Getting Back on the Rails

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Revenue from rail freight traffic is increasingly bearing the burden of the cost of passenger traffic. In a high fixed cost industry like the railways this amplifies the impact of a downturn in freight movement on overall revenue. But will the constitution of a Rail Tariff Authority help the Railway Board implement tariff revisions that will bring some order to the finances of the railways?

The web version of this article corrects a few errors that appeared in the print edition.

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The Ministry of Railways is reported to be working on a Rail Tariff Authority, which may serve to insulate railway tariffs, particularly passenger fares, from changing and short-term political considerations.

The context is the current poor state of railway finances and the experience with the 2012-13 Railway Budget, when a move to revise passenger fares was overturned by the party boss of the Trinamool Congress (TMC), at that time a coalition partner of the central government. The questions that arise are, one, is it possible to effect a modest increase of passenger fares that needs to be implemented to set railway finances right, and, two, can an instituted authority that may be given some form of independence make this happen?

Tentative enquiries in Rail Bhavan have revealed that the authority it has in mind may be an entity empowered and competent to examine the economics of operation, distribution of costs, needs of the different streams of traffic and so on and to make recommendations that would be binding. It is being recalled that the railways had an in-house Rail Tariff Committee, which consisted of the chief commercial managers of the railway zones and which operated under the Indian Railways Conference Association, now sadly in disuse. The new authority may hence be a revival of that committee but with professionals, like economists and accounting experts, being included. This may provide the authority with the credibility that it would need to offset compulsions to act against its advice.

It is also being noted that the proposed authority would need to be created in the context of the existing Railways Act, which says that "rates would be fixed by the Central Government". As things stand, railway rates are proposed by the union railway minister and they are fixed when the budget is passed by Parliament. While controls to manage transport system financing exist in many countries, these are more in urban transport systems and the emphasis is on ensuring quality of service and providing a subsidy to support the operators. Many inter-city railway systems also use devices like flexible pricing to maximise the utilisation of resources. But the role of the authority being thought of in India is one where it may use such instruments to work out the most appropriate pricing but it would need the legal and administrative influence to prevail over indiscipline as was seen during the last budget.

While the Railway Board may have ideas on how to set up such an organisation, it is felt that a look at how India's railway finances behave may provide some pointers towards what changes we actually need and whether the railways can manage to bring them about by themselves.

Railways' Costing

It is well known that the nature of railway systems is that their costs are dominated by fixed costs. When the railway system is breaking even, the revenue stream covers the large fixed burden and the entire additional working surplus that comes from an increase in the level of operation adds to the bottom line. This is the boom that we saw during the good years in the last decade, which many commentators described as the Indian Railways "turning the corner". But the downside is that if there is any fall in the level of operations, there is no proportionate reduction of costs and the balances are soon in the red. This is the condition that we are now seeing, as a result of the recession as also rising prices of inputs and the higher wage bill.

When railway finances first became a matter of concern in the 1990s, there was a belief that what ailed the system was falling capital support from the central government and investment in new lines which were approved for political rather than economic considerations. Efforts were made to generate a cabinet note for a policy that would ensure that railway finances did not bear the burden of such expenditure. But it became evident that the dividend burden of such projects did not amount to a great deal and what the railways needed was really a dose of additional traffic. This materialised during the latter half of the 1990s and in the past decade, leading to a large surplus. But while higher loading and higher traffic prevented the need for any thinking about structural change, what happened during the last couple of decades was that passenger fares were kept low while freight tariffs were steadily increased. This has increased an existing lopsidedness in the ratings (tariffs), which during a downswing worsens conditions of high fixed cost industries, which the railways exemplify.

The costs of the railways – maintenance of track and rolling stock, fuel costs, and payment to staff – are incurred both for goods traffic as well as passenger traffic. The earning figures from the two streams are in the ratio of 3:1, but the costs are not in the same ratio. While goods trains punish the track more than passenger trains, the lines need to be kept available for time-tabled passenger trains and facilities have to be provided for passengers in coaches and in stations. The railways carry about 680 billion tonne-kilometres of goods and about 1,100 billion passenger-kilometres in a year. But earnings every year from goods are Rs 90,000 crore against only Rs 36,000 crore from passengers. The earnings from a passenger-kilometre is about 30 paise, against earnings of about Rs 1.30 from a tonne-kilometre of goods traffic. Not that there need be parity between the two figures, but the ratio has been getting worse, adversely to goods traffic, over the years and the ratio is also widely different from the figure in railway systems in other parts of the world. Against a ratio of worse than 1:4 in India, it is around 4:4 in most countries and goes to 4:3 in some cases. No doubt higher priced passenger lines in some countries are of high speed and quality and surpass what we have in India. But what we do have is under-priced and paid for by the revenue that arises from goods traffic.

