

A note on the January 2007 fare increases

From 2 January Southeastern's regulated fares are to increase on average by 6.3%. However, Sevenoaks commuters will be subject to above-average increases –

- All Sevenoaks to London season tickets are to rise by 10.7%;
- Standard Class ordinary returns to London will increase by 6.7% and First Class returns by 6.4%; and
- Standard Class off-peak returns rise by 6.8%.

This note looks at the background to the latest increase and trends in fares from Sevenoaks and other stations.

How are fares regulated?

The Department for Transport (DfT) regulates prices of season tickets and standard day singles and returns. Other fares, including off-peak, promotional, and all first class tickets, are set freely by the train operating companies ('TOCs') according to what the market will bear. Nationally (ie in GB), regulated tickets represent just over 42% of all fare revenue. (Just over half of all expenditure on rail fares is paid to train operators in London and the South East.)

Increases in regulated fares are linked to inflation as measured by the all-items Retail Price Index ('RPI'). Since the completion of a Review by the Strategic Rail Authority in 2003, each TOC's 'baskets' of regulated fares can be raised by the 12-month change in the RPI (based on the previous July's figure) *plus* 1 percentage point ('pp') partly to reflect the Government's intention to reduce subsidies to rail commuters. So beginning 2 January 2007, most train operators will be raising their regulated fares on average by the 12-month change in the RPI to July 2006 (3.3%)¹ plus 1 pp, or 4.3% in total.

Southeastern's fare regime

Under the terms of its franchise, Southeastern, is permitted to raise its baskets of regulated fares annually by the RPI *plus* 3 pp, or 6.3%. Its allowable increase is the highest in the country (matched only by the West Yorkshire Passenger Transport Executive).

In order to provide incentives for improvements in services, all train operators are allowed to vary individual fares within their regulated 'baskets' provided that the revenue-weighted average increase overall is no more than the formula. (On a weighted basis above- and below-average changes must therefore cancel out.) There is, moreover, a 5 pp 'cap' on the amount an individual fare can be raised above the average allowed. So for Southeastern, the maximum annual increase at an individual station can be the change in RPI *plus* 3pp *plus* 5pp. In 2007 the maximum regulated fare increase is therefore 11.3%.

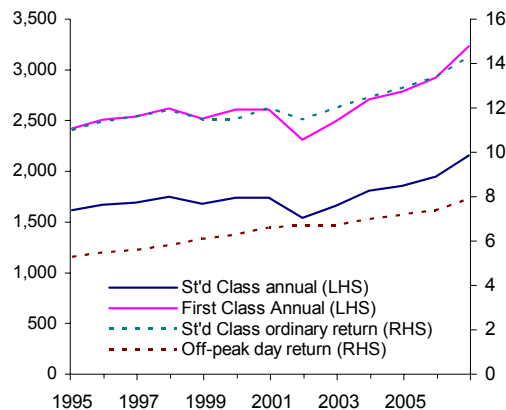
¹ Inflation measured by the RPI has since risen and was 3.9% in November 2006.

This year's increase in the price of season tickets from Sevenoaks to London of 10.7% is thus close to the maximum allowed. Southeastern has said that above-average increases have generally been applied to stations like Sevenoaks with faster and more frequent services. At present we do not know whether the adjustment this year to Sevenoaks fares is a once-off 'correction' or the first of a number of above-average increases. In justifying above average increases for some stations, Southeastern also [refers](#) to below-inflation increases in the recent past, improvements in trains, station infrastructure, and more punctual and reliable services. We examine these arguments in the light of recent trends below.

