

## VICTORIAN GOVERNMENT SUBMISSION TO THE PRODUCTIVITY COMMISSION'S INQUIRY INTO PROGRESS IN RAIL REFORM

### 1. Introduction

The Victorian Government welcomes the opportunity to participate in the Productivity Commission's inquiry into *Progress in Rail Reform*.

The inquiry is a timely opportunity to review progress and achievements in the context of the various rail related reviews in recent years, including the Industry Commission's 1991 *Study of the Rail Industry*, 1994 *Urban Transport* report and 1997 report on the *Australian Black Coal Industry*.

Victoria draws the Commission's attention to material submitted to previous reviews including the Victorian submission to *the Inquiry into the Role of Rail in the National Transport Network*.

This submission outlines the fundamental principles governing Victoria's approach to rail reform and then follows the structure of the Commission's issues paper. Under each issue there is a general discussion and then, where necessary, urban and non-urban services are separately discussed.

A brief overview of the Victorian rail industry is provided below in Box 1.

### 2. Victoria's reform objectives

Since 1992 the Victorian Government has successfully undertaken a major program of rail reform which has improved service performance and reduced the cost of public transport to the taxpayer. Having achieved the objectives of that reform package, the next logical step in Victoria's ongoing reform is the privatisation of its rail services to capitalise on private sector expertise.

In reforming Victoria's rail services the Government is seeking to balance the following objectives:

- to secure a progressive improvement in the quality of services available to public transport users in Victoria;
- to secure a substantial and sustained increase in the number of passengers using the public transport system;
- to minimise the long term costs of public transport to the taxpayer;
- to transfer risk to the private sector; and
- to continue high levels of safety.

**Box 1: A snapshot of the Victorian rail industry****Passenger Rail Transport**

The Victorian public passenger transport system is an integrated network of metropolitan train, tram and bus services, as well as country train and coach services. The metropolitan train and tram systems are both extensive by world standards.

The metropolitan train system (operated by Bayside Trains and Hillside Trains) consists of a total network of 366 route kilometres and 151.5 six-car trains. The tram system (operated by Swanston Trams and Yarra Trams) consists of 240 Route Kilometres and 476 trams. In 1997/98 the metropolitan train system carried around 114 million passengers and the tram system carried around 117 million passengers. Regional Victoria is served by V/Line Passenger, providing an integrated network of rail and coach services, which carried a combined total of around 7 million passengers in 1997/98.

**Rail Freight**

Rail freight within Victoria is largely provided by V/Line Freight (VLF), a state-owned integrated rail freight business. The VLF fleet comprises 107 locomotives, over 2,600 wagons, and in the year ended 30 June 1998 carried over 5.4 million tonnes of freight including 2.6 million tonnes of grain. VLF has five main business portfolios (grain, industrial, regional intermodal, intercapital intermodal, and Fast Track), and accesses an intrastate network consisting of 3,288 track kilometres of broad gauge track, 454 track kilometres of standard gauge track, 22 track kilometres of dual gauge track, and a further 482 track kilometres of broad gauge minimum maintenance lines. VLF also has access to the ARTC interstate network.

**The ARTC**

ARTC, owned by the Commonwealth Government, was established in July 1998 to manage several standard gauge interstate lines. Following an agreement between the Commonwealth and Victoria, ARTC is also leasing and managing the standard gauge interstate mainlines in Victoria for the next five years. The aim behind this arrangement is to provide a one stop shop for operators seeking access for interstate services.

In recognition of the different needs and requirements of the freight business from those of the passenger businesses, the Government's particular objectives in the privatisation of its freight rail business, V/Line Freight, are:

- to maximise sale proceeds and minimise any associated long term costs to the taxpayer;
- to transfer risk to the private sector;
- to facilitate the development of an expanding rail freight industry in Victoria as a viable alternative to road transport; and
- to secure a progressive improvement in the quality of services available to freight customers in Victoria.

