

Privatization Politics:
The story of the German Railroad System

- Draft -

Comments welcome!
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Wolfgang Tiefensee, Germany's Federal Minister for Transport, Building, and Urban Development from the Social Democratic Party of Germany (SPD), stated at a press conference on April 15, 2008 that the SPD Commission's proposal to partially privatize the Deutsche Bahn Corporation was a "decisive step" in the privatization debate and confidently declared that the coalition has now "opened the door for the future security of the train service." Tiefensee was confident that the way was finally clear to implement his brainchild, the DB privatization. However, this proved to be a miscalculation as the events of 2008 unraveled.

The journey begins

The German railroad system is dominated by the state-owned company Deutsche Bahn (DB), which is not only active in transporting passengers and freight but also manages railway infrastructure and operates logistics enterprises across the globe. The DB is engaged in transnational freight and passenger transport and has started to invest in international passenger transport. In 2006 the DB employed 237,299 persons, had revenues of 30 billion euros and earned a net profit of 1.68 billion euros. The freight and transport ventures are dominated by non-railroad transport and logistic activities, amounting to 13.8 billion euros in revenue. Schenker, a subsidiary company, handles 13.2 billion of this revenue, and the small-specialized logistic service company Stinnes is responsible for the remainder. Railroad transports by Railion account for only 3.2 billion euros in revenue. Altogether the freight and transport ventures (Schenker, Stinnes and Railion) account for 46% of the DB's revenue and for 25% of its profits.¹

In 1993, the German parliament decided to begin reforming the DB, which at that point was in a poor state. After accumulating operational deficits during the 80s, while providing low-quality services, the DB lost much of its former customer base. Whereas, in the 1920s, the DB handled 70% of the market share of freight transports, by the 1990s, this figure had plummeted to less than 20%.

The first steps in the federal government's reform mission were to clean up the railway's debts and to overhaul the DB's organizational structure into a private joint stock company (named DB AG). Both steps were intended to reduce the political influence on the continuing development of the DB and to strengthen the entrepreneurial initiative of the DB. On top of these reforms, the federal government would invest heavily in railway infrastructure and open the areas of local and freight traffic

¹ Cp. DB (2006). *Facts&Figures 2006*. Retrieved January 17, 2008, from http://www.db.de/site/shared/en/file__attachements/reports/facts_figures_2006.pdf

to competition from private companies. In the end, the reform mission was supposed to result in the complete privatization of the DB (changing the organization already constituted the first step in privatization, making the DB organizationally privatized).

The approach was successful; the steep decline of the railroad's market share was halted, the DB's operational deficits were reduced and the quality of the railroad services improved. However, the reform led to increased prices, and few of the more ambitious ideas were realized. The main problem with the achieved reforms was the failure of the railroad's overall market share to increase significantly, an outcome originally hoped for by reformers. Regardless of the mixed outcome, the partners agreed to continue the reform process, but the complications surrounding the DB's future soon became evident.

The railroad is not the only means of transportation in Germany. It competes with road and air traffic in both freight and passenger transportation. No inter-city bus services exist in Germany – the law forbids such operations. Inland water transport and pipelines offer competition for freight transportation. Comparing the market shares of these systems, the most frequently used transportation infrastructure system is roads, followed by railroads. Roads are by far the preferred traffic system in Germany, handling 70% of freight and almost 90% of passenger transports. The German government appropriates approximately 10 billion euros to the DB, as compared with 5.5 billion euros to federal roads.² Of the 9.38 billion euros the railroad system received in 2007, 3.49 billion were invested in infrastructure. Most of the remaining money was transferred to the German states, where the money is used to organize and operate regional train services.³

This heavy investment from the federal government can be traced back to the railroad's history. The tracks were first laid in the 19th and 20th centuries when the national train system was both highly profitable and completely vital for reducing transport costs and securing economic growth. From the rise of industry in the years of National Socialism to the environmental movement of the 1980s, socio-political influences of Germany's past were and still are tied to the train system.

As environmental protection groups often point out in their arguments supporting the railroad system, the real costs of transportation must be examined. The direct costs (e.g. the train or airplane ticket price) for using a traffic system normally differ from the real costs of this usage for society,

² The federal government is the only government level in Germany that spends money on railroads. The federal roads are financed by the federal government and the federal states. (Data taken from: ProMobilität (2008). *Finanzierung der Fernstraßen im Bundeshaushalt 2008 und der mittelfristigen Finanzplanung der Bundesregierung*. Retrieved February 15, 2008, from <http://www.promobilitaet.de/downloads/Pro-Mobilitaet-Thema-Fernstrassenetat-2008.pdf>, p. 2).

³ The federal states act as the ordering party for the short-distance passenger transport. They issue tenders for regional train lines and pay the contractor for operating them.

which include the infrastructure costs and the environmental side effects in terms of pollution, noise and also land consumption. Railroad traffic, for example, produces considerably less CO₂ emissions than road traffic per passenger kilometer. This is important to keep in mind because of the current climate change debate, especially as traffic already accounts for 19% of Germany's CO₂ emissions. This share might rise significantly in the next years, since traffic is projected to increase. The Ministry of Transportation estimates, for example, that the total amount of freight traffic will increase about 50% by 2050.⁴

| Traffic System | CO ₂ emissions for freight traffic (g/tkm)* | CO ₂ emissions for passenger transport (g/pkm)* |
|------------------------|--|--|
| Railroad | 29 | Short distance traffic: 100 Long distance traffic: 54 |
| Trucks | 158 | – |
| Private cars | – | Short distance traffic: 155 Long distance Traffic: 122 |
| Buses | – | Short distance traffic: 78 Long distance traffic: 33 |
| Air traffic (domestic) | – | 333** |
| Inland water transport | 31 | – |

Table 2: Overview over the average CO₂ emissions of traffic systems⁵

* The average emissions are measured in gram per ton kilometer and in gram per passenger kilometer.

** The direct average CO₂ emission of domestic air travel is only 157 grams of CO₂ per passenger kilometer, but since the CO₂ is emitted in heights of several kilometers, its negative effect on the atmosphere is stronger. Therefore most CO₂ calculators use 333 grams of CO₂ per passenger kilometer for domestic travel.

Investing in the railroad system also raises a strong debate about social welfare issues. Experts argue the railroad system is particularly important for people who cannot afford a car, or who are unable to drive. Currently, 92% of the German population lives within ten minutes of the nearest public transport system.⁶ Thus, the poor, young, old, and disabled members of society profit

⁴ Cp. BMVBS (2007). *Progtrans – Abschätzung der langfristigen Entwicklung des Güterverkehrs in Deutschland bis 2050*. Retrieved November 22, 2007, from http://www.bmvbs.de/Anlage/original_999441/Gueterverkehrs-prognose-2050.pdf, p. 91.

⁵ Cp. FAZ.NET (2007, October 15). *Fracht auf die Schiene!; Bahn gefahren wird genau zur falschen Zeit; Die Bahn im Klima-Test*. Retrieved June 11, 2008, from: <http://www.faz.net>.

⁶ Cp. Financial Times Deutschland (2007, November 1). *Wege aus der Provinz*. Retrieved November 22, 2007, from: <http://www.ftd.de/recherche/archiv.html>.

enormously from a functioning public transport system (which includes of course not only railroads, but also buses, subways and trams). This aspect will continue to grow in importance as the price of oil is expected to rise on the long and the EU's plan to price CO₂ emissions comes into full force. Additionally, those who do not use the railroad system can also profit from it as it can help to prevent and reduce road congestion by diverting traffic from the roadways. As the number of people traveling by train increases (the transportation system with the least amount of accidents) and as the general roadway congestion decreases (the transportation system with the most amount of accidents), the overall safety of the German transportation system improves.