Trend in fares from Sevenoaks

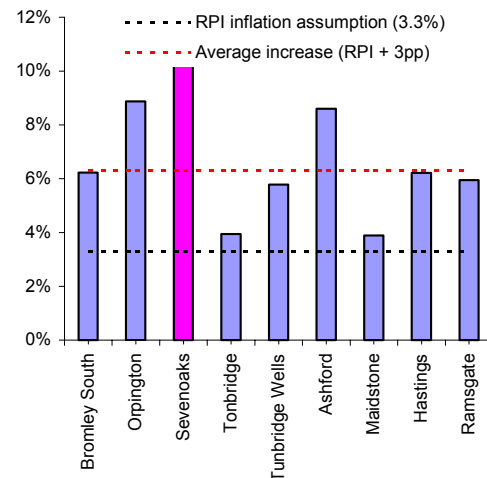
Chart 1 shows the trend in fares since 1995. Prices of season tickets from Sevenoaks were cut in January 1999, were left unchanged in January 2001, and reduced in January 2002. These reductions reflected adjustments for below-standard performance. In addition to the RPI-based formula² London and South East TOCs were also subject to the Fares Incentive Adjustment Payments system ('FIAP'), whereby an adjustment of up to ± 2 pp was made in relation to performance against standards in the year to the previous July (and performance of most TOCs declined sharply in the aftermath of the Hatfield crash on 17 October 2000). Following the SRA review mentioned above, this automatic link between changes in regulated fares and performance was replaced by the system of rebates under the Passengers' Charter.

Chart 1
Sevenoaks to London fares 1995-2007 (£)



Source: Southeastern
As fixed in January of each year (February in 1995)

Chart 2
Increase in standard class annual season to London from Jan 2007



Source: Southeastern (fares) and National Statistics (RPI)

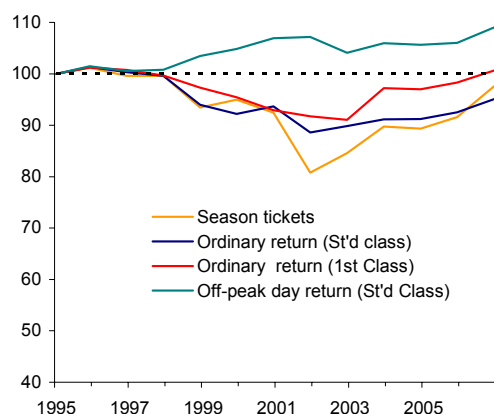
Chart 2 compares the latest rise for Sevenoaks with other large stations within the Kent franchise. Above-average increases have been applied to Orpington, Sevenoaks and Ashford, but below-average increases to Tonbridge, Tunbridge Wells and Maidstone.

² Following privatisation, this was initially set at the RPI and subsequently at the RPI less 1pp.

Local fares and inflation.

To what extent is it the case that fares have lagged inflation in recent years? As in all such calculations, it rather depends on the starting point. Chart 3 shows Sevenoaks-to-London fares adjusted for inflation since early 1995. In real terms, regulated fares (standard class seasons and ordinary returns) generally fell between 1998 and 2002 but have since risen to a little below their 1995 level.

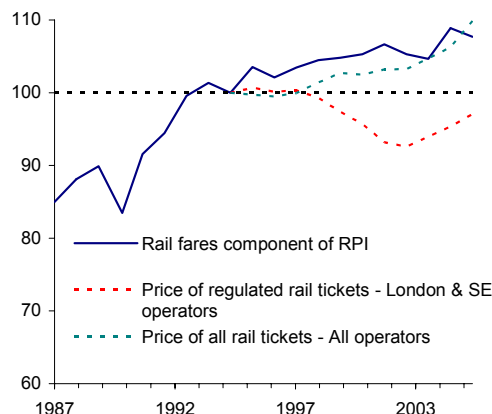
Chart 3
Inflation-adjusted fares Sevenoaks to London (February 1995 = 100)



Indices of fares deflated by the all-items RPI.

Sources: Southeastern (fares) and National Statistics (RPI). In 1995 fares were increased in February. Figure for January 2007 is based on the change in the RPI to November 2006 (3.9%).

Chart 4
Longer term inflation-adjusted rail fares 1987-2006 (January 1995 = 100)



Indices of fares deflated by the all-items RPI.

Sources: Price of rail tickets Office of Rail Regulation (prices of rail tickets) and National Statistics (RPI data - all-items and train fares series).