### 3. Background to Victoria's Rail Reforms

#### 3.1 The Early 1990s

In the early 1990s Victoria's public transport system was performing poorly:

- the Economic and Planning Advisory Council found the then Public Transport Corporation (PTC) to be the worst performing GBE in Australia;
- Business Review Weekly ranked the PTC as the country's worst performing transport company; and
- a Bureau of Industry Economics report on rail freight found the PTC to be the most inefficient rail freight authority in Australia.

As well as poor service performance, the PTC was requiring cash injections of more than half a billion dollars per year. If measured in accrual terms and allowing for the cost of capital, the full cost was likely to have been significantly more than twice that sum.

The imperative for reform was obvious.

#### 3.2 Initial reform phase

In January 1993, the Government embarked upon a comprehensive public transport reform package under the banner of "Transforming a System into a Service". The broad objectives of the reform were:

- transformation of the public transport system into a service responsive to the needs of the public; and
- ensuring the long term viability of public transport in Victoria by implementation of productivity improvements aimed at reducing the total annual deficit of the PTC by 50 per cent, or \$245 million, over three years.

The major elements of this reform included:

- internal restructuring of the PTC into five main business units: Met Train, Met Tram, Met Bus, V/Line Passenger, and V/Line Freight. The new structure was more business oriented and encouraged greater customer-responsiveness;
- service quality improvements including: better operational performance (improved punctuality and reliability), upgrading of station facilities (better passenger security and information); integration with other forms of transport (bus interchanges, carparks); and safety improvements (such as the establishment of an independent rail safety board);
- major productivity improvements following a historic labour agreement between the PTC and the rail unions over work practices and efficiency reforms. Examples included driver-only train operation, the introduction of automated ticketing (refer Box 2 below), the phasing out of tram conductors, and more efficient maintenance activities. Other gains were made from the contracting out of non-core activities

(for example, information technology), and from better use of capital (for example, depot rationalisation); and

- greater focus on core activities. Approximately two thirds of the Met Bus fleet was privatised in December 1993 and the remainder privatised in 1998. Two train services in rural Victoria were contracted out.

The two main reform objectives have now been achieved:

- overall services have improved. Increased punctuality and reliability has been achieved in passenger services, and extra services introduced. As a consequence, patronage on the passenger businesses has increased by over 10 per cent. Furthermore, the level of customer amenities is far better than it was in the early 1990s; and
- the Government's savings target has been met. A May 1998 report by the Victorian Auditor General's Office confirmed that, by the end of June 1996, the Public Transport Corporation (PTC) had achieved total savings of \$643 million in recurrent expenditure and ongoing savings of at least \$245 million<sup>1</sup> a year.

#### **Box 2: Experience with Automatic Ticketing on Metropolitan public transport**

To meet the Government's objectives of an integrated multi-modal public transport system tenders were called to provide an automated ticketing system for Melbourne's trains, trams and buses. The initial start-up issues associated with the implementation of the system have been well documented.

However, Melbourne's public transport system is now well positioned for the future:

- the system enables people to travel around the city using an integrated ticket utilising all modes of public transport. Surveys conducted by an independent research firm in May 1998 (at a time when the system was not yet fully commissioned) indicate a high level of customer acceptance. For example, 78 per cent of the respondents rated the ease of using the validators as good to excellent;
- ATS will provide a wealth of information about patronage and revenue which has not previously been available. ATS data will allow operators to learn more about their passengers and better tailor their services to their needs; and
- the system is capable of modification for use with simple proximity cards. These cards use stored value technology and need only to be passed close to the sensors in order to validate. A stored value smart card ticketing system has recently been introduced in Hong Kong and has proved very successful for both passengers and operators.

#### **4. Further reform underway**

Having achieved the objectives of creating a better and more cost effective system, the Government is now extending reforms by seeking to capitalise on private sector

<sup>1</sup> Source: "Public transport reforms: Moving from a system to a service", Victorian Auditor General's Office, Special Report 57, 14 May 1998.

expertise in light of the lessons learned about the benefits of private sector participation in other parts of the Victorian economy, and in the transport sector globally.

