

STRUCTURAL REFORM OF THE RAIL INDUSTRY
HUNGARY
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1. This submission provides an overview of the Hungarian rail sector from a liberalisation perspective. The market opening is quite a recent development, therefore we have no widespread market experience and the regime is still evolving. This paper describes the current regulatory framework, but it has to be noticed that the new Railway Act (originally intended to pass the Parliament in 2002, but still delayed) is under elaboration and might finally be adopted in 2005. This January the Minister of Economic Affairs and Transport appointed the Commissioner of Rail Regulation to co-ordinate the accomplishment of the new Act and to establish the Hungarian Rail Office. The adoption of the new Act might partially or completely overwrite the system described below.

Overview of the Rail Sector

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2. The Hungarian railway sector has historically two – still vertically integrated – incumbents: the Hungarian State Railways (*Magyar Államvasutak*, hereinafter referred to as “MÁV”) and the *Győr-Sopron-Ebenfurti Vasút* (hereinafter referred to as “GySEV”). The major incumbent MÁV covers about 98% of the rail market and provides all possible rail services. Recently the lack of adequate government support resulted in a critical financial situation and has made a reorganisation process inevitable. The other incumbent GySEV has a special status, it operates a fraction of the Hungarian and the Austrian rail track between two cities (Győr (in Hungary) and Ebenfurt (in Austria)) under concession and provides passenger and freight services on that infrastructure. This railway company is registered in and controlled by both states (the Hungarian state has a majority: 61%). Its market share in Hungary does not exceed 2%. Hungary’s extensive infrastructure is mostly unexploited (only 60% of the network is frequently utilised) and needs development. The role of railway companies changed considerably in the past fifteen years. Nowadays the rail services represent only about 40% of their level in the eighties, the sector faces intensive inter-modal competition and also has to keep up with the railway companies of the surrounding countries, as transit transport is an important factor in this region. Until 1993, the incumbents acted as single operators, then the new legislation started to diffuse gradually the former state rail monopoly and transform the incumbent companies and the whole railway industry.

3. The railway sector is regulated by the *Railway Act*¹. The major objectives for the sector appear in the preamble of the Act: the promotion of rail (and multi-modal) transport for environmental reasons and the provision of public services. These objectives are applied together with the goals of the general transport policy like the development of infrastructure, the improvement of transport safety, the preference of public transport to individual means, the requirement of efficient operation etc. In the process of establishing the legal background for rail transport, it has always been important to follow the EU transport rules and harmonize our legislation – with a view to the distinctive features and possibilities inherent in the Hungarian situation. Hence the major characteristics of the regulatory regime are similar to those of the EU

¹ Act XCV of 1993 on Railway (it has been amended several times)

Directives. Besides the reasons mentioned above, the aim to minimise subsidies as well as employment aspects have always played a decisive role in government measures concerning the railway industry for the past ten years.

4. The Railway Act defines public railways as track railway (responsible for the construction, development, modernisation, maintenance and operation of the infrastructure) and train-operating railway (providing passenger and freight transport services, and traction). These activities can be performed within one vertically integrated organisation – the railway company. The accounting separation of these activities is compulsory, but the Act does not require structural separation. The services provided by the incumbents are currently carried out in four divisions: (1) infrastructure management, (2) passenger transport, (3) freight transport and (4) engineering (traction). In the short term, it seems that the incumbents will not be legally reorganised into two or three distinct companies. A ministerial decree setting the principles and rules of accounting separation was issued in 2003². At the same time professional administrations for the separate activities were established. During the streamlining process, a range of activities – which do not belong directly to the core activities – were also separated and formed into distinct companies (e.g. real estate management). The objectives of the accounting separation were to limit the financial responsibility of the state and the local authorities, to enable the establishment of competitive conditions for transport activities on the track railway and also to enable other rail operators to enter into the market.