Legal issues

The future structure of the DB has to meet two legal requirements: it must comply with the requirements of the German Basic Law⁷ and with the specifications of the European railroad sector laws (called the railroad packages). The first legal restriction is the Basic Law's explicit requirement in article 87e that the federal government is responsible for the railway infrastructure. This means that the state has to keep the majority ownership of the infrastructure and that it has to have real control over its property. The infrastructure includes track systems, railroad stations and all technical facilities. On the other hand, the German Basic Law does not limit the privatization of the transportation and logistic activities. Restrictions on infrastructure ownership could be overruled by amending the Basic Law, which requires the passage of a federal law with a two-thirds majority in both the German Parliament and the Federal Council of Germany. However, while the Basic Law has undergone many general changes since its adoption, it is very unlikely that it could be changed in this point. Few political parties would agree to such a change in 2008, and such a proposal would meet strong resistance from the electorate. Yet, there is precedent for such an initiative, as article 87e was amended in 1993 allowing for the DB's organization to transition into a private stock company.

The second legal restriction on the DB's future organizational form is the European railroad sector regulation, which is established in three railway packages. The goal of these laws is to strengthen the European railroad system by creating a competitive Single European Railroad Market. The first railway package (2001) required national regulation authorities to secure discrimination free access to the infrastructure for all railroad operators. It also laid down a broad principle for charging companies for using railroad infrastructure. The second railway package (2003) set down rules for security and interoperability within Europe and opened all domestic and international freight traffic in Europe to competition. In the third railway package (2007), Europe decided to open the international passenger

⁷ The German Federal Constitution.

transport market in 2010. Following its general strategy, the European Union hopes that the non-discriminatory access for all companies to the railroad infrastructure will lead to a functioning railroad market with real competition. It is hoped that competition will improve the price and service ratio of the railroad system and thereby strengthen the railroad in its competition against other transportation systems.

In contrast to other countries, the railroad system in Germany does not face competition from a bus line system. The passenger transportation law forbids the operation of bus lines for domestic destinations. The only exception (due to its special status during the cold war) is Berlin, as some bus lines operate from West German cities (e.g. from Düsseldorf) to Berlin.⁸

Available Options

Two rather divisive models dominate the debate over the future privatization of the DB: the *integrated model* and the *separated model*. Beyond these two models, there are more alternatives available, most notably, the *holding model*, which incorporates elements of both models. Generally, the most important points on which these privatization models differ is the status of the infrastructure, the conditions/restraints of the state's control over the infrastructure and the maximum possible degree of privatization. Probably the most debated question is about the organization of the future DB. The question is whether the DB should be privatized as a whole, or divided into smaller pieces before the privatization. In the former case, the DB would keep its current structure after the privatization. In the second case, its infrastructure activities would be separated from its transport and logistics activities and only the transport and logistic activities would be privatized.

Following the **first option**, known as the *integrated model*, the DB would not be divided before its privatization. The infrastructure, transport and logistic activities would remain part of one corporate group. The DB would also continue to hold the infrastructure ownership. Up to 49.9% of its shares could be sold to private investors, and the state would have to be the majority shareholder in order to comply with the Basic Law. Finally, the state's subsidies for the infrastructure (for maintenance and extension) would be paid directly to the DB under the term of a cost-performance contract.

Contrary to the first option, the **second option**, the *separated model*, would compartmentalize the DB into two companies. One company called Net AG would oversee the infrastructure activities of the DB and own the railroad infrastructure. Although the Net AG could theoretically be privatized up to 49.9%, most of this model's advocates favor that it would remain in complete state ownership. The

⁸ Cp. Passenger Transport Act (§ 13 paragraph 2).

transport and logistic activities then would be transferred to a different company. This company would be completely separated from the Net AG, so it would be possible to privatize it completely. It would have no administrative connection to the infrastructure's management and would not be allowed to hold shares in the Net AG. The state's subsidies for the infrastructure would be transferred directly to Net AG, and these payments would be regulated with a cost-performance contract between state and Net AG.

According to the *holding model*, the **third option**, the DB would be transformed into a financial holding company. The transport and logistic activities would be separated from the infrastructure activities into two different companies. These companies would be run independently of each other, but the DB holding company would maintain shares in both. Compared to the first model, the main difference is that the DB's control over its subsidiary companies would be more limited. As a financial holding company, the DB could only indirectly influence its subsidiary companies as a shareholder; while in the *integrated model*, the DB's corporate group would have direct power through control agreements. The infrastructure would be owned and managed by the infrastructure company. The state would pay its subsidies directly to this company and would negotiate a cost-performance contract with it. The state could secure its control over the infrastructure either by holding the majority of the infrastructure company's shares directly, or by holding the majority of the holding's shares, which itself would hold shares of the infrastructure and of the transport company. The possible degree of privatization would be 49.9% for the infrastructure company and 100% for the transport company if private investors invest directly into these companies. This option is advocated by some SPD politicians hoping to overcome the grand coalition's dissension in the privatization debate. If private investors would invest in the holding, the possible degree of privatization would be 49.9%.

Privatizing the DB is of course not the only possibility for its future organization. Since 1993 the organization of the DB is that of a stock company entirely owned by the state. The state could refrain from changing the organization of the DB and maintain the stock structure. This would be the **fourth option** for the DB's future structure.

| Characteristics | First option: Integrated model | Second option: Separated model | Third option: Holding model | Fourth option: Do nothing |
|-----------------------------------|-----------------------------------|-----------------------------------|--------------------------------|------------------------------|
| Structure | undivided | divided | divided | undivided |
| State of infrastructure control | indirect | direct | indirect/direct | direct |
| Possible degree of privatization* | 49.9% | 100% / 49.9% | 100% / 49.9% | - |
| Implications for federal budget** | 14 – 23 | 8 – 14 | 9 – 16 | 0 |

Table 2: Overview over the privatization models

* If there are two numbers: The first number gives the possible degree of privatization for the transport, the second number states the possible degree of privatization for the infrastructure activities.

** The forecast of the budgetary implications of the privatization models compared to the status quo is based on the net present value method. The net present value of the Status Quo is therefore 0. The figures considered in this calculation are the revenue from the IPO, the dividend payment (when the state does not privatize 100% of the transport activities), the value of the infrastructure company, and the possible savings of reduced prices for the regional transport due to increased competition. It is important to keep in mind that the numbers are only estimates and may vary significantly depending on the time of the IPO, the market environment, and many other factors. The numbers are given for the maximum possible degree of privatization, in billion euros.⁹

The politics of Privatization

Germany is a federal democratic republic, in which the federal legislative power is vested in the Federal Parliament and the Federal Council of Germany. The government is headed by the Chancellor and the political system is shaped by the plurality of a multi-party system: The most important parties are CDU/CSU, SPD, FDP, the Greens and The Left. The CDU (Christian Democratic Union) and the CSU (Christian Social Union of Bavaria) form an alliance on the federal level; they act as one party in the federal parliament. During the time of the privatization debate, the government was formed by their faction (in the following text abbreviated with CDU) and the SPD (Social Democratic Party of Germany). This so-called Grand Coalition was inaugurated in November 2005; the next elections will take place in September 2009. The opposition parties are the liberal FDP (Free Democratic Party), the Green Party and The Left, the successor of the former communist party SED, which was the governing party of the former East Germany.