In 1990 and 1995 fares were increased in February rather than January which accounts for the apparent reductions in those years. (The February values for the train fares component of the RPI in those years are 90.7 and 102.4 respectively.)

The trend in unregulated fares (which include off-peak day returns and all first class tickets) is mixed. The price of off-peak day returns has trended upwards in real terms throughout the period shown. First class seasons (not shown) have commanded a 50% premium to standard class seasons throughout and so have shared the latter's real profile. The real cost of ordinary first class returns has now been brought back to its 1995 level after an earlier decline.

Chart 4 shows the trend in the train fares component of the RPI relative to the all-items RPI over a longer period beginning in 1987. While the increase in real fares on this (national) measure has been relatively modest since the mid-1990s, it is evident that real fares were increased significantly in the run-up to privatisation in April 1997.

From 1995, another dataset is also available from the Office of Rail Regulation (ORR) for ticket prices sold respectively by (1) all TOCs in Great Britain and (2) London and South East TOC's as a group (including Southeastern and earlier operators of the Kent franchise). The real price of *regulated* tickets sold by London and South East TOCs has broadly the same profile of that for Sevenoaks. The ORR

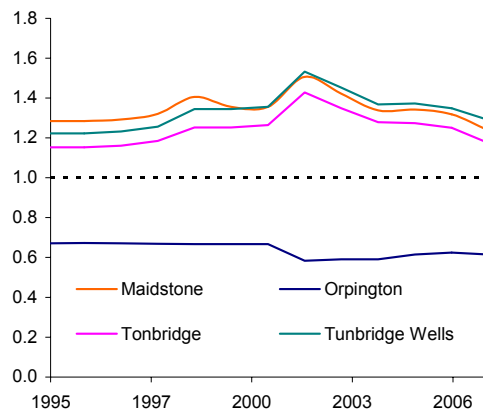
series for the price of *all* tickets sold by all TOCs has recently risen faster than the RPI fares series. Note that this chart does not include the January 2007 increases.

How has Sevenoaks fared relative to other stations?

The above average rise in Sevenoaks fares may reflect an element of catch-up. Charts 5 and 6 show, respectively, the trend in the relative cost of (regulated) annual seasons and (unregulated) off-peak returns to London charged at other stations in the Kent franchise. It is apparent that at Tonbridge and Tunbridge Wells the price of season tickets rose relative to those at Sevenoaks during the early years of the current decade but that recent changes have brought them back to their relative level of the mid-1990s. The relative increase in fares on the Maidstone East line in the early part of the decade (see also data for Kemsing in Chart 7) may have been a factor encouraging commuters from new housing estates such as Kings Hill to use Sevenoaks despite a long car journey, although this trend has been reversed more recently.

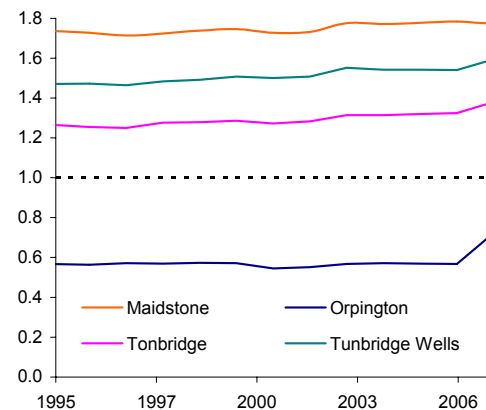
There has been little change in relative price of (un-regulated) off-peak returns (Chart 6), although the latest round of increases seems to have been relatively favourable to Sevenoaks travellers). The ‘spread’ of relative fares is much more pronounced than is the case for (regulated) season tickets, suggesting more active pricing in relation to demand factors (which will be influenced by incomes and the price and availability/convenience of alternatives).

Chart 5
Relative cost of a standard class annual season (Sevenoaks = 1)



Source: Southeastern and SRTA calculations.

Chart 6
Relative cost of a standard class off-peak return (Sevenoaks = 1)



Source: Southeastern and SRTA calculations.