5. A ministerial decree³ regulated the licensing of railway companies. It defines the operating licence granted by the Central Transport Authority (KKF) as a prerequisite for any transport activity carried out on the traction. The detailed conditions of granting the licence are laid down in the decree. The regulation ensures that the applicant is obliged to meet the requirements relating to good repute, financial fitness and professional competence. The regulation entered into force in July 2002, providing that the incumbents should obtain the licence within a certain period of time. A ministerial decree issued in 2004⁴ determines the rules for granting a safety certificate. The Railway Act set up the capacity allocation body (CAB) and the regulatory body (RB) of the rail sector and relating ministerial decrees⁵ prescribe their tasks and procedure. The CAB is an independent, state-owned institution, and is responsible for the allocation of railway infrastructure capacity and the charging of infrastructure fees. The RB operates besides the Supreme Transport Authority (KFF) and is only entitled to deal with appeals against the decisions of the CAB, but lacks other sector specific competences. Both the CAB and the RB are very small institutions, their staff combines is below 20, and work temporarily until the regime is finalised according to the new Railway Act.

6. On 1 May 2004 the completion of the legal framework created the possibility of market opening. This year four Hungarian private train operating companies (TOCs) – *Magyar Magánvasút Rt.*, *Floyd Kft.*, *MÁV-Hajdú Kft.*, *CER Rt.* – applied for operating licences and were already granted licences. However, the entry was limited under the negotiated access regime. The new TOCs managed to operate only a few trains over the past 8 months.

Role for competition and role for regulation

7. Under the Hungarian regulatory regime, rail freight services and engineering are operated on a commercial basis, while rail passenger transport services remain (to-be-regulated) public services, since

² Joint Decree 34/2003 (V.28.) GKM-PM on the Unbundled Accounting of Railway Activities

³ Decree 15/2002 (II.27.) KöVIM on the Licensing of Railway Companies

⁴ Decree 51/2004 (IV.22.) GKM on the Railway Safety Certificate

⁵ Decree 67/2003 (X.21.) GKM on the Allocation of Railway Track Capacities; Decree 66/2003 (X.21.) GKM on Determining Fees for Railway Track Use

the present market situation does not allow for competition in the passenger transport services sector. Track operation constitutes public service as well.

(2) Competition is supposed to play the main role

8. Considering the rail freight transport market, both inter-modal and intra-modal competition exist, road transport still poses serious challenge to railway companies. The important role of inter-modal competition even has an impact on prices. Though the rail market was opened for competition in May – in the form of conventional competition in the market – and new train operators have already entered the market providing freight transport and traction services, intra-modal competition is still at its infancy. Railway infrastructure is managed by the vertically-integrated incumbents, but they have to provide access to TOCs: thus the service-providing divisions of the incumbents operate in theory simultaneously in the market with new entrants. The incumbents have considerable market power, the new entrants' market presence represent less than 1%.

9. In freight transport the role of railways decreased radically in the last decade, now the government transport policy aims to drive it back – at least partially – from road to rail or water by means of indirect or regulatory measures (e.g. allowances for multi-modal transport) and possible government subsidies (e.g. investments in equipment necessary for combined transport) as well. Facilitation of competition between TOCs through mandatory access is expected to affect the competitiveness of the whole rail sector, the variety of rail services might contribute to the promotion of non-road or combined transport modes and thus the government objectives.

(3) Regulation is supposed to play the main role

10. As mentioned above, scheduled domestic local and long-distance passenger transport services are provided on the basis of public service obligation. It means that almost all domestic passenger services – even services like inter-city or urban commuter trains – are defined as public services, except for special trains (ordered individually, independent of the working timetable). International passenger transport is obviously excluded from the public service category, it is operated by the incumbents on a commercial basis and especially in cooperation with other national flag-carriers. Under public service obligation the railway company is obliged to conclude contracts in order to perform these services. Accordingly, the tariffs are officially regulated through the fixing of maximum prices and the general service contract terms (e.g. timetable, quality and safety requirements) are also under ministerial oversight.

11. Similarly, infrastructure management is also a government responsibility: in these segments the incumbents serve as a means to provide for public service activities and deliver the governmental objectives for the sector. The responsibilities and obligations of both parties are set out by regulation and specified by the annual agreements between the state and the incumbents, e.g. the role of state in financing the basic level of service and the investments required, and in improving the efficiency of the operation. In general, the costs of track maintenance and investment are covered partially by infrastructure charges paid by train operators, and the rest should have been financed by the state. On the other hand, the government is to control the use of infrastructure (e.g. approval of infrastructure charges).