The Government commenced the next steps in the reform programme in 1997. While benefiting from private sector expertise is a theme common to general government reforms, the characteristics of the passenger and freight businesses have necessitated a different approach. The two main elements of this reform programme are:

- the franchising of five passenger rail businesses through a competitive bidding process. The successful private sector bidders will buy rolling stock, lease infrastructure, and operate train or tram services, and receive a Government subsidy for the period of their franchise; and
- the privatisation of V/Line Freight through a competitive bidding process. The new private sector purchaser of the business will purchase the rolling stock and other assets of the business, and enter into a lease of intrastate infrastructure of fifteen years (with certain rights of renewal).

With these changes, Victoria is moving towards independent, commercially driven businesses operating within a transparent regulatory and contractual framework.

These activities are expected to be completed in 1999. The Transport Reform Unit (TRU) of the Department of Treasury and Finance has been established to manage the restructuring and sale of these businesses, and receives support from external advisers and expertise elsewhere in Government.

## **5. Franchising of Passenger Rail Services**

### **5.1 Overview of Franchising**

Franchise lengths are likely to be between seven and fifteen years, after which time the services will be refranchised. These franchises will be on a vertically integrated basis. Franchisees will enter into a "Franchise Agreement" setting out the services they will provide, as well as an "Infrastructure Lease" which sets out the terms upon which franchisees use their infrastructure.

Importantly this reform is coupled with the introduction of service quality standards and selective spending on investment in infrastructure and rolling stock (refer Box 3).

**Box 3: Features of Franchising Arrangements**

The new program will feature:

- *new incentives for increasing patronage* — focussing on the profit motive and peer comparison. New financial incentives will focus on patronage growth;
- *financial incentives for meeting targets and penalties for non-delivery* — for example, if passenger rail franchisees exceed service punctuality benchmarks, they can earn bonuses. If they do not meet these standards, penalties may be payable to the Government;
- *innovation* —incentives to find better ways of marketing to customers, operating the business, and maintaining infrastructure and rolling stock; and
- *new investment* — mandated replacement of infrastructure, rolling stock replacement and franchisee-sponsored enhancements.

The sales process will be structured in a way which maximises the scope for innovation, investment and value.

Legal guarantees will protect the existing services which passengers value and the bidding process will drive service enhancements and investment. The new system is underwritten by guarantees for public transport passengers (refer to the "Passengers' Charter document attached), as well as service delivery targets and performance criteria built into the contracts for the soon to be privatised rail services.

The Franchise Agreement will be the principal interface between the Government and the newly franchised industry. This clearly defined and transparent agreement is in essence the Government buying back better quality rail services from the private sector. It includes requirements for:

- passenger service levels;
- first and last services;
- maximum fares at current levels, adjusted for inflation;
- maximum service intervals; and
- operational performance (including punctuality and reliability, capacity, quality of service and journey times).

The preparation of the Franchise Agreement has required the Government to clearly articulate its service requirements. Greater detail on the contractual arrangements that will apply is set out in the document "The Future of the Passenger Rail Industry".

## 5.2 Use of Franchising in the new Industry Structure

### *Why franchise?*

Different mechanisms can be appropriate for the introduction of private sector involvement ranging from outright sale of assets to franchising and its close

equivalents (such as BOOT schemes), through to outsourcing. The preferred model must have regard to what are the overriding objectives of the introduction of the private sector and the potential for increased competition.

Government has decided to offer the businesses by way of medium to long-term franchises and considers it the logical next step in a continuing program of improvement and reform. Franchises allow the introduction of ongoing competitive pressure through "competition *for* the market", where competition *in* the market may be relatively muted.

The proposed franchising structure helps overcome the lack of competition inherent in the urban rail system because of its natural monopoly characteristics. Competition in the bidding stage for exclusive franchise rights substitutes for competition in the retail end of the market.

Furthermore because the passenger businesses are (currently) loss-making and require Government subsidy, a conventional sale might not be appropriate.

Franchising differs from the contracting out of certain other public services in that it involves transferring business control, and consequently, a substantial measure of opportunity and risk to the private sector.

#### *Vertical Integration*

The franchises will be vertically integrated, with the exception of VLP (which is provided with access to track largely by V/Line Freight,). Franchisees will be responsible for operating their business, maintenance and investment in rolling stock, and maintenance and investment in track, signalling and other infrastructure.