Even though the CDU and the SPD were merely able to agree on the formulation of a very general statement of their goals for the DB, they did make one thing clear in their Coalition Agreement from November 11, 2005: "The railroad reform will continue." They agreed to continue on the reform path and to prepare an initial public offering of the DB. This was not a small achievement, considering the contrary positions of the CDU and the SPD in the question of the DB's future organization. To begin with, however, the grand coalition did have several common goals for the DB privatization process. First of all, everyone agreed that they wanted to reduce the CO₂ emissions in Germany by 40% by 2020 as compared to the figures from 1990. Secondly, they agreed to try to cut the states financial subsidies to the DB as much as possible. Furthermore, the coalition wanted to make Germany more attractive to investors by keeping the railroad infrastructure in a good condition.

⁹ Data taken from Booz Allen Hamilton (2006). *Privatisierungsvarianten der Deutschen Bahn AG "mit und ohne Netz"*. Gutachten im Auftrag des Bundesverkehrsministeriums und des Bundesministeriums der Finanzen. Retrieved November 8, 2007, from http://www.bmvbs.de/Anlage/original_952625/Gutachten-Privatisierungs-varianten-der-Deutschen-Bahn-AG-mit-und-ohne-Netz-_Maerz-2006.pdf

However, despite these common goals, the partner's visions for how to plan the DB's future were completely different. While the Union favored the privatization of a divided DB (according to the separated model), the SPD wanted to privatize up to 49% of an undivided DB (more or less following the integrated model).

Most important to the CDU was securing the state's control and ownership over the railroad infrastructure along with generally improving competition in the railroad sector. The general consensus in the CDU was that the only way to achieve its goals would be to complete the privatization process through the separated model. Furthermore, the CDU believed that the separated model would minimize the state's financial subsidies over time and also be the most successful plan to shift traffic back towards the railroad. The SPD, on the other hand, favored the integrated model because of the relative stability in its projected level of employment through the privatization process. Additionally, the SPD thought this model would guarantee the continued inclusion of services to less important train stations as well as alluring investors whose interests were close to the public welfare. Yet it must be said that the SPD was less united in their opinion than the CDU. The SPD's left wing did not agree completely on the actual privatization of the DB, while the SPD's right wing wanted the privatization and would have even agreed to a separated model.

After a long debate, Tiefensee finally led the coalition to an agreement on a compromise model on November 24, 2006. The compromise model closely resembled the integrated model's structure in most of the characteristics, but it was relabeled as the *Eigentumssicherungsmodell* (property securing model). The name of this model came from the differentiating aspect of this compromised model, meaning that in this model the state was set up to retain the civil property rights of the infrastructure. While this aspect seemed to resemble the separated model, upon closer inspection it started to look like a mere illusory measure. The DB would gain the infrastructure's economic property rights for 15 years as well as the contract to manage the infrastructure for 15 years. This means that the DB would be able to continue including the infrastructure's value on its balance sheet. Furthermore, the state would have no real access to the infrastructure as long as the DB would fulfill its legal obligations laid down in a cost-performance contract. The state would also continue to pay its infrastructure subsidies directly to the DB. In the end, the compromise would allow a division of the DB's infrastructure and transport/logistic activities after the initial 15 year period. Yet this compromise model seemed a bit too hypothetical as opponents were quick to point out. Hermann Scheer, an outspoken critic of the privatization of the DB and a Member of Parliament in the SPD forecasted the outcome of this compromised deal when he said: "The discussion is not over," because some "serious questions are not answered yet."

From its conception, the newfound compromise was scrutinized by both stakeholders and representatives within the coalition. Yet Minister Tiefensee stood by his plan while his subordinates in the Federal Ministry of Transportation and Building and Urban Affairs transformed the first of the plans into law. Nevertheless, criticisms continued to increase.

One of the few stakeholders satisfied with the law was the DB's Chief Executive Officer Hartmut Mehdorn, who called the compromise "an important and positive sign for the DB, its employees and its customers." He evaluated the compromise to be a good working basis for the DB's future, which would allow the DB to seize the opportunities of the increasing competition. Mehdorn's positive assessment of the compromise was not surprising since he was one of the most distinguished advocates of a privatization. From the onset, he had preferred the undivided structure as he thought that this option would guarantee the best conditions for the DB's future growth and net profits of all the privatization models.

The largest transportation workers' union, Transnet (which about 50% of the DB's employees are members of), also supported the compromise. The union's role in determining the DB's future structure is important and has grown continuously. After the start of the reform all new employees were hired with normal contracts and not as civil servants, who are not allowed to organize in unions (in 2006 only 16.8% of the DB's employees were still public servants). The unions considerably influenced the SPD's position in the privatization debate as the SPD was afraid to create a plan that might lead to strikes. The Transnet leader, Norbert Hansen, had long said he would back a privatization under the condition that the DB would be undivided. He feared that a division of the DB would endanger the current wage agreement that prohibits dismissals.

Critics of the compromise included the newly founded anti railroad privatization protest groups, trade associations, environmental NGOs, scientific experts, the federal states, other ministries and parts of SPD and CDU. The most important points which attracted critique were the compromise's effect on competition, its compatibility with the German constitution and the financial implication of the property ownership construction.

Both the Ministry of Economics and the trade associations held the view that the compromise would endanger the competition of the railroad market. The Ministry of Economics went as far as to label Tiefensee's compromise as having "serious defects" in a 10-page critique written at the beginning of May 2007. Their objections stemmed mainly from the fact that the compromise would have allowed cross-subsidization between the DB's business units. They complained that with this,

the DB could raise the user-prices for its infrastructure in order to lessen the profits of its competitors. "The first tendencies of such practices can already be observed," mentions the critique.

The compromise plan received a further blow when all of the independent experts testifying before the German parliament on May 22, 2007 claimed that it would not be legal under the Basic Law. One of the experts, Robert Uerpmann-Witzack from the University of Regensburg stated: "The model is not compatible with the Constitution." His colleagues shared this opinion, along with the experts in the Federal Ministries of Justice and the Interior who had also raised their concern before the hearing.

The coalition's opposition, of course, also criticized Tiefensee's compromise. The leader of the Green party, Fritz Kuhn, even stated the "formulaic compromise" would create a corporate group "which would harm the customers with state support." The Green Party's general stance towards a DB privatization was positive, but held a strong opinion as to how to reach their main goal (the shifting of traffic to the railroad in order to reduce pollutant emissions). The Green Party thought this goal would be best served by a privatization along the lines of the separated model. The FDP was also in favor of this model (its most important goal being to the strengthen competition in the railroad market) and it criticized the Tiefensee compromise severely. The Left's motivation to criticize the compromise on the other hand was its general skepticism towards privatizations.

Furthermore the federal states had their own criticism of the compromise. Since it is obligatory by law for the federal states to ratify any agreement about the privatization, their voice mattered. They saw their two main interests, first that the prices for short distance passenger transport stay the same and second that no regional railroad tracks be discontinued, endangered by Tiefensee's compromise. The Hessian Minister of Economics, Alois Rhiel (CDU), expressed these concerns in a letter to Tiefensee and threatened him with a veto of the federal states. Rhiel wrote: "This law's draft is not acceptable from my perspective." He went on to explain his impression that Tiefensee designed the compromise "only to strengthen the federal company Deutsche Bahn AG." According to Rhiel's opinion, it would be impossible to strengthen the railroad's market share by the compromise model.

