

# Some insights on market segmentation and mark-ups in European countries

PRIME-ENRRB Workshop

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Context

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## A. Economic background

### **Ramsey-Boiteux scheme :**

In the context of natural monopolies, marginal cost pricing maximises the use of the infrastructure but are not cost-covering

In other words, marginal cost pricing leads to a loss for the IM

Economists have identified a variety of solutions to cover the costs :

- Public subsidies
- Average cost pricing
- Ramsey-Boiteux pricing (mark-ups over marginal costs are distributed according to inverse elasticities, which means that consumers in segments with the lowest price elasticity have to cover the highest mark-up)

### Implementation of a Ramsey-Boiteux scheme:

#### Article 31-3 of Directive 2012/34EU :

*“Without prejudice to paragraph 4 or 5 of this Article or to Article 32, the charges for the minimum access package and for access to infrastructure connecting service facilities shall be set at **the cost that is directly incurred** as a result of operating the train service (...)”*

➤ Marginal cost pricing as the basic charging principle

#### Article 32-1 of Directive 2012/34EU :

*“In order to obtain full recovery of the costs incurred by the infrastructure manager a Member State may, **if the market can bear this**, levy mark-ups on the basis of efficient, transparent and non-discriminatory principles, while guaranteeing optimal competitiveness of **rail market segments** (...)”*

➤ Above marginal costs, charging scheme derived from Ramsey-Boiteux pricing

## C. Overview of IRG-Rail papers of WG Charges

### On direct costs (art. 31(3) of Recast + CIR 2015-909):

- The IRG-Rail has published **4 position papers on direct costs** between 2012 and 2014 prior to the publication of CIR 2015-909.
- In 2016, publication of an **introduction to the calculation of direct costs** (using econometric and engineering methodologies)

### On market segments and mark-ups (art. 32(1) of Recast):

- In 2016, publication of an **initial approach to the definition of market segments and the calculation of mark-ups**.
  - ✓ Objectives: provide a description of current application of art. 32(1) in IRG-Rail Member States, underline practical problems and propose solutions to the application of art. 32(1).

### Review of charging practices for the minimum access package in Europe:

- Paper presenting the **charging practices in 21 European countries** and comparing the roles of the regulatory bodies in these countries.

## Current practices within IRG-Rail Member States

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# A. Current practices within IRG-Rail





| Country<br>(as of 2016) | Different charges<br>according to the<br>type of services | Market segments<br>(in relation to Article<br>32(1) of the Recast) | Mark-ups<br>(in relation to Article<br>32(1) of the Recast) | Change in the<br>national charging<br>system (next 12<br>months) |
|-------------------------|---|--|---|--|
| Austria                 | ✓   | ✗  | ✗   | ✓  |
| Belgium                 | ✓   | ✗  | ✗   | ✗  |
| Bulgaria                | ✗   | ✗  | ✗   | ✓  |
| Croatia                 | ✓   | ✗  | ✗   | ✗  |
| Denmark                 | ✗   | ✗  | ✗   | ✗  |
| Finland                 | ✓   | ✗  | ✗   | ✗  |
| France                  | ✓   | ✓  | ✓   | ✓  |
| Germany                 | ✓   | ✗  | ✗   | ✓  |
| Greece                  | ✗   | ✗  | ✗   | ✗  |
| Hungary                 | ✓   | ✗  | ✗   | ✓  |
| Italy                   | ✓   | ✓  | ✓   | ✗  |
| Luxemburg               | ✓   | ✗  | ✗   | ✗  |
| Netherlands             | ✓   | ✗  | ✗   | ✗  |
| Norway                  | ✓   | ✗  | ✗   | ✓  |
| Poland                  | ✓   | ✓  | ✗   | ✓  |
| Romania                 | ✓   | ✓  | ✗   | ✓  |
| Slovakia                | ✓   | ✓  | ✗   | ✗  |
| Slovenia                | ✓   | ✗  | ✗   | ✗  |
| Spain                   | ✓   | ✓  | ✓   | ✓  |
| Sweden                  | ✓   | ✗  | ✗   | ✓  |
| Switzerland             | ✓   | ✓  | ✓   | ✓  |
| UK                      | ✓   | ✓  | ✓   | ✗  |

## B. Insights on market segments

- **8 countries rely on market segments (close to 2/3rds of Member States do not)** (some countries may not need to define market segments as they do not levy mark-ups)

### Practices :

- Standard distinction : freight vs. passenger (required by Recast)
  - Freight subdistinctions : primarily rely on commodities transported
    - Poland : trains carrying dangerous goods vs. other freight trains
    - UK : 20 commodities distinguished (only three commodities bear mark-ups)
  - Passenger subdistinctions :
    - Passenger within PSO : required by Recast (e.g. Italy or France)
    - High speed lines (as in the Netherlands, in Italy, Spain or France)
    - Geographical distinctions (e.g. Poland : regional vs. inter-regional services, France : services not running through Paris)
  - Important : not all regulators consider the current market segmentation of their IM justified enough (e.g. Spain or France)
- This and the recent deadline for the transposition of the Recast may explain that half of the countries are undergoing reforms of their national charging systems

## B. Insights on market segments

### Main obstacles in defining market segments (identified by IRG-Rail) :

- List of pairs : interesting but cannot make up for lack of methodology, should be complemented (e.g. look at method to define *relevant markets* in competition analysis)
- Challenge of finding relevant criteria to segment the market
- Challenge of accessing data on relevant criteria to segment the market (e.g. characteristics of traffic, cost structure of RUs)
- How to deal with PSOs?
- Market segmentation and industrial structure of the market (designing market segments without competition in the market)

## C. Insights on mark-ups

- **5 countries levy mark-ups (more than 3/4th of Member States do not)**

### **Practices :**

- All countries which levy mark-ups have defined market segments (required by Recast)
- Some countries which do not levy mark-ups yet have defined market segments
- Interesting diversity in the charging units used:
  - Thousand gross tonne.km : UK (freight)
  - Seats.km offered : Spain (passenger)
  - Percentage of turnover of the service : Switzerland (passenger)
  - Train.km or train.path.km : Most other countries
- This information is likely to evolve as half of the countries in the sample are undergoing reforms of their national charging systems

### Main obstacles in deriving mark-ups (identified by IRG-Rail) :

- Recast : insights on how to define market segments (list of pairs) but no information on how to calculate mark-ups (list of pairs does not even single out the services which have a higher ability to bear the mark-ups)
- Challenge of finding data on relevant criteria to calculate the mark-ups (e.g. characteristics of traffic, cost structure of RUs)
- Challenge of the choice of methodology to be adopted to calculate mark-ups (i.e. consider RUs, final consumers, both ?)
- Challenge of conflicting objectives: recovering costs vs. optimal competitiveness of rail services
- Challenge of determining the level of mark-ups for PSO services

Next steps from IRG-Rail WG Charges

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# Main objective of 2017 working programme

- Descriptive paper : *“Direct costs, fixed costs and public compensations - European benchmark on railway financing and cost structures”*
- Aims (very preliminary list):
  - ❖ to enter into a deeper comparison of pricing systems and cost issues
  - ❖ to understand and compare the financing of rail infrastructure in different countries
  - ❖ to give clarity about the different levels of state subsidization
  - ❖ to compare the methods of calculation of direct costs and mark-ups
  - ❖ to compare the level of costs in the member states:
    - level of direct costs
    - level of fixed costs and mark-ups
    - level of public compensations
  - ❖ to add value and background to other papers from IRG-Rail (e.g. direct costs and mark-ups)

**Thank you for your attention!**

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