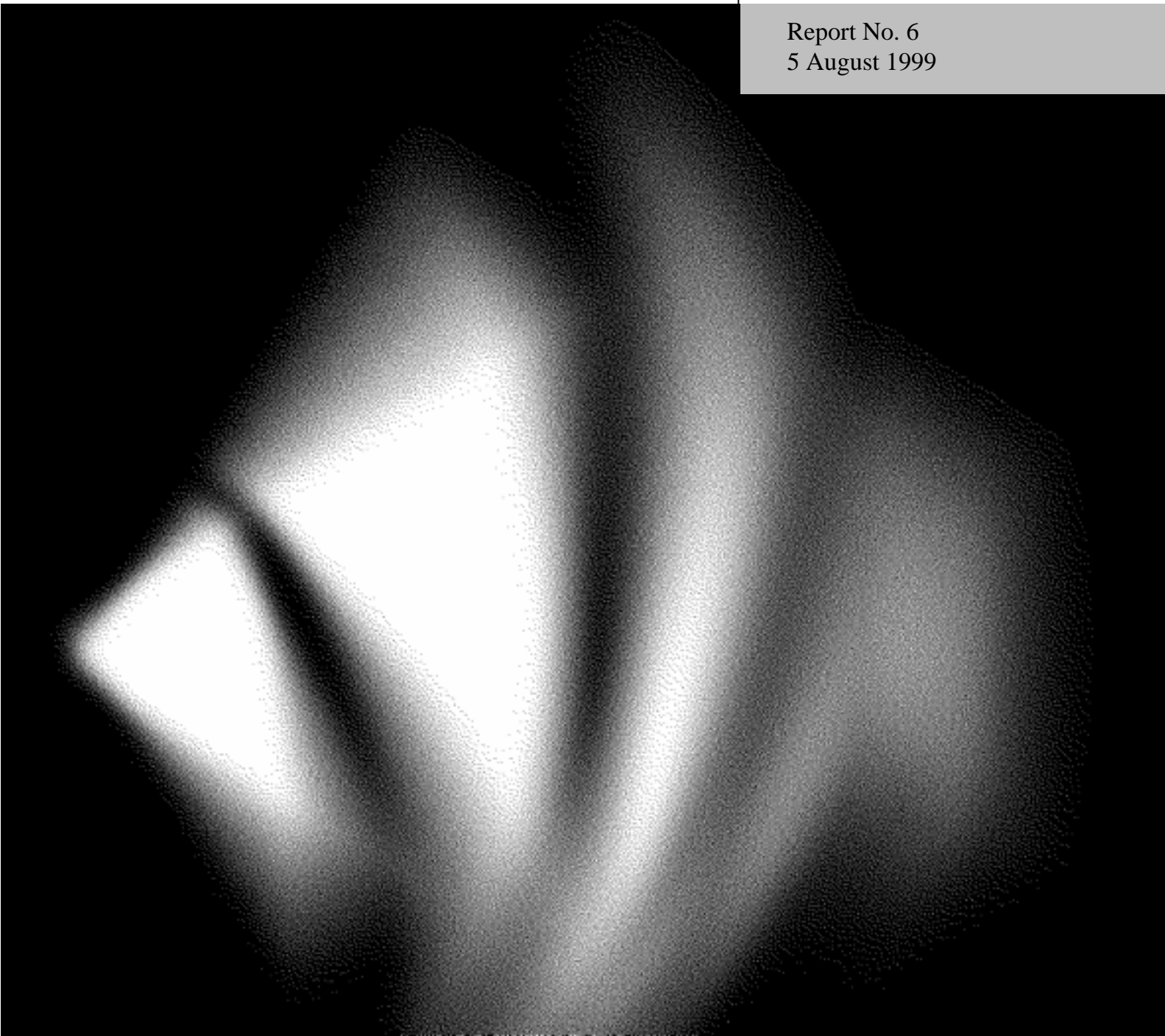




Progress in Rail Reform

Inquiry Report

Report No. 6
5 August 1999



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The Productivity Commission

The Productivity Commission, an independent Commonwealth agency, is the Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Information on the Productivity Commission, its publications and its current work program can be found on the World Wide Web at www.pc.gov.au or by contacting Media and Publications on (03) 9653 2244.

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Abbreviations

Abbreviations

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AFFA	Department of Agriculture, Fisheries and Forestry
AN	Australian National
ANZSIC	Australian and New Zealand Standard Industrial Classification
ARA	Australasian Railway Association
ARSAA	Australian Rail Safety Accreditation Authorities
ARTC	Australian Rail Track Corporation
ASR	Australia Southern Railroad
ASU	Australian Services Union
ATAC	Australian Transport Advisory Council
ATC	Australian Transport Council
ATN	Australian Transport Network
AURDR	Australian Urban and Regional Development Review
AUSTRAC	Austrac Group and Capricorn Capital
AWB	Australian Wheat Board
BFA	Bicycle Federation of Australia
BIE	Bureau of Industry Economics
BNSF	Burlington Northern and Sante Fe Railway Company
BOO	Build-Own-Operate
BOOT	Build-Own-Operate-Transfer
BR	British Rail
BTCE	Bureau of Transport and Communications Economics
BTE	Bureau of Transport Economics
BTO	Build-Transfer-Operate
BV	Banverket
CASA	Civil Aviation Safety Authority Australia
CIPR	Competitive Imputation Pricing Rule

CN	Canadian National
COAG	Council of Australian Governments
CP	Canadian Pacific
CPA	Competition Principles Agreement
CPI	Consumer Price Index
CR	Consolidated Rail Corporation
CRS	Constant Returns to Scale
CSO	Community Service Obligation
CSX	CSX Transportation
CTC	Competitive Tendering and Contracting
DBAG	Deutsche Bahn Aktiengesellschaft
DEA	Data Envelopment Analysis
DORC	Depreciated Optimised Replacement Cost
DTRS	Department of Transport and Regional Services
EBA	Enterprise Bargaining Agreement
EBIT	Earnings Before Interest and Tax
EBR	Emu Bay Railway
EC	European Commission
ECMT	European Conference of Ministers of Transport
EWS	English Welsh Scottish Railways
FA	Ferrocarriles Argentinos
GNRS	Great Northern Rail Services
GSR	Great Southern Railway
GST	Goods and Services Tax
GTW	Grand Trunk Western Inc
HORSCCTMR	House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform
IC	Industry Commission
ICR	Illinois Central Railroad Company
IGA	Intergovernmental Agreement
IPART	Independent Pricing and Regulatory Tribunal of NSW
IRG	Industry Reference Group
JNR	Japanese National Railways
KCS	Kansas City Southern Railway Company
LAP	Labour Adjustment Package
NCC	National Competition Council
NCP	National Competition Policy
NEC	National Electricity Code