It was decided not to separate rail services from infrastructure provision (vertical separation) on two grounds because vertical integration:

- allows the franchisee to optimise its operating environment. Because of the likelihood that the franchisee will be the main user of its own track, it makes sense to allow that operator to maintain and control the infrastructure in the manner that best suits its business (both operations and rolling stock). It also makes clear accountability for service performance; and
- can avoid some unproductive monopoly problems such as the complication of having a separate monopoly track operator negotiating over charges with a monopsonist service provider.

The risk of reduced competition was considered. Access to the track by other operators will be provided for separately under a statutory access regime (refer discussion on Access below) and is expected to ensure access on reasonable terms to new entrants.

#### *Size of Businesses*

While the PTC historically had a metropolitan train business unit and a metropolitan tram business unit, the decision was made to divide up the Met Train business unit into two separate rail corporations (Hillside Trains and Bayside Trains) and the Met Tram

business unit into two corporations (Swanston Trams and Yarra Trams). The reasons for this were two-fold:

- research by independent consultants did not indicate that there were any significant economies of scale in having businesses larger than the size of the new smaller entities; and
- benefits can be derived through *competition by comparison* between the two same-mode businesses. This is discussed further below.

#### *Franchise Length*

Franchises are likely to be for seven years for trams and fifteen years for trains. Franchise length is a trade-off between:

- the benefits of greater competition through regular retendering which include pressure on the incumbent to perform, and greater flexibility for Government to take advantage of changing technologies, operating systems and demand when reassessing needs over the long term; and
- the benefits of a longer investment horizon. The length of the franchise will affect the investment decisions, and to a lesser extent maintenance decisions, made by the successful bidder. A longer franchise period allows franchisees a sufficiently long timeframe over which to make and recover investments with a significant payback. This issue is particularly important in a capital intensive industry with long-lived assets such as rail.

### 5.3 Competition in Passenger Businesses

Box 4 outlines the various forms of competition that are essential in meeting Victoria's objectives of a better quality and more affordable passenger rail services.

Rail providers will also be competing with other modes of transport, especially road-based transport. The metropolitan passenger businesses in particular will experience competition from car trips to and from central Melbourne.



**Box 4: Competition in Victoria's passenger rail services**

Competition, in a number of different forms, is expected to be instrumental in fulfilling the State's objectives:

**"Competition for the market"**

The main driver of value in franchising is expected to be competition between Bidders tendering for Franchises on the basis of detailed operating and commercial information about each Business. The bidding process - divided into "Indicative Bid" and "Final Bid" stages - provides opportunities for Bidders to assimilate information and refine the parameters of their bids over a number of months. It also allows the State to assess the market's response to specific elements of the franchising proposal - for instance, new rolling stock investment - before it takes decisions on the detailed specification of Final Bids.

**"Competition by comparison"**

Since Franchises are founded on geographically based service groups, direct competition between Franchisees is unlikely to be a significant driver of business performance. However, the State believes that there will be benefits in generating "competition by comparison" between the two metropolitan train Businesses and between the two tram Businesses. To this end, it has prohibited cross-ownership of these Businesses.

**"Competition in the market"**

The State has established a statutory access regime to allow third party operators access to the train and tram networks on fair terms. The State believes that the potential competitive challenge from other operators will provide a useful spur for Franchisees to deliver high standards of operational performance and customer service.

**5.4 Benefits Expected from Private Sector Expertise**

Greater private sector involvement is expected to generate major improvements in the performance of the businesses. The State expects to capture significant benefits for the community through the competitive bidding process for Franchises, sharing in the added quality and value that private sector management will bring. Likely improvements include:

- *revenue and patronage growth* through:
  - ◆ *new and improved services* including improved punctuality, reliability and speed; improved passenger security; and more efficient mode combinations and intermodal exchanges; and
  - ◆ *better marketing and promotion* including new ticketing initiatives, better sales networks. Box 4 below shows one example of a set of initiatives that could be employed to achieved to generate greater revenue and patronage;
- *productivity gains* through increased labour productivity (for example, multi-skilling, flexible working practices), more cost effective rolling stock and infrastructure maintenance, reduced corporate overheads as well as other opportunities to reduce a substantial cost base; and

- *new and innovative investment* in operating, rolling stock, and infrastructure assets leading to improved vehicle reliability, depot rationalisation, better information systems.