12. Public service passenger transport receives two kinds of government subsidies. On the one hand, consumer price subsidy as part of transport fare policy: this support means the compensation for discount passes and tickets (law prescribes the system of discounts available for preferred passenger groups like students, senior citizens). On the other hand, government is to finance the costs (not covered by revenues) of public domestic passenger transport services provided by the incumbents – however, for budgetary reasons, the amounts paid by governments only partially (25% as estimated) cover these costs and the resulting losses of MÁV has to be restructured periodically (every 2-3 years). This compensation does not

always take the form of direct subsidy, but a bank loan with government guarantee. The regulatory control of the former raises no problems (the present ticketing system and the counting of passengers mostly fulfil this function, but a more adequate intelligent ticketing system is under development); for the latter, there exists no institutional control mechanisms, only public procurement might provide an indirect control over the use of subsidies. Moreover, the reorganization process of the incumbent railway companies also requires government subsidy in the short run, while in longer term, the reforms aim at cutting down costs and these supports.

Vertical structural issues

(4) Major categories of the infrastructure

13. The Railway Act categorises the infrastructure (i.e. the railway network and its accessories) by the owner: most of the railway lines are owned exclusively by the state (national network) or local authorities (local networks like tramways) and can be used publicly, and there is a small number of privately-owned and used railway tracks. The national public railway network is operated by the infrastructure management divisions of the incumbents, while local public networks are operated by companies of the local authorities. The national network is used for all kinds of freight and passenger transport services, while the local networks are primarily to arrange local passenger transport.

14. Privately-owned (industrial) lines are used within the premises of industrial customers. However, the law allows that certain lines managed by the incumbent are classified as “industrial”, thus making access to certain assets impossible. There are 12 narrow-gauge separate regional networks in operation. The tracks are owned by the state. The narrow gauge railways operate in a vertically integrated structure. Four narrow-gauge networks are operated by MÁV; the others are operated by private or municipality-owned companies. There are two running pilot-projects to divest branch lines from MÁV in a similar manner. In the future, the establishment of regional integrated networks might be possible under the new Railway Act.

15. The Network Statement makes a different categorisation: it divides the infrastructure into three categories on the basis of complex quality criteria. All three categories can be used for both freight and passenger transport.

(5) Access I.

16. The Railway Act states that the infrastructure manager (the track railway or the railway company) is obliged to grant access – according to the capacity allocation process and in return for a specified fee – to the infrastructure to:

- any domestic train-operating railway or any international grouping founded by a domestic operator;
- any train-operating railway seated abroad in case of international agreement or reciprocity;
- any train-operating railway seated in the EEA in order to provide international inter-modal freight transport services on the national public railway lines;
- any international grouping founded by a railway company seated in the EEA in order to provide transit services on the national public railway lines;
- any train-operating railway seated in the EEA in order to provide international freight transport services on the trunk railway lines.

17. According to derogatory provisions of the Accession Treaty, from 1 May 2004 until 31 December 2006 only 20% of the network capacity of the TERFN (which covers most of the Hungarian railway lines) can be used by railway companies seated in the EEA. From 1 January 2007, they will have access to the whole TERFN in Hungary. Until now, no EEA-seated railway company has entered the market, so the available limited network capacity is not even utilised.

(6) Access II.

18. The market opening in Hungary mainly resulted from the requirements of EU law and the objectives defined therein (primarily the promotion of seamless services within the European market), consequently the principles for capacity allocation and charging follow more or less the directions of the First EU Railway Package.

19. As the infrastructure is operated by the vertically-integrated incumbents, the capacity allocation process and the charging are managed by the CAB (formally) independently of railway companies to ensure that access is granted on a non-discriminatory basis. The TOCs apply for infrastructure capacity to the CAB. Requests for yearly timetable paths have to be filed in twelve months before the timetable period, but it is also possible to present ad hoc requests. The CAB consults the infrastructure manager and takes its decision depending on data provided by the infrastructure manager. The CAB resolution itself does not allow for track use, the TOC is obliged to conclude an access agreement with the infrastructure manager, defining the concrete terms of track use on the basis of the Network Statement and the CAB decision (thus the current regime is a negotiated access regime). The Network Statement that was worked out by infrastructure managers and CAB, and approved by the minister determines the general contracting terms and conditions for allocation and access: procedural rules together with the scheme of charging and discounts applicable. Under the access agreement the infrastructure manager is in general obliged to provide infrastructure services (provision of infrastructure elements and train control), and the TOC is obliged to satisfy the safety and traffic requirements and pay the infrastructure charge. The TOCs are to pay the settled yearly infrastructure fee in monthly instalments, while ad hoc requests have to be paid in advance.