Yet despite all of the criticism (even some SPD regional associations declared their rejection of Tiefensee's compromise and the parliamentary faction of the union publicly demanded improvements for the law) the federal cabinet decided on July 24, 2007 to endorse the Tiefensee compromise and present it to parliament as a draft law. The plan of the federal government was to finish the parliamentary deliberation as fast as possible, at the very latest before the SPD party convention at the end of October 2007. On July 24 it seemed as if the CDU faction would be the largest impediment in keeping the ambitious timeframe. CDU vice chairman Dr. Hans-Peter Friedrich spoke about the

compromise as a good starting point for the parliamentary deliberations with negative and positive aspects, while the SPD faction's press release welcomed the cabinet's decision and rejected all criticism of the compromise. But this picture was misleading, the SPD proved to be the main obstacle to its own minister.

The debate continues...

It all started in July 23, 2007 when Andrea Ypsilanti (the Hessian SPD leader and known advocate of the SPD's left wing) suggested selling the DB shares to private investors, in order to exclude institutional shareholders from becoming major shareholders. This was the birth of the SPD's leftist idea of privatizing the DB with *people shares*. Potential investors and experts reacted negatively to this idea: "that is social romanticism," said Jürgen Meyer, head of the German shares department of SEB Asset Management. Another equity fund manager stated, "[t]he DB simply is not ready for an initial public offering." Other SPD politicians rejected the proposal (among those Tiefensee), as did the vice leader of the SPD faction, Ludwig Stiegler, who dismissed the idea saying, "These ideas are wool-gathering in front of the fireplace. The DB shares are not suitable for a people share model." Yet the SPD continued to argue about the privatization process while pressure from the local party organizations mounted to such intensity that the parliamentary decision about the compromise was prolonged past the previous benchmark of the SPD's party convention at the end of October.

During the party convention, the privatization with *people shares* became such a popular idea that it was passed in a resolution mandating the privatization of the DB with nonvoting preference shares (called people shares by the SPD). The point behind this type of shareholding system is to exclude investors with interests opposed to the common welfare. The shareholding investors in the DB would not obtain a right to vote but would be promised a minimum dividend of around 5%.¹⁰ As the CDU and other stakeholders pointed out, a privatization with people shares would have several disadvantages, the most important being the reduced attractiveness of the DB for strategic investors. The core interest of strategic investors is the possibility to influence the development of their investment. Giving out nonvoting shares makes this impossible. It basically implies that only smaller, private investors would buy DB shares whose main interest for doing so would be the guaranteed minimum dividend. The people shares would furthermore drastically reduce the expected privatization revenue and in turn constitute a considerable financial risk to Germany. The federal government would be liable for the payment of the guaranteed minimum dividend.

At this point, the compromise draft law's future looked bleak. However, the resulting deadlock did not persist for long since the federal government introduced an alternative concept at the beginning of

¹⁰ Cp. (2007, September 9). *Volksaktie ermöglicht Bahn-Spaltung*. Retrieved November 22, 2007, from: <http://www.ftd.de/recherche/archiv.html>.

November 2007. The new holding model was developed by the Minister of Finance Peer Steinbrück (SPD), and was endorsed by Tiefensee, Mehdorn and Secretary of the Chancellery Thomas de Maizière (CDU) in a high-level meeting on November 8, 2007. Basically, the plan was to sell 49% of the transportation and logistic company to private investors. Representatives of the SPD's left wing started to criticize the new proposal immediately because the proposed people shares were not mentioned in the new concept. "In my opinion the holding model fails to fulfil the requests of the SPD," said Uwe Beckmeyer, Political Traffic Speaker for the Social Democrats in the Bundestag. "The [holding] model belongs to the separation models; thereby the train group begins to slip. I will not support such politics." The SPD delegate Hermann Scheer also firmly rejected the separation of the rail network and train service. The holding model, however, does not automatically have to go in this direction, as Scheer stated: "it is conceivable that the SPD can agree upon the development of a model." Scheer, previously an advocate of the people's share, said this model should only be a "bridge building suggestion. Under no circumstances do we want to sell the infrastructure. If that is guaranteed under the holding model without people's shares, then the model is in no violation of the party convention decision."

Mehdorn did support the new plan. As a source close to him said, "[t]he holding model is still better than no privatization."

Yet despite these new positive tendencies, the privatization debate was not over yet. Before the holding model plan could gain the necessary political momentum, another issue pushed the privatization debate out of the public's attention. A trade dispute between the DB and the labor union GDL (the union of the engine drivers) began during that summer and became the center of transportation politics in Germany. The conflict dragged on for several months with strikes, lawsuits and special strike timetables. In the beginning of December it seemed like the conflict was ending and an unlimited strike through Christmas was avoided. Minister Tiefensee pressured the DB into accepting an agreement to avoid further strikes. Mehdorn was not happy with this intervention and proclaimed that the agreement was not "a victory of reason. It [was] a defeat, not only for the DB, but also for Germany." Mehdorn further declared that the DB would have to lay off workers because of the additional costs of the wage agreements.

In response, Tiefensee demanded that "as its owner, the federal government expects the DB AG to continue the good partnership with the labor unions." This incident was commented on by a DB manager, who preferred to stay anonymous, "The relationship between these two is currently rather chilly." The trade dispute still continued and was finally settled in the beginning of March. But by this

time, the public and political focus had already turned again to the question of the DB's future organizational structure.

On January 20, 2008 the DB expanded its international activities by buying the British railroad company Laing Rail, one of the largest railroad operators in Great Britain. With the combination of Laing Rail and EWS (another freight transportation company DB already owned), DB's business volume in Great Britain reached 1 billion euros. One month later the competition in Germany increased, when the French transport company Veolia bought the freight train operator Rail4Chem and doubled its own business volume in Germany.

Finally a solution?

Meanwhile, the SPD continued in its struggle to find the 'right' approach to the DB's privatization model. Compounding left wing attacks on the holding model claimed that this model would lead to the division of the transportation and logistics activities from the infrastructure activities. At the same time, a debate about details of the holding plan broke out between Mehdorn and the federal government. This debate focused on whether Mehdorn could be the Chief Executive of both the financial holding and the independent companies. Such dual mandates are problematic not only because of conflicting interests between the different positions, but they can also lead to a situation where the financial holding becomes liable for the transport company. Since dual mandates would not be allowed, Mehdorn could only be head of the privatized transport company (and take orders from the holding) or be head of the financial holding. Furthermore, questions regarding whether a holding model privatization would lead to significant revenues, and who would get these revenues (the federal state or the DB), were open.

Despite these problems, the SPD announced on March 10, 2008 that it would complete a strategy for the DB's future before the end of April. The SPD's left wing answered this announcement with the publication of data reporting the real costs of capital procurement for the DB. Hermann Scheer explained that raising money for the DB's investments with shares would be the most expensive form of capital procurement (an alternative would be issuing a bond loan). "Shares are the highest yielding type of investment for the investors, therefore they inevitably have to be the most expensive way of raising capital for the issuers," as Scheer wrote. Uwe Beckmayer, one of the SPD's transport experts, replied: "The numbers alone don't say much. One has to recognize that strategic investors bring new ideas and strategies to a company." Mehdorn also reacted and accused Scheer of only being interested in "ideological quarreling."