Revenue and service initiatives may well prove to be more important to franchisees than productivity opportunities.

In looking to the future, the experience of the UK bodes well. Subsidies are halving over seven years, and service on many lines is improving.

#### **Box 4: Possible improvements to Melbourne's urban rail system**

DOI investigated the feasibility of achieving a 40 to 50 per cent growth in rail patronage over the next 15 years. Sets of alternative scenarios were modelled and the results suggested developing a series of measures, such as outlined below, would enable patronage growth to increase by around 50 per cent over the next 15 years. This was estimated to increase mode share for travel to and from central Melbourne from 30 per cent to 46 per cent and increase total market share from 6 to 7 per cent.

Private franchisees may devise similar measures and strategies to achieve results of this magnitude given the financial incentives included the franchise contracts.

This program could include:

- new rolling stock
- faster services on key routes by the removal of redundant infrastructure, improved reliability and rail operations
- more express running to meet the needs of long distance commuters
- more frequent off-peak services on key routes
- increased reliability through rolling stock improvements and selected infrastructure works
- extending electrification of the train system
- improved facilities at key interchanges
- electronic ticketing and real-time information systems
- integration with a more extensive cross-town bus network

## **6 Privatisation of Freight Services**

### **6.1 Overview of the Privatisation Structure**

Freight rail services in Victoria and adjacent States are provided by V/Line Freight which is in the process of being sold. There has been active bidder interest from Australia and overseas. When privatised it will have a 15 year lease over track, signalling and other infrastructure (this lease is renewable for two more 15 year periods). A preferred bidder will be chosen by February 1999.

## 6.2 Competition

The greatest potential for competition is in the interstate rail market. Victoria is already leading the way in terms of reform with several private operators competing on the interstate network. Access rights are controlled by the ARTC (which in turn leases the track from VicTrack). On intrastate lines, potential competition is provided for by an access regime, which is a condition of V/Line Freight's lease of the infrastructure. Development of the market may well result in a few trunk players on the Eastern Seaboard plus a number of niche players.

## 6.3 Benefits Expected from Private Sector Involvement

V/Line freight is a substantial business with revenue and expenditure forecast at around \$160 million in the first full year of private operation (1999/00). While V/Line Freight's revenue may not be as large as some other railways, this is largely because Victoria does not have the coal and ore base of other States.

V/Line Freight has substantial opportunities for further growth and is well placed to prosper as a privatised company in a deregulated national transport market. Opportunities include scope to win further traffic from road, niches in the interstate market (especially given the breaking down of artificial State boundaries), and scope for further cost reductions. The new owner will be able to build upon V/Line Freight's good reputation with customers. The sale is welcomed by major customer interests such as the Victorian Farmers Federation and the Australian Wheat Board.

## 7. Corporatisation and commercialisation

The best way to make rail operations more commercially focussed is to have private businesses run them. However, corporatisation and commercialisation of Government-owned commercial activities can assist in achieving some of the potential gains if privatisation is not immediate, and there is a clear political commitment to reform. With this in mind, Victoria's experience in corporatisation is discussed below.

### 7.1 General Approach

The Government concluded some time ago that the PTC's centralised structure was no longer appropriate to its needs. Over the past 18 months, the Government has broken up the operating businesses of the PTC into six corporatised entities, leaving some heavy maintenance businesses in the PTC (which are in the process of being sold).

### 7.1 V/Line Freight and VicTrack

The corporatisation of V/Line Freight was announced in the Government's 1996 transport policy. It evolved from recognition that the freight business had different needs, policy, and strategy requirements to the passenger businesses. The Rail Corporations Act 1996 (Vic) established two statutory corporations — V/Line Freight to operate the PTC's freight business and VRT to provide access to country track. V/Line Freight and VRT commenced operations as independent statutory corporations on 1 July 1997. V/Line Freight and VRT have commercial charters, are headed by

independent Board members drawn from the private sector, and are responsible to the Treasurer.