NECA	National Electricity Code Administrator
NEM	National Electricity Market
NEMMCO	National Electricity Market Management Company
NOHSC	National Occupational Health and Safety Commission
NRC	National Rail Corporation
NRR	Northern Rivers Railroad
NRTC	National Road Transport Commission
NS	Nederlandse Spoorwegen
NSC	Norfolk Southern Corporation
NSW	New South Wales
NSWLGSA	Local Government and Shires Associations of NSW
NSWTSB	New South Wales Transport Safety Bureau
NT	Northern Territory
ntkm	net tonne-kilometre
NTPT	National Transport Planning Taskforce
NZRC	New Zealand Rail Corporation
NZRL	New Zealand Rail Limited
OECD	Organisation for Economic Cooperation and Development
ORG	Office of the Regulator General (Victoria)
ORR	Office of Regulation Review
Patrick	Patrick The Australian Stevedore
PC	Productivity Commission
pkm	passenger-kilometre
PTB	Passenger Transport Board
PTC	Public Transport Corporation
QCA	Queensland Competition Authority
QMC	Queensland Mining Council
QR	Queensland Rail
RAC	Rail Access Corporation
RIS	Regulatory Impact Statement
ROA	Return On Assets
ROE	Return On Equity
ROSCOs	Rollingstock Companies
RSCA	Rail Safety Committee of Australia
RTBU	Rail Tram and Bus Union
SA	South Australia
SALGA	South Australian Local Government Association
SARCC	South African Rail Commuter Corporation

SCNPMGTE	Steering Committee on National Performance Monitoring of Government Trading Enterprises
SCOT	Standing Committee on Transport
SCT	Specialized Container Transport
SJ	Statens Jarnvagar
SOO	Soo Line Railroad Company
SRA	State Rail Authority of New South Wales
STA	State Transport Authority (South Australia)
TFP	Total Factor Productivity
TPA	<i>Trade Practices Act 1974</i> (Cwlth)
TOCs	Train Operating Companies
UIC	International Union of Railways
UP	Union Pacific
US	United States
VicTrack	Victorian Rail Track Access Corporation
VLf	V/Line Freight
VLP	V/Line Passenger
VRS	Variable Returns to Scale
WA	Western Australian
WCR	West Coast Railways

Glossary

Above track operations	Train operations for freight and passengers using rollingstock.
Access charge	A fee paid by an operator of transport services for the use of infrastructure.
Access regime	Procedures to govern access to rail track. Includes setting an access pricing policy, criteria for permitting access, and operating conditions.
Average length of haul	Net tonne-kilometre divided by net tonne carried. This is a measure of the average distance that freight is carried.
Average load per locomotive	Net tonne carried divided by the number of locomotives. This is a measure of the average load hauled by a locomotive.
Below track infrastructure	Physically fixed infrastructure such as track, sleepers, signals, terminals and yards.
Bulk freight	Comprises commodities such as coal, iron ore, other minerals and grain.
Catenary system	Overhead power cables for electric trains.
Competition for the market	Competition between bidders tendering to provide a given service.
Competition in the market	Encompasses competition between train operators and other modes, between train operators for the same customers, and between train operators for train schedules.
Competitive tendering	The process of selecting a preferred supplier from a range of potential contractors by seeking offers (tenders) and evaluating these on the basis of one or more selection criteria.

Commercialisation	Embodies the same principles of Corporatisation but does not usually have an equivalent legislative basis.
Community Service Obligation	A community service obligation arises when a government requires a public enterprise to carry out activities (relating to outputs and inputs) which it would not elect to do so on a commercial basis or which it would only do commercially at higher prices.
Competitive neutrality	Refers to government and private enterprises competing on a similar footing regarding commercial incentives and disciplines, taxation and regulation. It also refers to different transport modes operating under similar or consistent investment, taxation, charging and regulatory frameworks.
Contracting out	An arrangement whereby a contracting agency enters into a contract with a supplier from outside that agency for the provision of goods and/or services which typically have previously been provided internally — not necessarily involving competitive bids. Also called ‘outsourcing’.
Corporatisation	Corporatisation aims to replicate private sector commercial incentives and sanctions on public enterprises. Corporatised public enterprises are constituted as either a limited liability company or as a statutory authority under separate legislation.
Data Envelopment Analysis	A linear programming technique used to estimate the relative productivity of railways.
Economies of density	Where average unit costs fall as the number of passengers or volume of freight increases on a particular route or network.
Economies of scale	Where average unit costs fall as the size of the railway increases.
Economies of scope	Where average unit costs fall as the railway increases the range of services it provides.
Externalities	Where the activities of one party impose costs or benefits on another.

Farebox revenue	The revenue a public transport operator collects directly from fares.
Franchising	Involves the granting of a right or licence to operate a defined service and to receive associated revenues. The World Bank refers to this arrangement as concessioning.
Harmonisation	The process of aligning regulations across States so that they are compatible.
Horizontal separation	The separation of an organisation by product (freight and passenger services) or by geography (regional railways).
Intermodal competition	Competition between rail and other modes of transport.
Jurisdictions	Commonwealth, State and Territory Governments.
Mutual recognition	The acceptance by other jurisdictions of accreditation of a rail operator or owner in one State or Territory.
Natural monopoly	Where economies make it possible for one firm to supply the entire market more cheaply than a number of firms.
Net tonne-kilometre	Unit of measure representing the transport of one tonne of freight over a distance of one kilometre.
Non-bulk freight	General freight, comprising containerised freight, steel, motor vehicles, paper products and other general merchandise.
Non-urban passenger	The movement of passengers between cities and country towns.
On time running	Measures the proportion of train trips which arrive within a given time of the scheduled arrival time.
Partial productivity indicators	The ratio of the quantity of a single output to the quantity of a single input.
Passenger-kilometre	Unit of measure representing the transport of one passenger over a distance of one kilometre.