This time the SPD's announcement proved to be right and the SPD leaders agreed to a compromise on April 14 – even though they were at odds with each other until the last minute. The SPD agreed to privatize the DB according to the holding model, with the constraint that only 24.9% of the transport activities could be privatized. On April 28, 2008, the CDU agreed to the new plan. Although the privatization skeptics used the parliamentary debate of the DB privatization law on May 30 for another round of criticism, this time the skeptics from SPD and CDU kept quiet and only let the opposition continue to fight against the privatization. October 27 was set as the final date for the initial public offering. Tiefensee concluded: "The citizens will feel the advantages of this part privatization quickly. With the fresh capital the DB will be able to renovate railroad stations, to reduce noise emissions, and to decrease speed restriction sections, and these measures will improve its service, speed, and punctuality drastically."

Despite the plan surviving the political attacks, the initial public offering was stopped in the first week of October 2008. The effects of the financial crisis had already decreased the expected revenue of the privatization from eight to four billion, but now even this seemed to be too optimistic. On October 16 the Minister of Finance Peer Steinbrück pointed out: "We are not going to sell the property of the Federal Government on the financial and capital markets in times like these." Going public is, "because of the recent financial market developments, not on the agenda within the foreseeable future."

While Tiefensee choose not to comment on this development and his Ministry's website continued to state that the DB would be privatized according to the plan (as of January 21, 2009), Mehdorn did talk about his reaction after the news on October 24, 2008 at a logistics congress: "I feel like a high-diver, who has been practicing for years and now climbed up to the ten meter platform to make the most beautiful jump of his life, only to realize that somebody let all the water out."

Addendum I: Operating Figures of the DB 2006¹¹

| Segments | Operating profit (in million euros)* | Revenues (in million euros) | Employees (full time)** |
|------------------------------------|---|--|---|
| <u>Passenger transport</u> | | | |
| Long-Distance Transport | 124 | 3,234 | 14,641 |
| Regional Transport | 690 | 6,480 | 25,700 |
| Urban Transport | 154 | 1,805 | 12,238 |
| <u>Transport and Logistics***</u> | | | |
| Schenker | 367 | 13,232 | 54,905 |
| Railion | 226 | 3,194 | 22,635 |
| Stinnes | 16 | 608 | 1,622 |
| <u>Infrastructure and Services</u> | | | |
| Track Infrastructure | 100 | 548 | 41,356 |
| Passenger Stations | 136 | 310 | 4,557 |
| Services | 31 | 94 | 26,689 |
| Energy | 166 | 362 | 1,628 |
| <u>Other operating entities</u> | 467 | 186 | 23,229 |
| <u>DB group</u> | 2,477 | 30,053 | 237,299 (39,869 of these civil servants) |

* Operating profit (EBIT - Earnings before Interest and Taxes) differs from the net profit (in 2006 1,680 billion euros)

** Part time employees are converted into equivalent full time employees for better compatibility

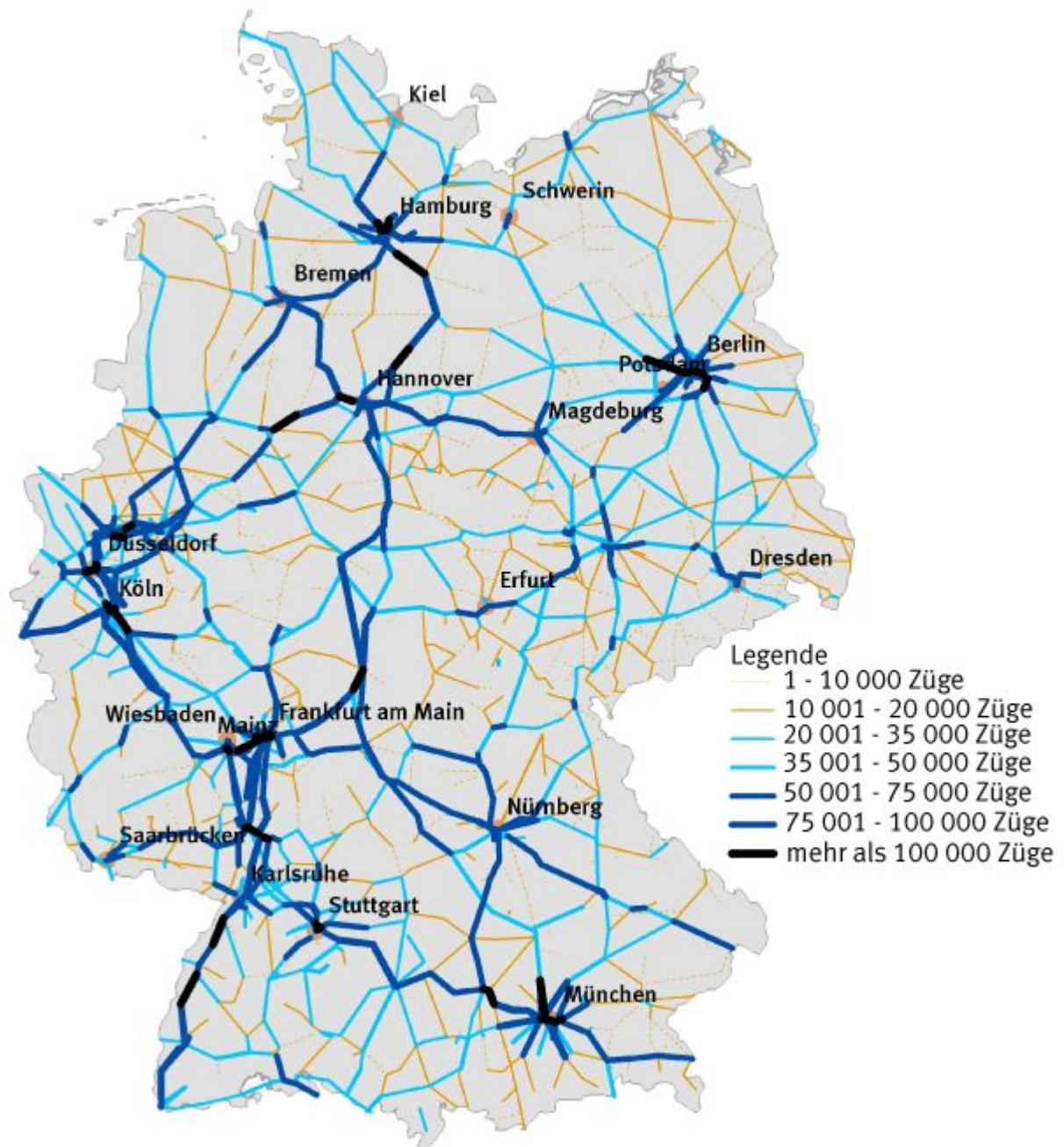
¹¹ Cp. DB (2006). *Facts&Figures 2006*. P. 15 and 17. Retrieved January 17, 2008, from http://www.db.de/site/shared/en/file__attachements/reports/facts_figures_2006.pdf.