Now, what is the fallout of falling traffic in the case of the railway industry? Having low passenger fares amounts to total collection from passengers being low and the contribution from passengers towards offset of costs also being low, if not negative. The contribution from goods traffic then has to bear an extra burden, which amounts to an additional cost. In good times, the high goods tariff is able to meet this with ease and the higher cost that is being borne is not noticed. But when traffic is falling, the cost of passenger traffic, which is a major cost, adds to the fixed cost burden and amplifies the revenue shortfall. The usual computation of the "leverage" or the effect of changes in level of operation on the net results considers the fixed cost component and the earnings from a given level of operations as single entities. But when there is a disconnect, with passenger economics piggybacking on the goods sector, then the fixed cost component, which is a drain on the contribution (mainly from goods earnings), is more than double what was computed and the effect in the case of falling traffic is more serious than expected.

When the Railway Budget for 2012-13 was being prepared, the Railway Board was aware of a grave shortfall in loading and earning and had the support of the then railway minister. The budget addressed the need to raise funds and it increased the rates of goods traffic. But, because the passenger sector had been left untouched for years and so as not to burden goods traffic even more, the budget took on what appeared to be, indeed was, responsible and bold action – it proposed raising passenger fares. The actual increases proposed were from Rs 1.07 to Rs 1.32, or nearly 25%, in the revenue of a tonne-kilometre of goods, and from 27 paise to 32 paise, an increase of less than 20%, in the revenue of a passenger-kilometre. This would have worsened the goods-passenger mismatch in revenue, but given populist politics it was at least an effort. But the proposal was against the wishes of the railway minister's party chief, and it led to the minister's replacement and his successor simply rolled back the increase in passenger fares.

It is in this context, a few months later, after the TMC party chief pulled out of the government, and the wind is favourable, that the Railway Board has proposed not to restore the increase in passenger fares, which everybody considers just and fair, but the creation of an institution of wisdom and learning, which would have the magic powers of pushing hard measures through even when the government lacks the numbers in Parliament.

Accounting Reform

But getting back to the crisis of funding railways when things go badly, we have seen that treating the finances of passenger and goods streams not separately but together confuses the picture. A first need would hence be to separate the costs of passenger and goods services. True, passenger and goods trains run on the same tracks and are drawn by similar locomotives, but the two services are different entities. The demand or supply of one does not affect the other and they have to be priced and marketed separately. The accounting reforms exercise that the Railway Board has been undertaking for some years now is a vital step in carrying out this separation. Separating costs will display the real cost of passenger services and while the government would be free to provide subsidies or other support, there would be no reason to do this at the cost of goods services. Separating costs would empower the Railway Board to force correct pricing in a way that no tariff authority can.

During the last budget exercise, the Railway Board made its proposals not

based on data but very much in line with tradition – of just finding a method for raising revenue to meet costs. The proposal to raise passenger fares was only because it appeared imperative and while the moderation in the increase may have been out of diplomacy, it does not appear that there had been any analysis preceding the proposals. Accounting reforms may therefore not only provide the Railway Board with weapons to counter political forces, but would educate the board itself and would surely bring out aspects of working that are not apparent.

Soft Skills

While accounting reforms and separation of passenger and goods costs would be one measure, the other need for the railways is behavioural change. The railways are a commercial undertaking in the sense that they need to at least break even, and the Railway Board is in charge of their running. The minister of railways represents the people and would guide the railways to run according to the policies of the government, but the minister cannot give guidance in the name of government policy that flies in the face of reasonable working. And, yet, minister after minister has got away with just that – some development for his or her home state, yes, but at the clear cost of the efficiency of the railways and also keeping fares at unrealistic levels. In these situations the railway management has not stood firm. The railway management has achieved many milestones – computerisation, electrification, automatic signalling – and these happened with neither help nor hindrance from the political leadership. But when it comes to being professional in matters of projects and populist measures, the railway management has been more than ready to compromise. The management has obliged by doctoring estimates and at times has anticipated political desires – “We do not even need orders, we will do it on our own”. This environment of “at your service” that the railway management creates may be by itself an invitation for the best of ministers to think the railways are his or hers to exploit.

In March 2012, when the minister in charge was sacked and the budget redrawn, the Railway Board secretariat had to rework the figures for presenting changed proposals to Parliament. But the members of the Railway Board could have stood their ground and resigned along with the minister. It would have been more eloquent than waiting till the dust had settled and proposing a tariff authority.