Privatisation	The transfer (sale) of a government enterprise to the private sector.
Productivity	The relationship between a rail system's total inputs and outputs. This relationship incorporates the effects of both scale efficiency and technical efficiency.
Purchaser-provider model (framework)	The separation of the responsibility for deciding what outputs should be produced from the responsibility for deciding how the output should be produced.
Rail-on-rail competition	Competition between train operators for the same customers on a given network.
Regulation	The Council of Australian Governments defines regulation to be the 'broad range of legally enforceable instruments which impose mandatory requirements upon business and the community as well as to those voluntary codes and advisory instruments ... for which there is a reasonable expectation of widespread compliance.' (COAG 1997, p.2)
Rollingstock	A generic term for locomotives, passenger cars, multiple unit railcar sets and freight wagons.
Scale efficiency	Reflects the extent to which a railway is advantaged or disadvantaged, in terms of its productivity, by the scale (or size) of its operations.
Structural separation	The separation of an organisation into discrete legal entities.
Technical efficiency	Refers to the productivity (or efficiency) of a railway after netting out the estimated advantages or disadvantages arising from factors such as the scale of its operations.
Total factor productivity	The ratio of an aggregate index of outputs to an aggregate index of inputs.
Track infrastructure	See Below track infrastructure .
Traffic density (freight)	Net tonne-kilometre divided by route-kilometre.

Train operations	See Above track operations .
Urban passenger	Generally refers to the movement of passengers within a town, city or metropolitan area.
Vertical separation	The separation of an organisation by function (track infrastructure and train operations).

Terms of reference

I, PETER COSTELLO, Treasurer, pursuant to Part 3 of the *Productivity Commission Act 1998*, hereby refer progress in rail reform to the Commission for inquiry and report within twelve months of receipt of this reference. The Commission is to hold hearings for the purposes of the inquiry.

Background

2. Australia's rail network forms a crucial part of Australia's transport infrastructure. Past reforms have delivered significant improvements in the operation of Australia's rail systems. However, the pace and nature of the reforms vary between systems. Performances in some areas continue to be below world's best practice. There is a need to undertake a stocktake of progress in rail reform to identify areas, including both urban passengers and freight, where further action is most needed. The Industry Commission last undertook a stocktake of progress in rail reform in 1991.

Scope of Inquiry

3. In undertaking this inquiry, the Commission should identify progress made in rail reform as well as areas which could be subject to further reforms and the benefits of pursuing further reforms. The Commission should also clearly differentiate its analysis of interstate rail operations from intrastate and urban rail operations.
4. The Commission should report on:
 - (a) recent reform initiatives and their implications;
 - (b) the current structure of the rail industry, including the regulatory environment;
 - (c) structural and operational rigidities and impediments which constrain the efficiency and development of the rail industry;
 - (d) the strengths and weaknesses of the Australian rail industry, drawing on international and intermodal comparisons where appropriate;
 - (e) the operation of third party access regimes for the interstate and intrastate rail freight networks;
 - (f) the implications of the changing role of the Commonwealth, the States and the private sector in rail operations and ownership;
 - (g) the implications for rail transport services and the economy generally of regulations, charges and arrangements affecting competing and complementary modes of transport; and
 - (h) international best practice in rail and impediments to achieving best practice in Australia.
5. The Commission should also:
 - (a) report on implementation strategies for any measures recommended by the Commission;
 - (b) take account of any recent studies undertaken; and
 - (c) have regard to the established economic, social, regional development and environmental objectives of governments.
6. The Commission's recommendations will be considered by the Government and the Government's response shall be announced as soon as possible after the receipt of the Commission's report.

PETER COSTELLO

5 August 1998

Overview

Key messages

- Reforms in the 1990s have transformed the structure and operations of Australia's railways;
 - there is now greater competition between railways and more private sector participation in some corridors.
- The productivity of Australia's railways has increased significantly;
 - but is still significantly less than in North America, even allowing for differences in scale and other factors.
- Most government-owned railways are still not viable:
 - they face increasing competition from other transport modes;
 - suffer from inadequate investment; and
 - require significant government subsidies.
- Greater commercial focus is needed, which is best achieved by:
 - contracting out, franchising or privatising existing government-owned railways;
 - the entry of new owners and further investment in the industry; and
 - rigorous application of contracts between governments and railways to meet non-commercial objectives.
- Subsidisation of track in regional areas is an inappropriate way of meeting social objectives.
- Different mixes of structural, access and ownership arrangements are required for different networks.
- The Commonwealth has an important role in:
 - developing a national transport policy framework;
 - facilitating ongoing harmonisation of regulatory arrangements;
 - establishing a single manager for the interstate network; and
 - ensuring a more commercial approach to road provision.
- The Commonwealth also has a role in financing freight bypass lines in Sydney;
 - subject to agreement by NSW to the interstate network manager.
- The suggested reforms have greatest relevance to Queensland, NSW and WA.
- Further reform is essential for the survival of most Australian railways.

Significance of railways in Australia

Railways are important to the economy.

Railways are an important part of Australia's transport system and make a significant contribution to the Australian economy. They play a major role in hauling bulk commodities to ports, transporting general freight along major transport corridors and carrying passengers, particularly in urban areas.