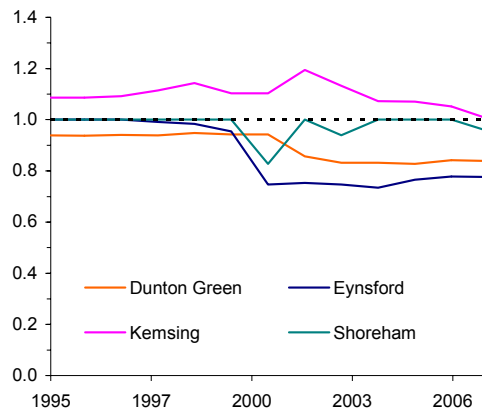
Local relativities

Ticket prices at Bat and Ball and Otford are the same as at Sevenoaks. However, over the years there has been some change in the relative cost of tickets at other stations in the SRTA membership area.

Chart 7 shows that in recent years there has been a fall in the cost of (regulated) season tickets from Dunton Green, and from Eynsford and Kemsing, but little net

change in those from Shoreham (after a short-lived reduction at the turn of the decade). The data for un-regulated off-peak day returns shows, if anything, the opposite trend, with a rise relative to Sevenoaks (Shoreham again excepted) (Chart 8). The relative cost of off-peak travel from Kemsing looks very high given its relatively infrequent service and short distance from Otford..

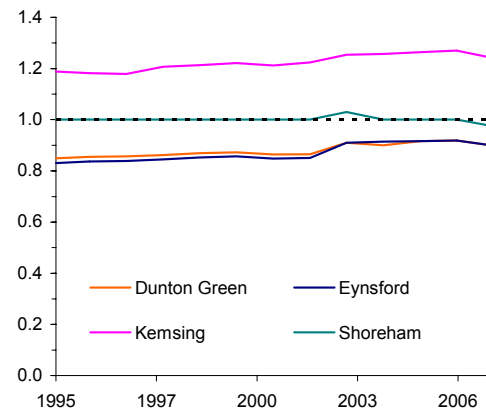
Chart 7
Relative cost of a standard class annual season (Sevenoaks = 1)



Source: Southeastern and SRTA calculations.

Fares from Otford and Bat & Ball have been the same as Sevenoaks throughout the period.

Chart 8
Relative cost of a standard class off-peak return (Sevenoaks = 1)



Source: Southeastern and SRTA calculations.

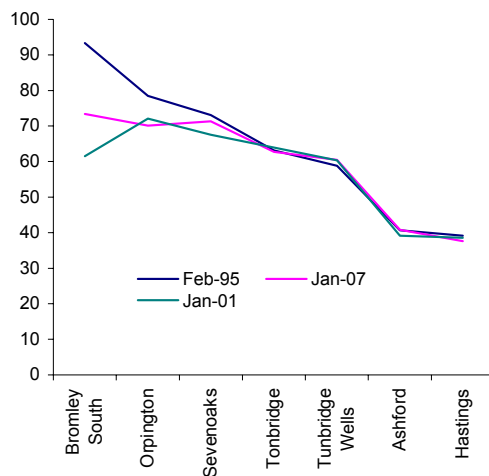
Fares from Otford and Bat & Ball have been the same as Sevenoaks throughout the period.

Cost of tickets in relation to distance travelled

The price of tickets per mile typically falls with distance travelled. This is the kind of pattern one might expect in an industry where fares are largely charged as a mark-up over costs and where the cost structure includes two components: a large fixed cost component unrelated to distance travelled which is shared out on a per journey basis, and a component that varies with journey length.

Charts 9 and 10 show how the cost of an annual season to London from some of the larger stations on the Kent franchise varies with journey distance, both in absolute terms and relative to Sevenoaks. For stations south and east of Sevenoaks, relative fares have remained quite stable over the last 12 years. There has been more variation in those closer to London. In the early part of the period there was a significant flattening of the curve for stations closer to London (Orpington and Bromley South), although this has been partly reversed since 2001.