Addendum II: Market shares of the DB and its competitors in 2006¹²

| | Short distance passenger transport | Long distance passenger transport | Freight transport |
|-------------|---|--|--------------------------|
| DB | 88% | > 99% | 90% |
| Competitors | 12% | < 1% | 10% |

¹² Cp. BDI, DIHK (2006). *Privatisierung der integrierten Deutschen Bahn – Auswirkungen und alternativen*. BDI Drucksache Nr. 380. P. 13. Retrieved February 12, 2009, from http://www.bdi-online.de/Dokumente/Verkehrspolitik/BDI-DIHK_Bahnstudie_-_Januar_2006.PDF

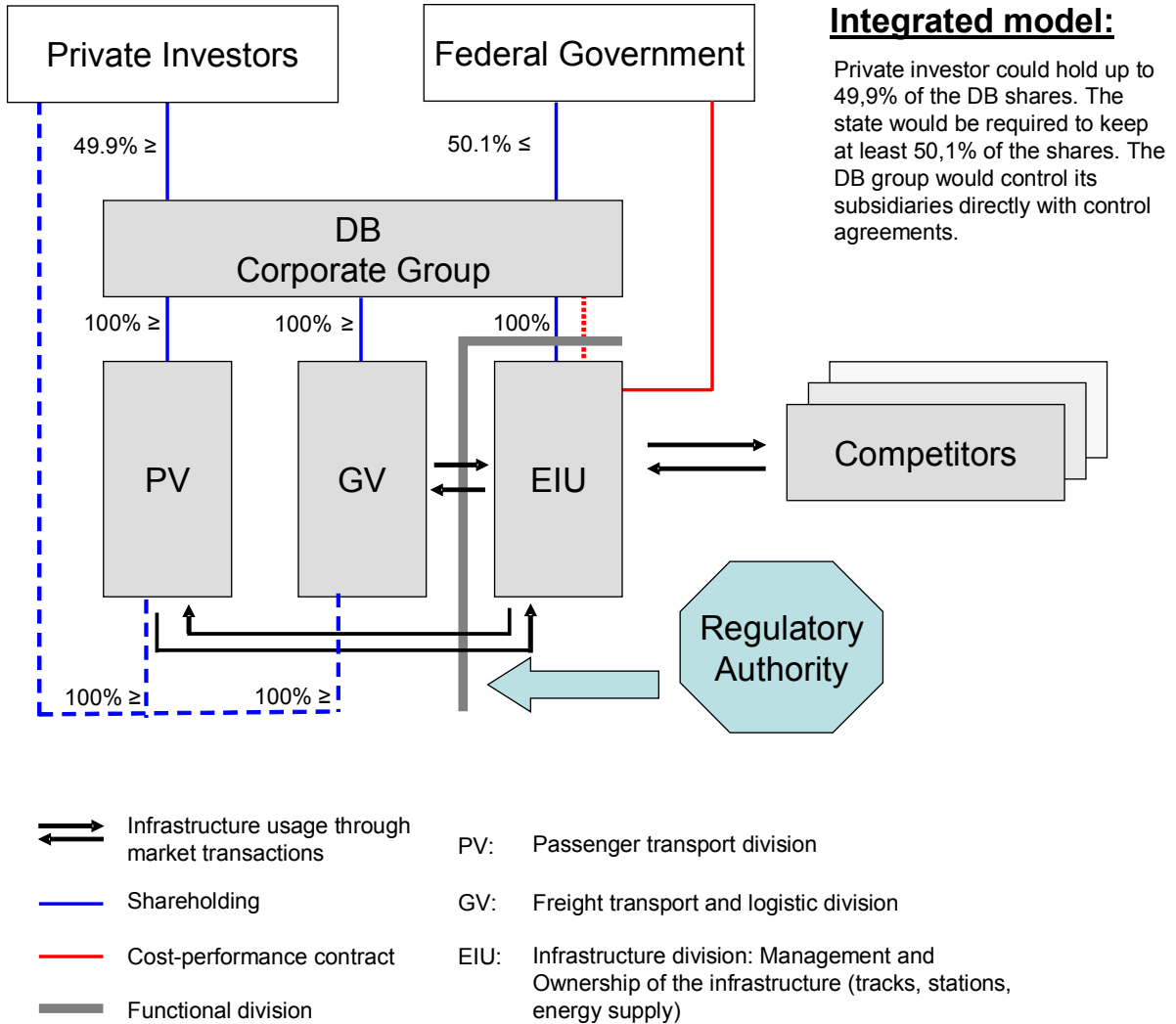
Addendum III: Capacity utilization of the railroad infrastructure¹³



* The map shows the usage of the railroad infrastructure from trains (passenger and freight) for 2005.

¹³ Cp. Statistical office of Germany (2007). *Karten zur Belastung des Schienennetzes*. Accessed February 13, 2009, from <http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/DE/Content/Statistiken/Verkehr/VerkehrsmittelbestandInfrastruktur/Tabellen/Content75/Verkehrsinfrastruktur.templateId=renderPrint.psm>.