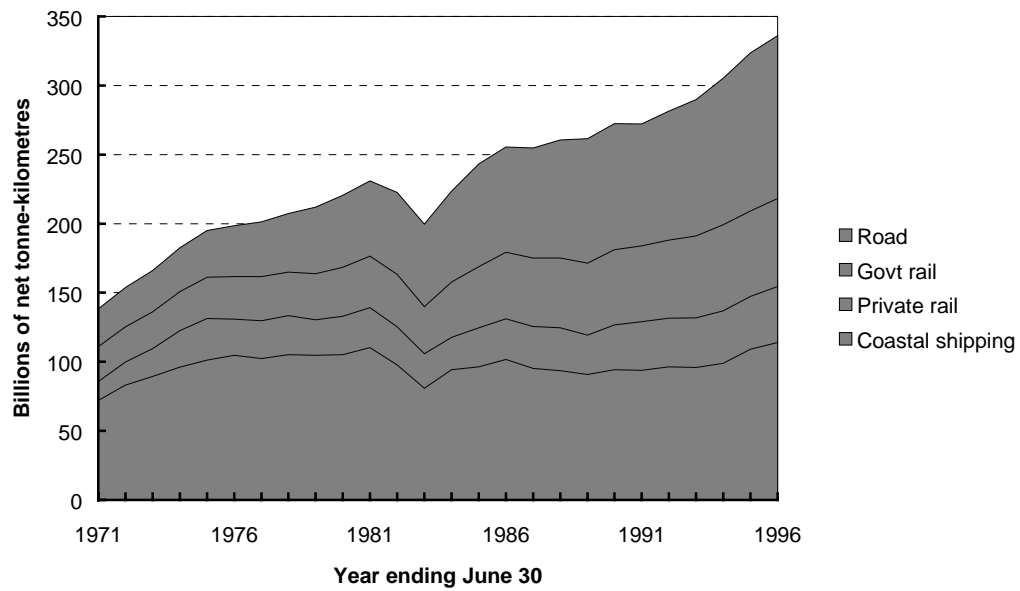
Some facts and figures

- Rail transport contributed 0.5 per cent of GDP and 8 per cent of transport value-added in 1997-98.
- Employment is around 36 500, down from nearly 90 000 in 1986, with a large proportion of the reduction occurring outside capital cities.
- The number of private railways has increased from six in 1991 to 19 in 1999.
- Rail has carried around one third of all domestic freight over the past 25 years:
 - with a fourfold increase in the tonnage of coal and minerals;
 - but a steady decline in market share in non-bulk interstate freight (down from 45 per cent to 32 per cent) and in agricultural products.
- Rail carries around half of all freight on the East-West corridor, but less than one quarter on the North-South corridor.
- States invested \$1.6 billion in rail in 1997-98, compared with \$151 million by the Commonwealth.
- State subsidies to rail exceeded \$2.3 billion in 1997-98.

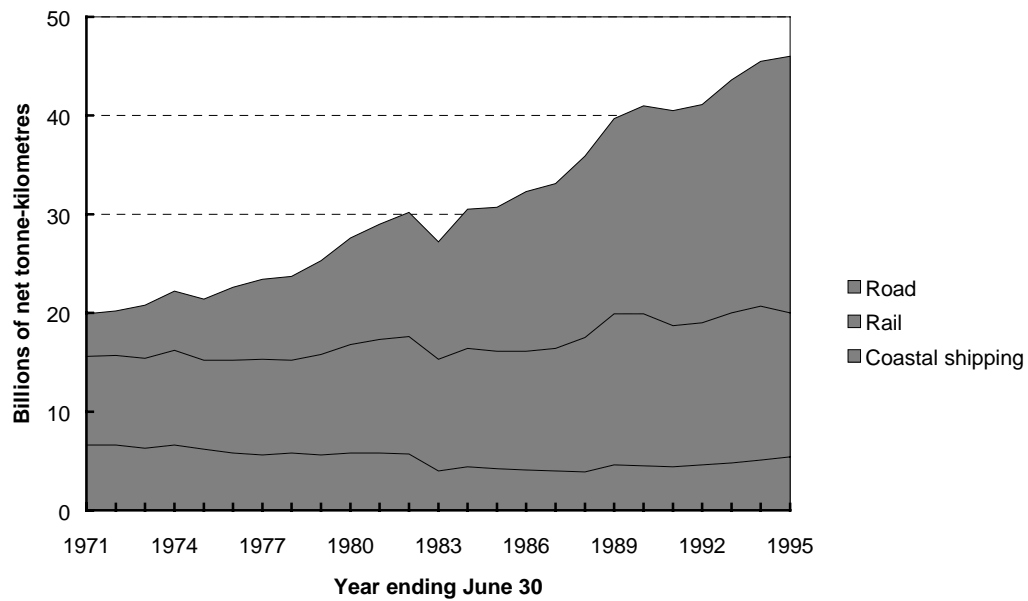
Significant changes have taken place in the composition of rail freight...

At the national level, rail has maintained its share of freight during the last 25 years because of strong growth in Australia's mineral, ores and coal sectors. But it has lost market share to road in the interstate transport of non-bulk commodities, more so on the North-South corridor compared with the East-West. The loss is mainly due to improvements in truck technology and road infrastructure.

Australian domestic freight (excluding pipelines)



Non-bulk interstate freight



and cities are increasingly car dependent,...

A major trend in Australia's urban passenger transport is the growth in the use of cars and the relatively static contribution of public transport (both bus and rail). The primary explanation is that the rail network is geared to providing transport along corridors to and from central business districts, while employment, retail and other activities have decentralised into suburban areas.



as are regional areas.

There has also been a decrease in non-urban passenger travel by rail, even though total travel by all modes (rail, bus, air and car) has increased.

Reforms since 1991

Since 1991, jurisdictions have introduced a variety of reforms relating to:...

Australian governments have long recognised the need to improve the performance of Australia's rail systems. Since the Industry Commission's 1991 inquiry into rail, all governments have implemented reforms. Although railways face similar problems, governments have adopted different solutions.

– structure;...

A wide spectrum of structural arrangements is now in place across jurisdictions. Some States (such as Queensland) have

retained a single integrated railway that provides all services, including freight, non-urban and urban passenger services and maintenance of rollingstock, as well as track infrastructure. NSW, on the other hand, has separated the former State Rail Authority into four businesses.

Similarly, there is a range of ownership and governance arrangements. In WA, Westrail currently operates as a commercialised (rather than corporatised) railway, with plans to privatise its freight operations by the end of 1999. In NSW, the Rail Access Corporation, FreightCorp and Rail Services Australia have been corporatised. In Victoria, V/Line Freight has been privatised as Freight Victoria, and Bayside and Hillside Trains (urban passenger) have been franchised to private operators. The Commonwealth has privatised parts of the former Australian National Railways (Tasrail, GSR and ASR). – *ownership;...*

Several joint initiatives between governments and industry have been undertaken to improve consistency of safety regulation and operating procedures and standards. Initiatives include simplification of safety accreditation processes and the development of codes of practice for operating procedures and standards. – *safety regulation and operating procedures; and...*

A variety of access regimes has been implemented across jurisdictions. Currently, access to the Commonwealth's track is covered under Part IIIA of the Trade Practices Act and administered by the Australian Rail Track Corporation. All mainland States have introduced access regimes, although none has yet been recommended for certification by the National Competition Council or accepted as an undertaking by the Australian Competition and Consumer Commission. – *access regimes.*

Recent reforms have led to greater participation by the private sector through the franchising and privatisation of some government-owned railways. In some instances, particularly on the East-West corridor, new private operators compete directly with existing government operators in niche markets. *Private sector participation is now greater.*

