Alternative Models For Freight Rail Concessions:
A Comparative Analysis

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An alternative to Europe's Open Access model is the Exclusive Franchise model of the Americas, which is prevalent in both North and South America. This is primarily a freight model, which is relevant because North and South America have mainly freight railways -- as is the case in Africa.

After a brief overview of RDC and our operations, an analysis will follow of how the railway environment varies from continent to continent, especially at the institutional level; why railway restructuring has occurred around the world -- and the results; and finally, how market forces, rather than political forces, have ultimately carried the day.

Background on RDC – General

RDC is a railway investment and management company based in Pittsburgh, Pennsylvania. Our focus is on "**Emerging Corridors in Emerging Markets**," meaning railways plus ports, railways plus fiber optics as well as other businesses related to railways in developing countries. In all cases, RDC is part of joint ventures; we are also the only U.S. company investing in African railways.

Background on RDC – Businesses

Our flagship in the USA is the **Iowa Interstate Railroad**, which is very much in the tradition of Africa -- a single track, unsignalled, relatively light density, intercity railway that handles a broad commodity base ranging from containers to grain.

RDC was involved in the first railway privatization outside of the USA, in Argentina. We are one of the partners in both **Buenos Aires al Pacifico** and **Ferrocarril Mesopotamico.**

Ferrovias Guatemala is the first case of a completely abandoned national railway system that has been restored to operation with 100% private sector financing.

In Peru, RDC is also one of the partners in the **Central Andino** railway, the world's highest railway reaching a height of 3 miles.

In Malawi, RDC is one of the partners in **Central East African Railways**, which is the former Malawi Railways. In this case we will be integrating the Malawi railway with Mozambique and together this will form the **Nacala Corridor**, consisting of the railway in Malawi, the railway in northern Mozambique and the port of Nacala. This will be the first integration of a port and a railway under private sector management on the planet for general freight. It is our expectation to include the Mozambique portions in late 2001.

In addition, RDC now has a presence in Europe. We are part of a consortium that signed the privatization agreement in April 2001 for **Estonian Railways**, which is the first railway of the former Soviet Republics to be privatized. This is a joint venture with Jarvis, the UK company, and Ed Burkhardt's U.S. company Rail World Inc., as well as Estonian investors.

The Railway Environment Varies from Continent to Continent

	North America	South America	Europe	Southern Africa
Distances	Long	Medium	Short	Medium
Traffic Patterns	Concentrated	Concentrated	Fragmented	Concentrated
Breaks of Gauge	0	Many	1	0
Capacity Constraints	Line Capacity	Ports	Clearances	Track
Orientation	Freight	Freight	Passenger	Freight

There are many dissimilarities from continent to continent and my focus will be on the "Orientation" line in the table above. The European railways are primarily passenger railways on which freight is more or less an afterthought, in contrast with North and South America and Southern Africa, where for the most part these are freight railways in which passenger service is secondary. There are many other differences such as gauge, distances, etc.; however, for the purpose of this discussion, Africa's focus on freight instead of passengers is the most important.

...Especially at the Institutional Level

	North America	South America	Europe	Southern Africa
BUSINESS LANGUAGES	3	2	Many	2
FRONTIERS	2	Many	Many	Many
OWNERSHIP	Private	Private	Public	Public

The institutional barriers to success for railways, meaning being able to interchange traffic and have a length-of-haul that is as long as possible in order to compete with trucks, covers a wide institutional range as well. In Europe there are many frontiers and the railways are in public hands, with the exception of the UK and shortly Estonia. However, in North America the ownership is almost 100% in private hands. Dealing with institutional barriers as fundamental as ownership is just as important as dealing with engineering problems when it comes to competing with trucks.

Railway Restructuring's Origins Range from Economic to Political...