Addendum IV: Structure and scope of design of the integrated model¹⁴

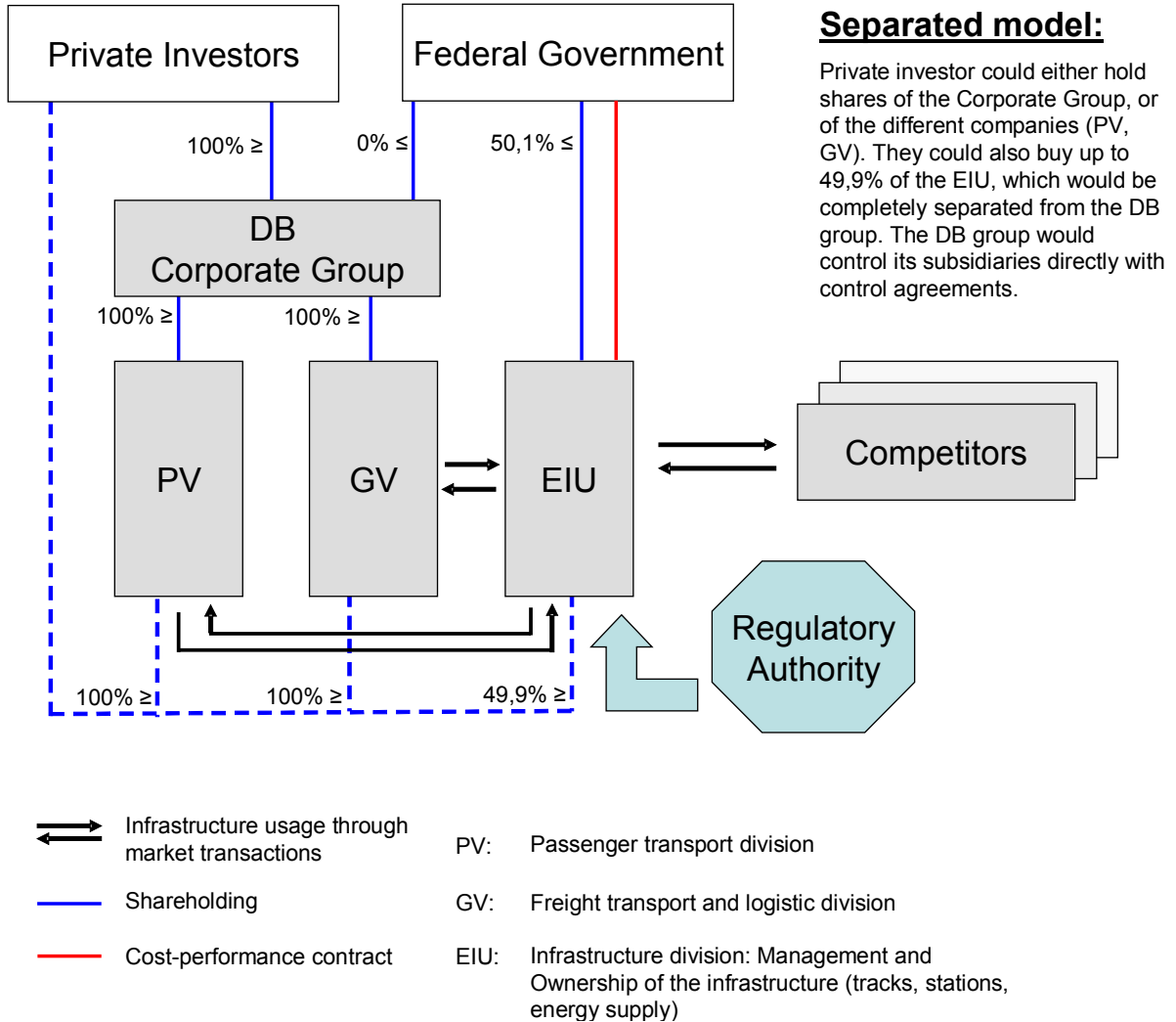


Integrated model:

Private investor could hold up to 49,9% of the DB shares. The state would be required to keep at least 50,1% of the shares. The DB group would control its subsidiaries directly with control agreements.

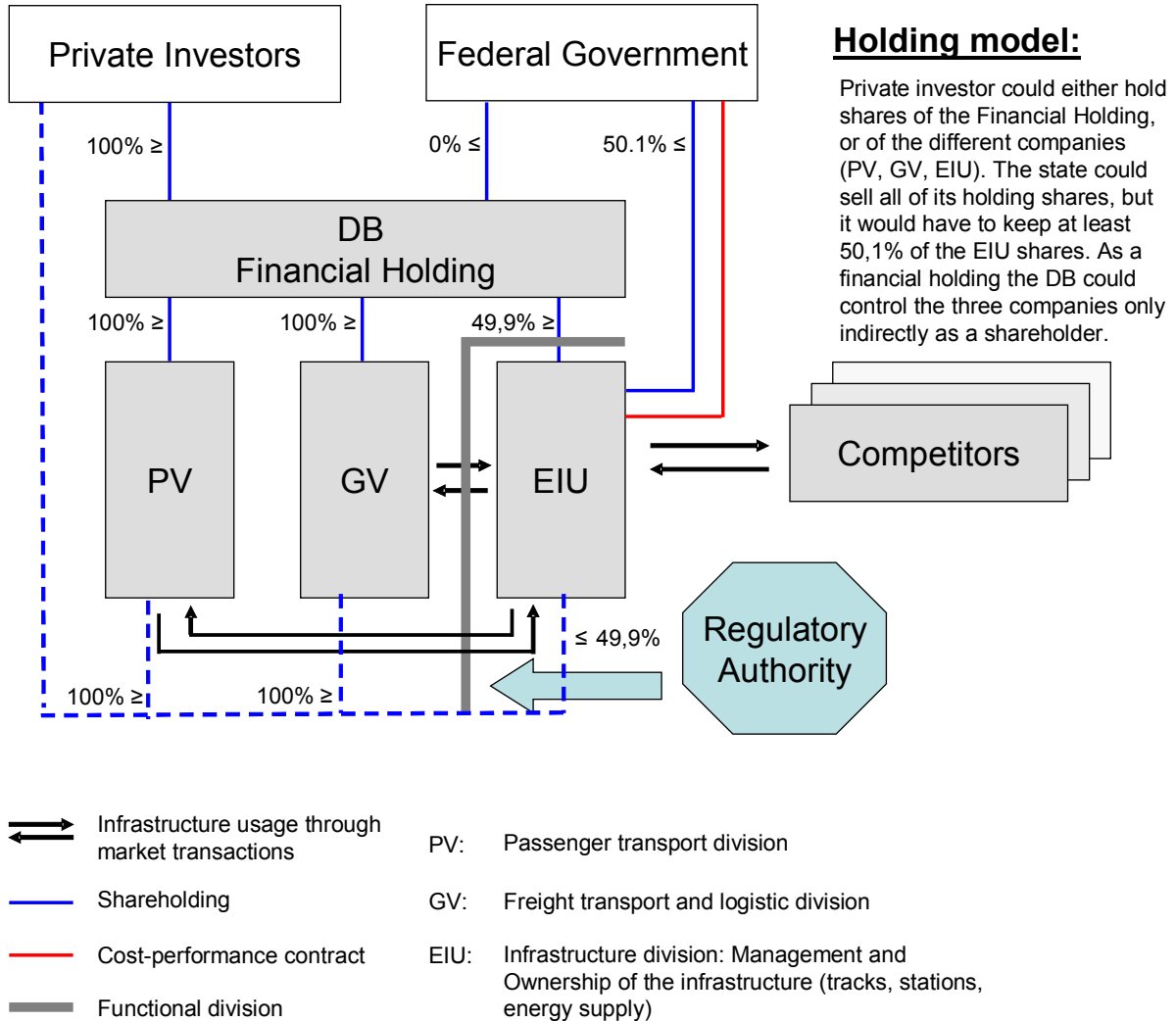
¹⁴ Cp. Booz Allen Hamilton (2006). *Privatisierungsvarianten der Deutschen Bahn AG "mit und ohne Netz"*. Gutachten im Auftrag des Bundesverkehrsministeriums und des Bundesministeriums der Finanzen. Retrieved November 8, 2007, from http://www.bmvbs.de/Anlage/original_952625/Gutachten-Privatisierungs-varianten-der-Deutschen-Bahn-AG-mit-und-ohne-Netz-_Maerz-2006.pdf

Addendum V: Structure and scope of design of the separated model¹⁵



¹⁵ Cp. Booz Allen Hamilton (2006). *Privatisierungsvarianten der Deutschen Bahn AG "mit und ohne Netz"*. Gutachten im Auftrag des Bundesverkehrsministeriums und des Bundesministeriums der Finanzen. Retrieved November 8, 2007, from http://www.bmvbs.de/Anlage/original_952625/Gutachten-Privatisierungs-varianten-der-Deutschen-Bahn-AG-mit-und-ohne-Netz-_Maerz-2006.pdf

Addendum VI: Structure and scope of design of the holding model¹⁶



Holding model:

Private investor could either hold shares of the Financial Holding, or of the different companies (PV, GV, EIU). The state could sell all of its holding shares, but it would have to keep at least 50,1% of the EIU shares. As a financial holding the DB could control the three companies only indirectly as a shareholder.