Performance

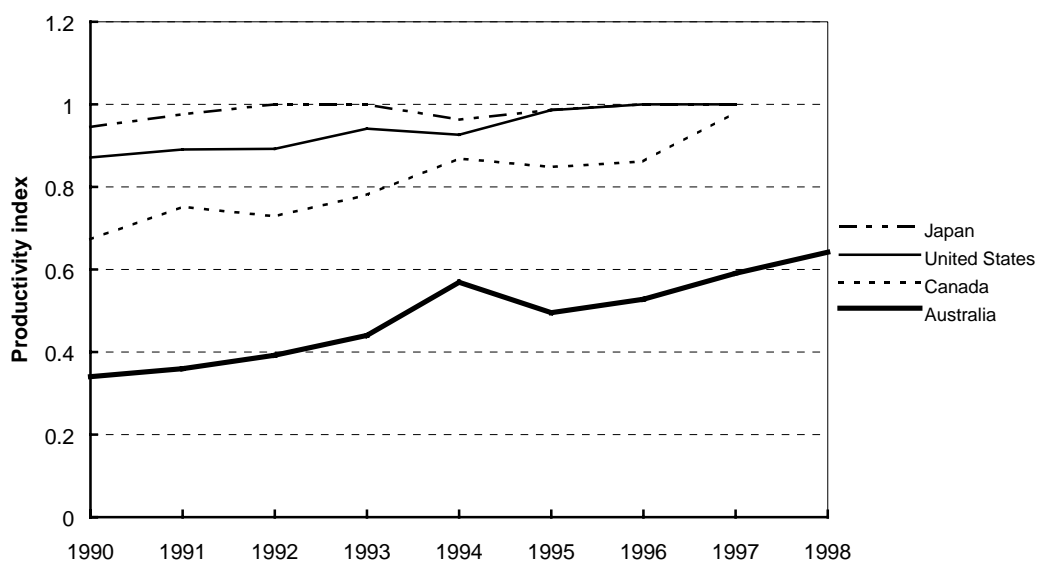
The productivity of Australian railways has improved substantially,...

There have been significant improvements in the productivity of government-owned railways in providing freight and passenger services in Australia over the period 1989-90 to 1997-98. The average annual growth in (total factor) productivity of around 8 per cent was greater than that of Canada, Japan and the United States.

but there is still a significant gap and...

While Australia has narrowed the productivity gap with these countries, there remains a significant difference. Australia's level of productivity in 1998 was about two thirds of the best performing countries (in 1997).

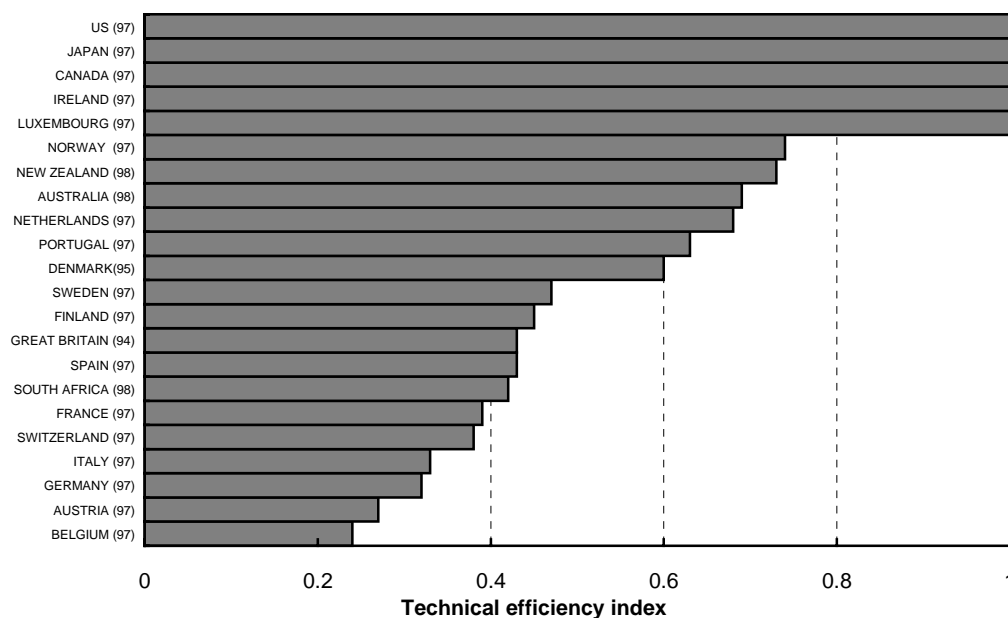
Productivity levels of freight and passenger systems



scope for further improvement.

Some of the difference is due to factors which inherently disadvantage Australia, such as scale of operation. However, technical efficiency (productivity adjusted for the effect of scale) remains 30 per cent below the best performing countries.

Technical efficiency levels of freight and passenger systems



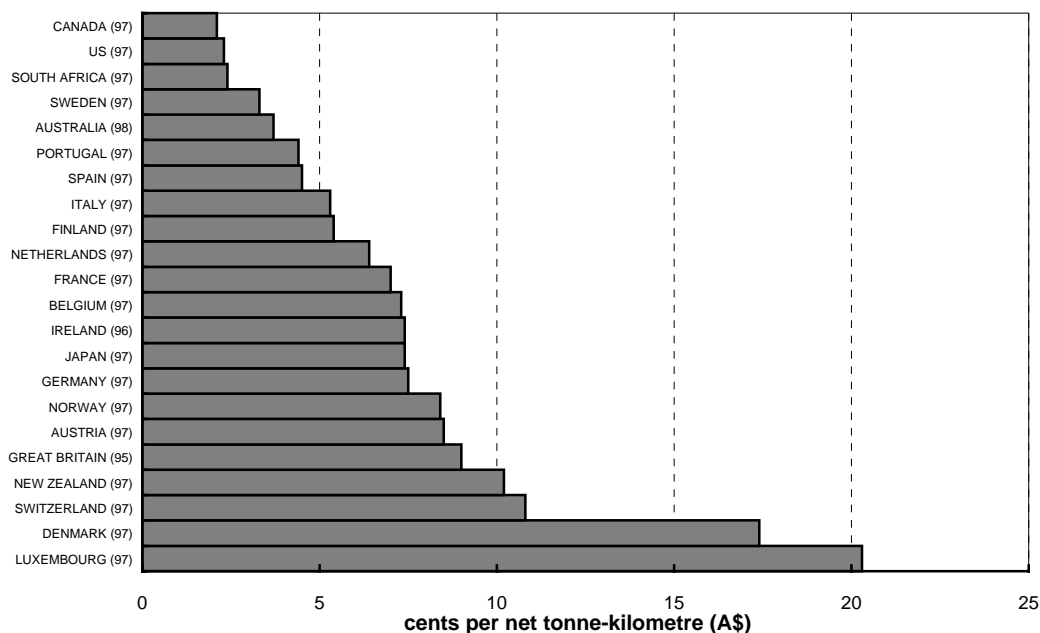
Freight customers in Australia have benefited from the improvement in productivity. Real freight rates decreased by 30 per cent between 1990 and 1998. This is comparable with decreases in Canada and the United States of 33 and 26 per cent respectively between 1990 and 1997.