REASONS		North America	South America	Europe	Southern Africa
ECONOMIC:	BANKRUPTCIES	X			
	LACK OF INTEREST	X	X		X
	OPERATING LOSSES		X	X	X
POLITICAL:	PRIVATIZATION THRUST		X		X
	DE-MONOPOLIZATION			X	

There are two main reasons why railway restructuring has occurred: (1) economic and (2) political. For example, in North America we restructured our railways because at one point (the lowest point) in the 1970s, one-third of our railway miles were in bankruptcy. Also there was an inability to raise capital because it was the private sector that was bankrupt. For that reason North America restructured its railways and deregulated, meaning: (1) shrink the network and (2) give railways the freedom to price competitively. Fortunately that worked. In 1977 when I went to work for the railways, many of my friends thought that it was a "stupid thing to do" because there was no future in the rail industry.

In contrast, the main force driving the railway restructuring in Europe is not economic, but political -- the de-monopolization thrust. To a certain extent the activities in Europe have been driven by political dogma, i.e. the desire to dismantle state-owned enterprises. There was more consideration being given to taking things apart rather than building something.

...Producing a Wide Range of Strategies

	North America	South America	Europe	Southern Africa
PRIMARY	Deregulation	Privatization	De-monopolization	Increased Trade
SECONDARY	Labor Reform	Labor Reform	Privatization	Privatization

As a result, a wide range of strategies have evolved. Deregulation is the prime strategy in North America, de-monopolization is the prime strategy in Europe. There are additional strategies in other parts of the world that are driving restructuring. In Southern Africa, many initiatives are driven by the desire to have more international flows of traffic among railways, resulting in integrated international concessions, like Sitarail in West Africa and the Nacala Corridor, which are market-driven processes.

...But, Results to Date Have Consistently Been Driven by Market Forces

Now compare how the Exclusive Franchise model of North and South America has held up against the Open Access model in terms of financial performance. To the extent that this conference covers how we can finance our way out of the problems that exist in Africa, it is worth considering the reaction of the financial markets to what is occurring in the Open Access environment as opposed to the Exclusive Franchise environment.

	EXCLUSIVE FRANCHISES	OPEN ACCESS
FINANCIAL MARKETS	Customer-specific investment in equipment and infrastructure (USA, Latin America)	Customer-specific investment in equipment (UK)
	Consolidation of Brazilian and Argentine franchises; USA rail mergers	Consolidation of UK trainload freight businesses
	High valuation of Mexican businesses; Conrail	Low valuation of UK trainload freight businesses (even after consolidation)

In the Exclusive Franchise area, there has been a consistent investment in equipment and infrastructure rehabilitation, etc. Substantial prices have been paid in the last decade for railways in North America. In contrast, consider the experience in the UK with the freight business. Investment has been made in freight wagons, however, a very low valuation has been placed on the freight business. For example, there was a low valuation of UK trainload freight businesses (despite their being divided into three units) even after they were put back together and became a so-called "monopoly." In fact it is not a monopoly because there have been other operators that emerged to cannibalize that business. The freight business in the UK brought a purchase price of approximately 20% of what it would have gained in an Exclusive Franchise environment. And history has now proven that even that price was too high.

	EXCLUSIVE FRANCHISES	OPEN ACCESS
TRANSPORTATION MARKETS	Increase in Latin American traffic	Decline in European traffic
	Return of Southern Africa's international flows	Growth in European river transportation (containers)
	Renegotiation of franchise terms (Latin America)	Capacity constraints on freight growth (UK)
	Penetration of eastern coal markets by western coal (USA)	Cannibalization of EWS coal flows by Freightliner (UK)

Let's now discuss the transportation market because after all, the prime beneficiary of railway restructuring is supposed to be the customer and not the financial markets. With the Open Access environment the European railways so far have stagnated at best, with their traffic being cannibalized by trucks and even by barge movement of containers. Looking at the freight business in 2001 in the UK, which is primarily a passenger railway, its growth is constrained by capacity. What business there is, is mostly business that has always moved by rail. Freight operators are cannibalizing each other's business. I am an avid reader of UK's Modern Railways and recently there was an entire page devoted to freight traffic flows that had been lost by EWS to other operators, namely GB Rail Freight and Freightliner. This is not about taking trucks off the highway; this is about taking business from one railway company and giving it to another. It would be very interesting to know whether the so-called explosive freight traffic has been partially driven by the fact that ballast trains, which in any other country would be considered non-revenue traffic, are now being counted as freight loads and if ballast trains are thus considered an area of freight growth.