¹⁶ Cp. Booz Allen Hamilton (2006). *Privatisierungsvarianten der Deutschen Bahn AG "mit und ohne Netz"*. Gutachten im Auftrag des Bundesverkehrsministeriums und des Bundesministeriums der Finanzen. Retrieved November 8, 2007, from http://www.bmvbs.de/Anlage/original_952625/Gutachten-Privatisierungs-varianten-der-Deutschen-Bahn-AG-mit-und-ohne-Netz-_Maerz-2006.pdf

Addendum VII: Total gross investment (public and private) in the traffic infrastructure in Germany¹⁷

| In billion euros* | 2003 | 2004 | 2005 | 2006 | 2007 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|
| Traffic routes | 19,164 | 17,919 | 14,742 | 14,789 | 14,409 |
| Railroad** | 6,505 | 5,655 | 3,107 | 3,447 | 3,287 |
| Tram lines*** | 982 | 727 | 677 | 662 | 619 |
| Roads (including bridges)*** | 10,801 | 10,670 | 10,090 | 9,839 | 9,692 |
| Federal roads*** | 4,514 | 5,126 | 4,919 | 4,776 | 4,541 |
| Water ways*** | 695 | 685 | 682 | 656 | 630 |
| Pipelines**** | 182 | 182 | 186 | 186 | 182 |
| | | | | | |
| Stations and reloading points | 2,473 | 1,850 | 2,471 | 2,618 | 3,204 |
| Railroad** | 825 | 759 | 1,120 | 1,246 | 1,046 |
| Domestic ports*** | 90 | 135 | 110 | 128 | 128 |
| Seaports*** | 439 | 427 | 562 | 559 | 585 |
| Airports*** | 1,118 | 529 | 679 | 685 | 1,444 |

* In prices of 2000.

** From 2005 on investment from non state owned companies are included.

*** All or almost all investment by public expenditure.

**** All or almost all investment is private.

¹⁷ Daten taken from BMVBS (2008). *Verkehr in Zahlen 2008/2009*. Hamburg: DVV Media Group.

Addendum VIII: Federal gross expenditure and investment in the federal traffic infrastructure¹⁸

| In billion euros | 2007 (target) | 2008 (target) | 2009 (plan) | 2010 (plan) | 2011 (plan) |
|-------------------------|----------------------|----------------------|--------------------|--------------------|--------------------|
| Federal roads | 5.65 | 5.88 | 5.53 | 5.48 | 5.48 |
| Only investment | 4.70 | 4.93 | 4.58 | 4.53 | 4.52 |
| Railroad | 9.34 | 9.23 | 9.49 | 9.54 | 9.65 |
| Only investment | 3.49 | 3.70 | 3.67 | 3.68 | 3.69 |
| Waterways | 1.61 | 1.68 | 1.72 | 1.72 | 1.72 |
| Only investment | 0.74 | 0.80 | 0.85 | 0.85 | 0.85 |
| Federal traffic routes | 16.60 | 16.79 | 16.74 | 16.74 | 16.85 |
| Only investment | 8.93 | 9.43 | 9.10 | 9.06 | 9.06 |

¹⁸ Cp. ProMobilität (2008). *Finanzierung der Fernstraßen im Bundeshaushalt 2008 und der mittelfristigen Finanzplanung der Bundesregierung*. P. 2. Retrieved February 15, 2008, from <http://www.promobilitaet.de/downloads/Pro-Mobilitaet-Thema-Fernstrassenetat-2008.pdf>.

Addendum IX: Overview of the different traffic systems' market shares¹⁹

| Traffic System | Market share of freight transports (2006) | Market share of passenger transports (2006) | Federal infrastructure investment (2007) * |
|-----------------------------------|--|--|---|
| Railroad | 17.2% | 9.4% | 3.49 |
| Road traffic (private and public) | 70.0% | 89.4% | 4.70 |
| Air traffic (domestic) | – | 1.2% | – |
| Inland water transport | 10.3% | – | 0.74 |
| Long distance pipelines | 2.6% | – | – |

* In billion Euros. The federal government does not invest directly into air traffic infrastructure and long distance pipelines.

¹⁹ Cp. DB (2006). *Facts&Figures 2006*. P. 13. Retrieved January 17, 2008, from http://www.db.de/site/shared/en/file__attachements/reports/facts_figures_2006.pdf.

Addendum X: Accidents with damage to persons of selected traffic systems in 2005 ²⁰

| Traffic System | Absolute number of killed persons | Killed persons per billion passenger kilometer | Absolute number of injured persons | Injured persons per billion passenger kilometer |
|-----------------------|--|---|---|--|
| Railroad | 7 | 0.09 | 290 | 3.87 |
| | | | | |
| <u>Road traffic</u> | | | | |
| Automobiles | 2,833 | 3.29 | 247,281 | 287.40 |
| Buses | 9 | 0.14 | 5,232 | 82.26 |

²⁰ Cp. Allianz pro Schiene (2007). *Sicherheit der Verkehrsträger im Vergleich*. Retrieved February 13, 2009, from http://www.allianz-pro-schiene.de/cms/upload/pdf-Dateien/Grafiken_Tabellen/PM_070509_Unfaelle_im_Verkehrstraegervergleich.pdf.

Addendum XI: Overview of the different traffic systems' length²¹

| Traffic System* | 2005 | 2006 | 2007 | 2008 |
|---|-------------|-------------|-------------|-------------|
| <u>Trans-local roads</u> | 231.5 | 231.5 | 231.4 | 231.2 |
| <u>Different road types:</u> | | | | |
| Highway (01.01.) | 12.2 | 12.4 | 12.5 | 12.6 |
| Federal road (01.01.) | 41.0 | 41.0 | 40.7 | 40.4 |
| State road (01.01.) | 86.7 | 86.6 | 86.6 | 86.6 |
| District road (01.01.) | 91.6 | 91.6 | 91.5 | 91.6 |
| | | | | |
| <u>Railroad (31.12.) **</u> | 41.3 | – | – | – |
| | | | | |
| <u>Waterway (31.12.) **</u> | 7.5 | 7.5 | 7.5 | – |
| | | | | |
| <u>Long distance pipeline (31.12.) **</u> | 2.4 | 2.4 | 2.4 | – |

* All numbers are given in 1000 kilometres. The numbers are either given for the beginning of the year (01.01.) or for the end of the year (31.12).

** –: Not yet published by the Statistical Office (as of February 2009).

²¹ Cp. Statistical office of Germany (2009). *Verkehrsmittelbestand und Infrastruktur*. Accessed February 13, 2009, from <http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/DE/Content/Statistiken/Verkehr/VerkehrsmittelbestandInfrastruktur/Tabellen/Content75/Verkehrsinfrastruktur.templateId=renderPrint.psml>.

Addendum XII: Excerpt from the Basic Law for the Federal Republic of Germany

Article 87e [Federal railway administration]

(1) Rail transport with respect to federal railways shall be administered by federal authorities. Responsibilities for rail transport administration may be delegated by a federal law to the Länder acting in their own right.

(2) The Federation shall discharge rail transport administration responsibilities assigned to it by a federal law, above and beyond those respecting federal railways.

(3) Federal railways shall be operated as enterprises under private law. They shall remain the property of the Federation to the extent that their activities embrace the construction, maintenance, and operation of the tracks. The transfer of federal shares in these enterprises under the second sentence of this paragraph shall be effected pursuant to a law; the Federation shall retain a majority of the shares. Details shall be regulated by a federal law.

(4) The Federation shall ensure that in developing and maintaining the federal railway system as well as in offering services over this system, other than local passenger services, due account is taken of the interests and especially the transportation needs of the public. Details shall be regulated by a federal law.

(5) Laws enacted pursuant to paragraphs (1) through (4) of this Article shall require the consent of the Bundesrat. The consent of the Bundesrat shall also be required for laws respecting the dissolution, merger, or division of federal railway enterprises, the transfer of tracks of federal railways to third parties, or the abandonment of such tracks, or affecting local passenger services.

Addendum XIII: Recommended literature

- Aberle, G., & Eisenkopf, A. (2003). *Schieneverkehr und Netzzugang*. Hamburg: Deutscher Verkehrsverlag.
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