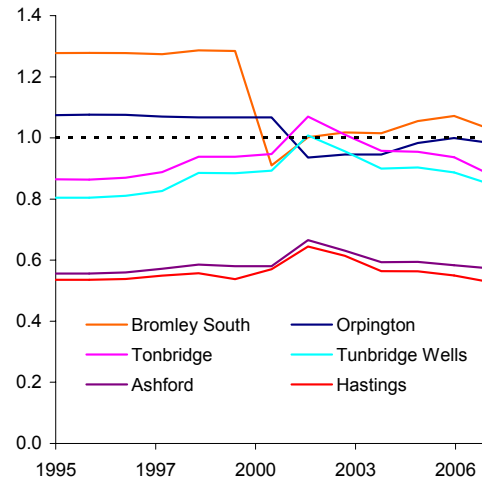
Chart 9
Cost of an annual season (1995£ per journey mile)



Source: Southeastern (fares), National Statistics (RPI) and SRTA calculations

Chart shows prices (in February 1995 prices) of an annual standard class season divided by distance to London. Stations are ordered from left to right in terms of distance from London.

Chart 10
Cost of an annual season per journey mile relative to Sevenoaks



Source: Southeastern (fares), National Statistics (RPI) and SRTA calculations

Chart shows prices of an annual standard class season divided by distance to London relative to Sevenoaks.

Trend in fare subsidies

Southeastern notes the Government's intention to reduce further the subsidy on commuter fares. Chart 11 below shows the trend in subsidies (expressed in terms of pence per passenger kilometre) for the Kent franchise and for all TOCs. The downward trend in the Kent franchise's subsidy was interrupted in 2003-04 largely because of the problems experienced with Connex South Eastern but has since resumed.

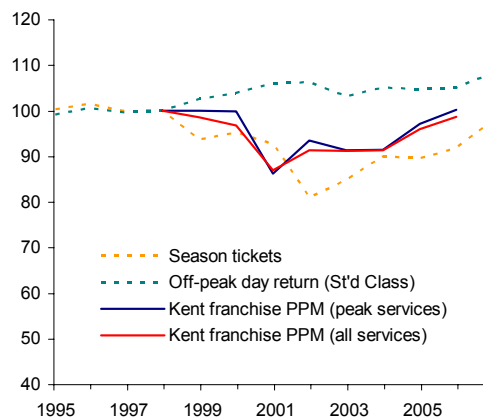
In 2005-06, of the 10 London and South East Regional TOCs, four made net *payments* to the government. In effect this revenue defrays some of the cost of subsidies to services operated by other companies. Of the remaining six TOCs, South Eastern Trains, which accounted for about 16% of passenger traffic, received one third of the net subsidy of £180 million. Assuming the average subsidy per kilometre applied to Sevenoaks-to-London return journeys, the subsidy on an ordinary standard class return would have been around £1.28 or about 10% of the net-of-subsidy cost of the ticket. A similar calculation for 1998-99 implies a subsidy of £2.08 or 17.6% of the net-of-subsidy fare.

Chart 11
Fare subsidies (pence per passenger km)



Source: ORR (subsidy data), South Eastern (fares) and SRTA calculations

Chart 12
Inflation-adjusted fares and performance (1998=100)



Source: ORR (PPM data) and Southeastern (fares and National Statistics (RPI data).

Figures for PPM are averages for financial years. Fare data are as of January each year and deflated by the RPI. The figure for January 2007 data assumes RPI inflation of 3.9%, the level in November 2006.

