train departs Shanghai at 7am and is always sold out, but by 10am the hourly trains are already leaving half-empty. The reason is that the five-hour journey costs 50 dollars, but the sleeper train, which takes eight or nine hours, costs 30 dollars - the difference is what the average Chinese person earns in a day.

The fares are too high for most of the population. Meanwhile, the business traveller, who is willing to pay 50 dollars to fly from Beijing to Shanghai, is often unable to board the popular morning peak departures because tickets have sold out (there is no option to pay a premium for a last minute booking). Furthermore, for safety reasons the journey speed on the railway is restricted to a maximum of 160mph rather than the 230mph it was designed for, which makes the train less competitive with air travel. Schabas doesn't think that safety is the real reason: “I think it has to do with the fact that when you don't have market pricing, there's no point running trains fast - there's no money in it. There's no point running them frequently, or fast.”

The remedy, Schabas believes, is to introduce market pricing. By charging the business people more it is possible to provide them with the speed, frequency and flexibility that they desire. Meanwhile, offering discounts where capacity is available can put fares within reach of those who were previously priced off by the flat 50 dollar tariff. Everyone wins.

As a nation run by engineers, Schabas says that the Chinese are fixated on load factors, but he believes that this approach is wrong.

“That's what they think is efficient,” he explained, “and that's what McNulty seems to think is efficient. He seems to think French trains are better because they carry 500 people in every train and the British trains only carry 500. I read this and I think - So, the best way to improve the productivity of British railways is to devolve Scotland, because we'll actually just by that move, increase the per train load by about 50 passengers.'

"If you do the sums, I don't think he's really thought that one through."

Train frequency and capacity is best determined by price signals, Schabas argues. "Why does the West Coast Main Line run three trains an hour between Manchester and Birmingham? Is it because of capacity or is it because of pricing? And what's the point of high frequency if everyone is on advance purchase tickets paying £200? Not much, but that third train an hour must bring some extra people who pay £200 a ticket," he reasoned.

"There's nothing wrong with that and I don't think McNulty gets that. When you see fares are 30% higher on average in Britain than they are anywhere else in Europe, that's not necessarily a bad thing. What can you pay if you want to? ‘You're ultimately trying to maximise net social benefit and that's a concept that is..."
"There is no right way to charge, but it is better to be approximately right than exactly wrong" Alfred E Kahn

sometimes a bit hard to prove.”
Tariff pricing worked for railways when they were monopolies and there was no
competition from motorways and airlines, said Schabas, but not today. Nevertheless,
most railways around the world still stick with
tariff pricing.

Britain and France are the only two countries that have truly embraced market pricing.
Germany’s Deutsche Bahn doesn’t really have
it, although it will be used by its new rival, the
new Hamburg-Köln Express (HKX) open
access operation, which Schabas is behind.

“We’re cream-skimming, or are we
bottom-skimming?” be mused. “We’re
going to be offering market pricing, but we
won’t be aiming to maximise anything other
than our own profits.

“We’ll be in a competitive environment, but
we do hope to get 80% load factors and charge
lower fares than Deutsche Bahn, because
otherwise we won’t get people.”

But while Schabas and his partners will be
using marketing pricing for HKX, he admits
that nobody really understands it exactly.

“You can talk to people in the airlines and if
they know what they’re doing they are keeping
quiet about it for commercial reasons,” he
said. “I think it’s as much art as science and it’s
probably going to stay that way for a long
time. It’s probably one of these intractable
problems. It’s a field that academics could
spend decades at. Alfred E Kahn was the guy
who deregulated the US airline industry, had a
good quote – there is no right way to charge,
but it is better to be approximately right than
exactly wrong.”

“I think Britain and France do it at least
half right, and before revisiting how Britain
does it you need to think about what you
might be giving up.”

France was the first to introduce market
pricing, during the construction of the TGV
network. Today SNCF’s fares vary significantly
with demand, but the ratio between the
highest and lowest fare is around 3:1 range
-narrower than the 10:1 ratio in Britain.

“They don’t milk the business traveller to
anything like the extent they do in Britain,”
Schabas observed. “And most of the tickets you
can charge right up to the last minute, with
a small fee. France is a socialist country and
SNCF is a socialist enterprise. So they have a
form of market pricing, but it’s to maximise
social benefit, it’s not to minimise subsidy.”

Load factors are high - around 80% on
TGV services - but some of this is the result of
geography. Between Paris and Bordeaux,
for example, there are good loads in both
directions. Parisians who go to Bordeaux
for business meetings probably live right in
the middle of Paris and it’s too far to drive.
Whereas in London, the people who go
to business meetings in Birmingham and
Manchester are as likely to live out in the
suburbs and beyond, and driving times may
be comparable. This creates an imbalance in
demand that keeps British load factors down.

Schabas believes that market pricing has
helped the French rail network to achieve
20% traffic growth since 1997 - almost
three times more than the rate of growth in
Germany, where tariff pricing remains.
The French rate of growth, however, is behind
the 45% traffic growth achieved in Britain over
the same period. Britain’s intensity timetable
is the most frequent in the world and load
factors are around 40-50%.

So, market pricing has given us lower fares,
if you’re flexible about when you travel,
higher passenger volumes and higher revenue
(although it’s difficult to establish how much).
But the Chinese aren’t yet persuaded and some
people in the UK arent either.

In the question and answer session that
followed his presentation, Sally Battifant,
Mid-Cheshire community rail partnership
officer, stated the commonly held view that
rail fare pricing is “stupidly complicated”.

Schabas responded: “You want the system
to be fair or logical. Go to the supermarket
and tell me why the prices are what they are.
You can’t tell me:

“People shouldn’t worry about the logic of
it, and they shouldn’t worry too much about
the fairness, as long as there are cheap fares
and as long as there is some regulation overall.

He concluded: “Life is complicated.
Railways are fantastically complicated.

If you want to make the fares system simpler,
we can do it by having fewer passengers,
lower revenue, higher subsidies or less railway.
I don’t think any of those are attractive so live
with the complexity - enjoy it.”

| TICKET PRICE RANGE AND GROWTH IN PASSENGER KM |
| Source: Michael Schabas |

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<tr>
<th>Country</th>
<th>200km high-speed second class fare (Jan 2010)</th>
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<tbody>
<tr>
<td>Japan</td>
<td>13%</td>
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<tr>
<td>Germany</td>
<td>10%</td>
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<tr>
<td>France</td>
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<td>Britain</td>
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<thead>
<tr>
<th>Growth in passenger km 1997-2007</th>
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<tbody>
<tr>
<td>Japan 13%</td>
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KEY: Lowest  Average  Highest