20. Besides state funding and surpluses from other commercial activities of the infrastructure manager, infrastructure charges shall provide the recovery of operational costs of the infrastructure manager and infrastructure expenditure. The infrastructure charges are defined by the CAB and published in the Network Statement, which must officially be issued – in accordance with the EU legislation – at least half a year before the deadline of applying for yearly timetable paths. Infrastructure charges consist of basic, additional, ancillary and extra charges.

- the basic charge consists of a reservation fee (fix charge/train) and a charge for running of a train (dependent on performance, defined in per trainkilometre): it provides for the handling of capacity requests, the permission to use capacity, the use of the requested train path and its accessories (e.g. passing tracks, safety and signalling systems), and train control;
- at the request of the TOC, the infrastructure manager render the use of certain facilities (e.g. electricity supply, refuelling facilities, stations, marshalling yards, storage siding, maintenance and other technical facilities) possible for an additional charge: the additional charge covers in passenger transport the catenary usage fee, the charge for using of stations for stopping, the charge for access to stations for reversing directions, the charge for shunting, while in freight transport the catenary usage fee, the charge for access to marshalling yards, the charge for shunting, the charge for access to serving facilities and the charge for serving of a train;
- the charge of ancillary services: e.g. the charge for dangerous goods or the charge for extraordinary goods;
- an extra charge can be applied in case of scarcity of capacity (congestion), certain investment projects or environmental effects, but these have not been calculated yet.

21. The infrastructure charge can be increased or decreased by mark-ups or discounts. For combined traffic, there is no surplus calculated for dangerous and/or extraordinary consignment.

22. The state-owned Hungarian railway track is operated by MÁV and – to a negligible extent – GySEV. As vertically-integrated companies, they provide train services as well. Their market share in the total train traffic is nearly 100%: only incumbents participate in passenger transport, and they almost cover the freight transport market too. Half year ago three private TOCs providing freight transport and traction services appeared as competitors, but their market presence have not really changed the share-structure of the industry, since their market share is yet less than 1%. The new entrants try to offer lower prices and better service quality than the incumbents. On the one hand, they look for new businesses especially in transit traffic, on the other hand obtain businesses detriment to the incumbents. Their market entrance and few-month operation has not been without difficulty, and has certainly reflected to some critical points and brought to light inconsistencies of regulation and resistance of incumbents. The complaints already arisen mainly relate to the capacity allocation process: the non-discriminatory allocation of train paths and the conclusion (contracting terms) of access agreements. The incumbents have decisive role in the capacity allocation process, as the CAB has no other choice but to rely on data provided by the incumbent and following the CAB decision the incumbents can easily delay or render the conclusion of the agreement difficult. It is not clear from the regulation which parts of the infrastructure can be accessed by the new TOCs. In the absence of clearly defined distinction between public and private lines and rights to access to station facilities each transport is negotiated in a very time consuming process without regulatory oversight.

23. The minimal operation and track use of the new TOCs have not raised any concern about their impact (e.g. damage) on infrastructure.

24. The market opening in the Hungarian rail sector in May have not yet led to material increase in competition, but it is primarily owing to the provisional derogation won by the Hungarian government during the accession negotiations. From 2007, foreign TOCs are expected to enter the market and that might change the overall market situation for the incumbents and the small private TOCs. At present the competition problems faced by new market actors mainly result (or are thought to result) from the inadequate – only accounting and functional, but not structural – separation of the incumbents. The market effects of the non-competitive activity of MÁV seems to overweight the contingent synergies of vertical integration as it tends to eliminate the development of intra-modal competition and the general sectoral objectives.

Competition Law Enforcement

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25. The Hungarian Competition Authority has not yet conducted any formal investigations in the rail sector.