Real freight rates have decreased by around 30 per cent...

On average, freight rates in 1998 were still higher in Australia (3.8 cents per net tonne-kilometre) than in Canada (2.1) and the United States (2.3) in 1997, although lower than most European countries and Japan. These differences partly reflect the underlying differences in productivity between the countries.

but are still significantly higher than those in North America.

Real freight rates by country



Despite progress, impediments remain

Despite reforms, problems still exist, including:...

Despite the reforms implemented since 1991 and higher productivity and lower freight rates, progress in some areas has been slow and impediments remain. The problems facing the industry have not been fully addressed by the reforms and new problems have emerged.

– *commercial unsustainability;...*

Many government-owned railways are losing money, even after the inclusion of payments by governments for non-commercial activities, or are barely viable.

– *inadequate investment in infrastructure;...*

Inadequate investment in infrastructure has been a particular problem (leading to speed restrictions on some sections of the interstate track), resulting in calls for significant government funds to improve existing networks and build new ones.

– *lack of commercial focus;...*

Despite corporatisation, government-owned railways are still insufficiently commercially focused. Governments, as shareholders, have not demanded nor enforced the same degree of commercial discipline as that placed on private sector operators.

Current arrangements do not ensure competitive neutrality between government and private railways, nor between transport modes.

– *lack of competitive neutrality;...*

The introduction of access regimes has been slow and the complexity of existing arrangements in some jurisdictions is hindering industry performance. There are deficiencies in the processes for pricing and allocating train schedules, such as grandfathering schedules to incumbents. These can act as barriers to entry.

– *complex and inadequate access regimes; and...*

There are still inconsistencies in safety accreditation fees and operating procedures and standards. These act as impediments to the entry of train operators, both on interstate and intrastate networks, and inhibit efficient operation in some markets.

– *inconsistent regulatory arrangements.*

Increased commercial focus is the key

Increasing the commercial focus of railways is the key to further productivity gains and to facilitating the investment required for rail to make its best contribution to Australian transport.

A greater commercial focus is required.

While most government railways are corporatised, the remaining problems may reflect the way the corporatisation model has been implemented.

Corporatisation has limitations, such as:...

Governments still subject their rail operators to multiple and often conflicting objectives relating to social welfare, employment and regional development.

– *conflicting objectives;...*

In addition, governments as shareholders facing budget constraints (and observing poor returns in rail) are often reluctant to provide adequate equity funding or allow railways to borrow on their own behalf, even if justified commercially.

– *inadequate access to capital; and...*

– *a lack of commercial discipline.*

Limitations may also apply to the corporatisation model itself. In particular, governments are often unable to maintain an arm's length relationship from their railway boards

because of political and community pressures. Public ownership also subjects governments and taxpayers to considerable commercial risks.

The private sector has a role through:... Private sector alternatives to government provision have an important role to play in overcoming these problems.

– *contracting out;...* If contracts are well specified and competitively tendered, contracting out offers potential benefits.

– *franchising; and...* Franchising can generate further gains because franchisees usually bear revenue risk, so strengthening their incentives to improve service quality and expand the size of the market.

– *privatisation.* The experience with recent rail privatisation in Australia is encouraging and supports privatising freight railways operating in competitive markets. Special arrangements would be required for rollingstock used by private franchisees on the main coal lines.

Recent experience with privatised railways

Tasrail

- Purchased by Australian Transport Network in 1997 for \$22 million.
- Revenue has increased since by around 50 per cent.
- Achieved an operating profit of \$1.2 million in its first seven months of business — the first profit in 130 years of Tasmanian railways.
- Plans to invest \$40 million over four years in rollingstock and infrastructure.
- Purchased the Emu Bay Railway — a minerals railway — from Pasminco for \$7.8 million in 1998.

Australia Southern Railroad

- Purchased Australian National Railways' freight and maintenance business in South Australia for \$57 million in 1997.
- Plans to invest \$62 million over five years.

Freight Victoria

- Purchased V/Line Freight (VLF) for \$163 million in 1999 despite VLF losing over \$15 million in 1997-98.
- Plans to invest \$36 million in rail infrastructure and rollingstock over two years.

Competition has a role to play

Where effective, competition can be relied upon to improve performance. There are a number of forms which competition can take, both ‘in’ the market, and ‘for’ the market. Much of the rail network is already subject to competition from road, air and coastal shipping and/or competition in downstream markets.

Competition can take many forms.

The emphasis in rail reform has been on introducing competition between train operators on the same track and for train schedules by implementing access regimes and reforming the structure of railways. Separating train operations from track (vertical separation) is designed to increase the effectiveness of an access regime by removing the conflict of interest an integrated railway has over allowing competitors access to its track.

Promoting competition ‘in’ the market has been the focus...

But, access regulation and vertical separation may be less effective in markets where there is limited scope for more than one train operator, effective competition from other modes of transport, and/or competition in downstream markets.

but this is less effective in some markets.

Railways can also be separated by function or geography (horizontal separation). Horizontal separation allows:

Structural reform is not limited to vertical separation.

- specific regulatory regimes to be put in place for different rail businesses;
- contractual arrangements to be implemented more effectively to provide non-commercial services; and
- services to be franchised — a means of addressing market power by introducing competition ‘for’ the market through periodic competitive bidding.

The benefits of structural separation need to be balanced against the costs, which can include a loss of economies of scope, coordination costs, a loss of commercial sustainability and adjustment costs. No single structure or access regime is appropriate for all networks.

Separation may involve costs and...

not generate adequate investment.

Structural reform to enhance competition in the market will not necessarily address problems of inadequate investment in track infrastructure.

Other reforms are also important

It is important also to improve other aspects of the rail operating environment. This includes improving the operation of the interstate network, achieving competitive neutrality, harmonising operating procedures and standards, and facilitating market-based access.