Conclusions

	OPEN ACCESS	EXCLUSIVE FRANCHISE
PRIMARY FOCUS	POLITICAL	CUSTOMER
SECONDARY FOCUS	CUSTOMER	INVESTOR
OPERATIONAL CONTROL	REGULATOR	OWNER
INVESTMENT IN INFRASTRUCTURE	NO	YES

The primary focus of Open Access is political, and the secondary focus is on the customer. I do believe that Open Access has created value for the customer; in fact, most of the margins of the freight business have been given to the customer. However, if most of the margins have been given to the customer, then why invest in railways?

In the Exclusive Franchise environment the primary focus is on the customer. Yes, we are a railway monopoly; however, because the customer always has other choices like trucks, that prevents us from acting as a transportation monopoly. There is a secondary focus on the investor because capital is needed for a successful business. The Exclusive Franchise model satisfies both needs -- it provides value for the customer and rewards the investor, therefore the business gets financed.

To summarize, **both the financial and the transportation marketplaces have repudiated Open Access**.

Since there are more small railways in Africa than large railways, let's review a case study proving that even the smallest and most difficult railway can have a future -- the railway in Guatemala (**Case Study follows speech text**).

In closing, everywhere RDC operates we have joint ventures. We feel that cultural skills and knowledge of the local economy are more important than railway skills. RDC has gone out of its way to ensure that we have local partners. We have local partners in Mozambique and Malawi, not because it is a government regulation, but because our business strategy is based on integration of ourselves into these various countries. The vision of the Nacala Corridor is to be a truly African company.

One inspirational slogan that RDC draws strength from is: "**A luta continua!**"; this quote from Samora Machel, the first President of independent Mozambique, means "**The struggle continues!**" The railway business is very difficult no matter where you go. The best way to deal with difficulty is to not be alone in the business.

Thank you very much.

CASE STUDY: Guatemala

In 1996, the railway was abandoned, and in fact, the only service in Guatemala was this private sector light rail service, which actually helped preserve the infrastructure as there was a problem with rails being stolen from the mainline.

This is how the mainline looked when the railway was abandoned. Squatters had to be relocated from the right-of-way.

In the three years that the railway stood abandoned, there was no maintenance done. As a result, when it rained, many of the bridges were washed away.

In 1998, rehabilitation was underway on the railway. This is not a TGV. This is a low technology labor-intensive solution based on the railway's ability to survive. We are very proud to say that we provided hundreds of manual labor jobs putting this railway back into operation. Please note that there are no concrete ties nor electrification.

This bridge was rebuilt using 50 manual laborers and the highest technology was a cement mixer. The cost of the entire project – 200 miles of a national railway system, track, rolling stock, etc. – under US$10 million. Why? Well, a railway with no revenue cannot justify an investment much higher than that.

In the middle of rehabilitation Hurricane Mitch struck in 1998. This is one of the mainline bridges after Hurricane Mitch.

Nonetheless, in 1999, despite more storms that severed our mainline again…

…after some creative engineering that included dragging the bridge (pictured above on its side) back into position using a bulldozer and a front-end loader (Truly a low technology approach!)…

…the railway was opened for commercial traffic.

Since the year 2000, we are moving containers, steel and other products.

"This railway project in Guatemala is a project that I take great personal satisfaction from being associated with because it is a combination of both economics and values.

"I would like to say that there is a message here…for these types of deals, it has to be more than a business – it has to be a cause – a cause that must be committed to with sufficient resources to see it through. In the case of Guatemala we did not renegotiate the concession. We rebuilt this railroad as we promised the government. It was late because Hurricane Mitch was not in the business plan. But we did it, not only because it is a good business, but also because we are committed to the business."

— **Henry Posner III**, Chairman of Ferrovias Guatemala.