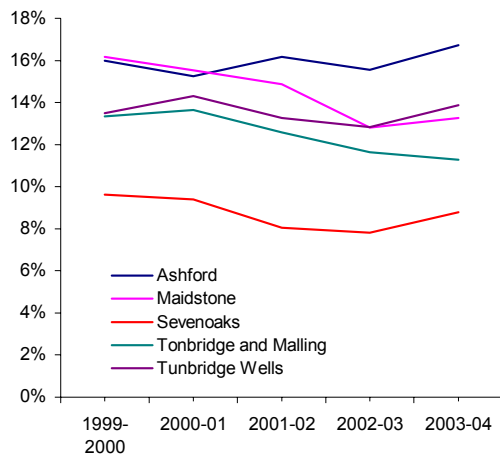
Trends in performance

A further justification made by Southeastern for above-average increases is to give recognition to the (much-delayed) introduction of new trains (with fewer seats despite the rapid growth in passenger numbers), recent improvements in station infrastructure, better reliability and punctuality, and to finance future investment. Given that other stations (such as Tonbridge) have also benefited (for example from additional services commencing in December 2006), it seems somewhat questionable to justify any above-average increases on this basis. Improvements in reliability and punctuality in recent years are also only relative to the very low levels of performance for a long period following the Hatfield crash (Chart 12 above). This chart superimposes the Kent franchise's [Public Performance Measure](#) ('PPM') for peak and overall services against regulated and unregulated fares. There is some relationship between the profile of real regulated fares and performance. (PPM data for 2006-07 will not be available until mid-2007.)

Affordability and the cost of alternatives

What has been the trend in affordability of local rail travel and how does this compare with the cost of alternatives? HM Revenue and Customs data on average incomes (of taxpayers only) are available for various localities in Kent. Chart 13 shows the cost of an annual season relative to pre-tax average (median) income in a number of towns with significant rail commuter traffic. Data more recent than 2003-04 are not yet available, so the impact of more recent real increases in fares is not captured. The pattern is quite mixed with, on balance, a fall in the burden of fares relative to income at Maidstone and Tonbridge but a rise at Ashford. There is little overall trend in the case of Sevenoaks and Tunbridge Wells. An important caveat in interpreting these series is that the data for median income are not drawn from a consistent sample in each locality in each year.

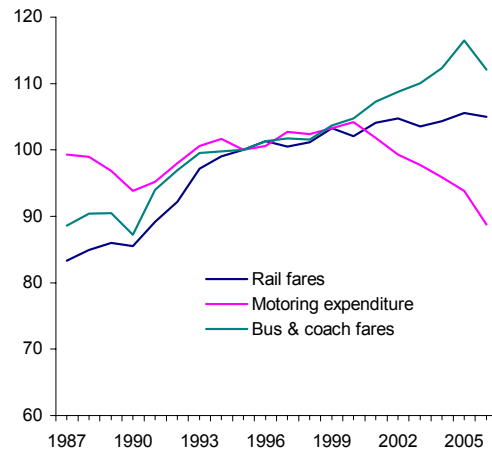
Chart 13
Annual season as percentage of median pre-tax income of taxpayers



Source: HM revenue and Customs (income data), Southeastern (fares).

Data are for fiscal years with the cost of tickets calculated as a weighted average of January fares in adjacent years. Income data are medians (half the sample of taxpayers has lower incomes, half has higher).

Chart 14
Relative real travel costs (1995 = 100)



Source: National Statistics

Data are respective travel components of the RPI deflated by the all-items RPI.

Finally, how does the cost of rail transport compare with private motoring and buses? Chart 14 compares the real cost of each (at the national level). It is clear that the real cost of bus and coach fares has risen more rapidly than rail travel. The striking reduction in the real cost of private motoring reflects a fall in car prices which has more than offset a rise in the real cost of other motoring expenses (maintenance, fuel and oil, and insurance and road tax). These trends in relative costs place the increasing problem of road congestion and recent arguments for road pricing into context. Unfortunately, with trains already [overcrowded](#), their ability to absorb further increases in numbers will depend on more investment in trains and the rail infrastructure.

Conclusions

The pricing of regulated train fares is subject to several, often conflicting pressures – allowing investors in the railway an opportunity to make a reasonable return commensurate with the risks they are taking; competition from alternatives; variations in service quality; and management of the government subsidy and strategic transport policy objectives generally. While these objectives are difficult to reconcile, recent trends in real fares and relativities between stations can be hard for train users to fathom on the arguments that are sometimes made. A strong case can be made for a clearer statement of the objectives and principles when setting fares and so greater consistency, thereby avoiding sharp, disruptive changes which only reinforce passenger scepticism. That way commuters and local authorities can make major decisions in an informed way with greater confidence that their plans will not be undermined.