Management of the interstate network

Current arrangements for the interstate track are complex and inefficient.

Across the interstate network there are four authorities responsible for access and five for allocating train schedules and investment. In some parts, the network is owned by a train operator (WA), while in others the train ownership is separated from track ownership (NSW). The multiplicity of network managers imposes costs on train operators in negotiating train schedules and access charges. Also it impedes the efficient allocation of train schedules, the overall use of the network and efficient investment.

The ARTC only partially solves the problems.

The Australian Rail Track Corporation's 'one stop shop' model goes some way to reducing the costs to operators. But deficiencies in train schedule allocation on the interstate network and coordinating investment across jurisdictions still exist.

A single network manager is required to...

To overcome these deficiencies, a single network manager (broadly based on those already operating in the electricity and gas industries) is required. It would manage competitive access to the interstate network and facilitate planning and investment.

administer a competitive interstate rail market.

Administration of the access regime should be flexible, pricing principles transparent, and appeal processes independent.

Competitive neutrality within the rail industry

While corporatisation has the potential to place government-owned railways on a commercial footing, in practice it appears insufficient to achieve competitive neutrality in the rail transport market.

Competitive neutrality may not exist between government-owned and private railways...

There are concerns that government-owned railways are able to offer lower freight rates than their private sector counterparts because the requirement to make a commercial return is not binding. There are also concerns about the retention of surplus assets by public rail operators.

Such practices could place existing private operators at a disadvantage relative to their government-owned competitors and deter new private sector entrants and investment. These concerns could be raised through competitive neutrality complaints mechanisms under the Competition Principles Agreement. A more effective approach could be to facilitate private sector participation through the appropriate use of contracting out, franchising or privatisation.

Competitive neutrality between rail and road

Government decisions relating to investment, taxes and charges, access regimes and safety regulations affect competitive neutrality between road and rail transport.

or between road and rail.

There are still concerns over the different funding criteria applied to road and rail and the comparative levels of government investment in each. The differences in funding have decreased significantly over the past 30 years. Nevertheless, evidence suggests there has been inadequate investment in some parts of the rail network.

Investment in rail has been inadequate,...

Notwithstanding recent reforms, heavy vehicle charges do not cover the full costs of road usage, including road and bridge wear, pollution, accidents and congestion.

while heavy vehicle charges under recover costs.

These factors disadvantage rail compared to road. But large subsidies also are provided to rail and the 1999 taxation legislation has partly addressed concerns relating to the diesel fuel excise.

A commercial approach, not subsidies, is required.

Adopting a more commercial approach to the provision of both rail and road would overcome competitive neutrality concerns. Further subsidies to the rail sector or a complex integrated approach to planning and funding would be less effective.

Safety regulation and operating procedures and standards

Accreditation fees are still duplicated.

Although progress has been made by Commonwealth, State and Territory Governments, and industry, to reduce inconsistent regulation in railways, the outcomes are uncertain. Accreditation fees are still duplicated across jurisdictions. If mutual recognition does not work, consideration could be given to establishing a single national safety regulator.

A permanent mechanism is required to facilitate harmonisation.

Codes of practice for operating procedures and standards are still being developed and are yet to be implemented. The process of ongoing harmonisation can be improved by establishing a permanent mechanism to facilitate change. Best practice regulation involving the assessment of the impact of proposals and industry consultation would be part of this process.

Access arrangements

Market mechanisms are required for access.

Access regimes should incorporate market-based mechanisms, such as auctions, for allocating and transferring train schedules. Prices would then reflect the value users place on access to the track.

What should governments do?

The objective of reform is an efficient transport system.

The overall objective of reform is to have an efficient transport system delivering Australian freight and transport needs.

A more commercial approach should be applied to all modes of transport. Reflecting this, the Commonwealth should develop an overarching national transport policy framework. A commercial approach for roads should be addressed by

adjusting current user charges for heavy vehicles and instituting a public inquiry into all aspects of road provision.

To fulfil its role in the transport system, rail needs to meet the challenge of increasing competition from other transport modes. In some markets, the future of rail without government subsidies is uncertain unless rail improves its performance and competitiveness significantly.

Improvements in efficiency can come from three sources:

- making better use of the existing infrastructure, rollingstock and technology;
- introducing appropriate infrastructure and equipment; and
- optimising the use of rail in the transport logistics chain.

Simply investing more government money without other reforms — particularly to loss-making railways — is not the answer. Rather, it is the role of governments to create a sound and stable operating environment to provide greater certainty for the industry.

Government investment should be conditional on reform.

There are grounds for the Commonwealth Government investing further in freight lines to alleviate bottlenecks in Sydney's rail system, given its national importance to the interstate freight network. This should be conditional upon acceptance by NSW of a single market manager for the interstate network.

Commonwealth Government

The Commonwealth Government has a significant role in leading the reform process, both in areas where it has direct responsibility and where a national approach is required. Priorities include:

The Commonwealth has an important role,...

- developing an overarching national transport policy framework;
- establishing a permanent mechanism to ensure ongoing harmonisation of rail operating procedures and standards;
- establishing a market manager for the interstate network, in conjunction with the States;

- investigating the feasibility of developing a market approach to access;
- contributing funds to alleviate congestion in Sydney, conditional upon further reform;
- promoting competitive neutrality between rail and other transport modes by adopting a more commercial approach in all modes; and
- establishing a public inquiry to examine the current institutional arrangements for road provision, including planning, funding, investment and road charging.

Individual jurisdictions

as have individual jurisdictions.

Individual jurisdictions should concentrate on introducing greater commercial discipline through appropriate ownership, structural and access arrangements, tailored to each broad class of railway (summarised below for interstate, regional, coal and urban passenger networks). Ultimately, under these arrangements the private sector would operate most railways.

Interstate freight network

Characteristics

- Standard gauge mainline (eg Brisbane to Perth); strong intermodal competition (road, sea); some rail-on-rail competition; multiple owners and network managers; market segmentation; potential for competition in access.

Appropriate policy package

- Single network manager, which does not own trains or track.
- Vertical separation of train operations and track infrastructure.
- An access regime embedded in a market code of conduct, approved by the ACCC.

Expected outcomes

- Coordinated management of access charges and train schedules; facilitation of planning and investment; more niche operators; increased market share; commercial viability.

Regional freight networks (without market power)

Characteristics

- Mainly intrastate (eg Tasrail); low volume; strong competition from road; limited rail-on-rail competition.

Appropriate policy package

- Horizontal separation from other freight and urban passenger networks.
- Vertical integration.
- 'Light handed' access regime.
- Privatisation of railway operations including track (or with a long term lease on track).

Expected outcomes

- Improved quality and cost of service; integration into the logistics chain; commercial viability.

Main coal networks (with market power)

Characteristics

- Main coal lines in Queensland and NSW; high volumes; geographically (intrastate) based; significant market power (little competition from road or rail-on-rail competition).

Appropriate policy package

- Horizontal separation from other freight and urban passenger networks.
- Vertical integration.
- Franchise the operation using competitive bidding for lowest freight rates.
- Lease track and rollingstock to franchisee.
- Access incorporated into franchise agreements.
- Private railway operators.

Expected outcomes

- Operational and commercial independence; increased transparency; market power addressed; competition 'for' the market; yardstick competition between coal networks; promotes integration into the logistics chain.

Urban passenger networks

Characteristics

- Non-commercial; no rail-on-rail competition; strong intermodal competition.

Appropriate policy package

- Horizontal separation from regional and interstate networks (and within metropolitan areas).
- Vertical integration.
- Contracting out or franchising through competition for lowest subsidies.
- Access incorporated into contracts or franchise agreements.
- Private railway operators.

Expected outcomes

- Increased effectiveness of purchaser-provider arrangements; competition for the market; more efficient urban transport system; lower subsidies.

Social issues

Governments can still pursue social objectives.

A commercial approach eliminates the need to subsidise rail for economic reasons, such as achieving competitive neutrality, but does not preclude governments from using rail services to achieve social objectives.

However, subsidisation of track infrastructure is a costly and indirect way of assisting people in regional areas. If governments wish to provide such assistance it is best done directly through contractual arrangements with regional railways, as in urban areas.

But the purchaser-provider framework should be applied rigorously.

More generally, governments need to address the existing deficiencies in the implementation of the purchaser-provider framework for such arrangements.

They should specify clearly their non-commercial objectives — social, regional or environmental — and the basis for the level of subsidy to be provided.

Railway workers have already faced significant job losses over the past 12

Employment in railways has declined significantly...

years. Employment has fallen by almost 60 per cent since 1986, two thirds of which was in regional areas. Changes in technology and increased competitive pressure from alternative transport modes, as well as past reforms, have contributed to this decline.

Concern about further job losses is natural and reform has to be handled sensitively. General assistance available to all displaced workers, such as training programs, have advantages. However, where job losses are regionally concentrated, a case for specific assistance to particular areas can be made if these areas have substantially greater difficulty than others in adjusting to structural change.

but specific assistance is not always appropriate.

There have been calls to abandon or slow down the reform process. But slowing reform of Australia's rail industry would disadvantage rail users and not necessarily lead to increased job security within the industry. Maintaining inappropriate employment levels would adversely affect the competitive position of railways in some of their major markets, such as coal, minerals, grain, and interstate freight, thus jeopardising future employment in rail.

Slowing reform is not the answer...

If reform of railways is not pursued, the industry may not survive long into the 21st century, other than as a carrier of coal and other bulk products.

and may jeopardise the future of the rail industry.

Further reform of rail will yield significant benefits to consumers of rail services. Passengers will benefit from better services. Rail is also an important input into many industries, especially the export-oriented mineral and grain sectors. Reductions in freight costs and improved service quality will result in significant benefits, not only to Australian industry, but also to the economy more widely.

Further rail reform will benefit the Australian community.

Recommendations

RECOMMENDATION 6.1

Urban rail networks should be vertically integrated and horizontally separated from other rail networks.

RECOMMENDATION 6.2

Train operations should be vertically separated from track infrastructure on the entire interstate network. The infrastructure should be managed by a single network manager.

A process involving the Commonwealth and affected States should be established to determine the roles and functions of the network manager and develop a code of conduct.

RECOMMENDATION 6.3

Regional rail networks without market power should be horizontally separated from other networks and vertically integrated.

RECOMMENDATION 6.4

Regional rail networks with market power (the main coal lines) should be horizontally separated from other networks.

RECOMMENDATION 7.1

Governments which own railways should pursue further private sector involvement (through contracting out, BOOT-type arrangements, franchising or privatisation) as an integral part of their approach to rail reform.

RECOMMENDATION 7.2

All remaining government-owned freight operations should be privatised, with special arrangements for the rollingstock used on the main coal lines.

RECOMMENDATION 8.1

The pricing and allocation of train schedules should reflect the value that users place on the track. To encourage this, the Commonwealth Government should establish a process to investigate the feasibility of developing a market approach for allocating schedules or transferring capacity on the interstate network.

RECOMMENDATION 9.1

A national approach should be developed for charging rail safety accreditation fees, with a single annual fee for accreditation and mutual recognition.

RECOMMENDATION 9.2

The principles of best practice regulation, as endorsed by the Council of Australian Governments, should be applied to the development and implementation of railway codes of practice.

RECOMMENDATION 9.3

The Commonwealth Government should establish a permanent mechanism to ensure the ongoing harmonisation or uniformity of railway operating procedures and standards.

RECOMMENDATION 10.1

The National Road Transport Commission should prepare — and recommend to the Ministerial Council for Road Transport for adoption — a revised schedule of heavy vehicle charges which ensures that each class of vehicle pays the full cost of its road use.

Governments should adopt a more commercial approach to railways and road provision. This will involve:

- the Commonwealth Government introducing an overarching policy framework for national transport;*
- applying competitive contracting out, franchising or full privatisation to railways;*
- establishing a network manager for the interstate track to manage competitive access and facilitate planning;*
- applying the purchaser-provider model rigorously where non-commercial objectives are being pursued; and*
- evaluating major road and rail projects using cost-benefit analysis where the projects are expected to have significant external effects.*

The Commonwealth Government should — as a matter of national priority — allocate additional funds to projects which would alleviate route congestion in the Sydney metropolitan area, subject to the adoption of a network manager for the interstate track.

The Commonwealth Government should establish a public inquiry into road provision in Australia. This inquiry should examine:

- road transport planning processes;*
- methods of investment appraisal (including the evaluation and allocation of costs and benefits);*
- funding arrangements (including taxation, charges and grants);*
- the scope to improve road pricing; and*
- current institutional arrangements and alternatives.*

Governments need to address the deficiencies in the application of the purchaser-provider framework to rail and should enter into transparent contractual arrangements with clearly specified non-commercial objectives.