Victoria considers that the transparency and independence brought about by corporatisation, together with the private sector perspective brought by the Board have led to increased innovation and efficiency within these two corporatised entities. This can be confirmed by referring to the V/Line Freight and VicTrack 1998 Annual Reports when they are released.

## 7.2 Passenger Businesses

The five passenger businesses were only recently corporatised (1 July 1998), although they had been operating more or less as independent divisions within the PTC since late 1997. While a significant factor in the decision to corporatise was to facilitate the transition to private sale, corporatisation has had positive effects such as making cross-subsidies more transparent, and adding greater commercial focus to the businesses through the introduction of a Board with private sector expertise.

## 8. The community benefits of a rail service

As outlined earlier the Victorian government is committed to purchasing high quality and affordable Metropolitan and Country rail services on both social and economic grounds. The justification for this support is outlined below.

### 8.1 Passenger rail

The underlying reason for the continued provision and purchase passenger rail services is the Victorian Government's commitment to the social issues associated with passenger transport. Rail, along with other modes of public transport, allows greater mobility for those not able to utilise or afford car travel. Through the subsidies it provides, and the concession fare policy, Victoria makes travel more affordable.

Victoria considers that there are also two main positive economic spillovers associated with the metropolitan rail service:

- *reduced congestion* — the provision of metropolitan rail services is important for Melbourne to efficiently function as a city. The radial train routes helps the overall traffic flow throughout the metropolitan and reduce congestion, and allow the CBD to operate more efficiently. It would be physically difficult to service the city centre solely by car and other modes of transport. As it stands congestion costs have been estimated by DOI to be between \$1 to \$2 billion a year in Melbourne; and
- *reduced pollution* — the provision of rail passenger services significantly reduces, particularly in the central area, the amount of car-generated exhaust pollutants.

These benefits are very difficult to capture or accurately quantify but the government will continue to purchase rail services. Although subsidy requirements have been reduced, passenger rail services still require substantial Government support (estimated to be upwards of \$800 million a year including an allowance for the cost of capital).

However, competition for the provision of rail services will reduce the need for government assistance.

## 8.2 Freight

As with metropolitan rail services, the Government will continue to purchase passenger rail services in country areas from the new VLP franchisee. The degree of financial support is dependent upon the outcome of the bidding process.

No significant ongoing CSOs or funding will be provided to rail freight services except for the "Fast Track" service (parcels and small loads).

## 9. Access regimes

Victoria has been at the forefront of national competition policy reform and strongly supports competitive access to monopoly infrastructure while having due regard to the impact on the infrastructure owner's business.

Victoria believes that it is not critical whether such infrastructure is publicly or privately owned in terms of the scope for parties to achieve competitive third party access.

### 9.1 Overview of Victoria's Access Regime

Victoria is implementing an open and competitive access regime appropriate to the post-privatisation environment. The Rail Corporations Amendment Act 1998 (Vic) will, upon proclamation, insert a third party access regime into the Rail Corporations Act (the Victorian Access Regime). Key principles are:

- infrastructure may be "declared". The Government may declare that certain rail or tram infrastructure owned by Government will be subject to the regime. It is intended that the Minister will, prior to the sale of the businesses, declare both the V/Line Freight country network, and the metropolitan train and tram network;
- a lessee of declared infrastructure (an Access Provider) will be obliged to use all reasonable endeavours to meet the requirements of a person seeking access. However, if a third party operator is unable to reach agreement with an Access Provider about access to declared rail or tram infrastructure, the access seeker will be able to refer the dispute to Victoria's independent regulator, the Office of the Regulator General (ORG);
- ORG could then make a determination (based on certain pricing and other principles specified in statute and regulation) setting the terms and conditions upon which the Access Provider would be required to provide the access seeker with access to its rail or tram infrastructure;
- access charges to passenger operators would be set by determining total costs attributable to passenger operators (based on infrastructure operating and maintenance costs, a capital charge on new investment excluding sunk costs, plus a margin) and allocating those costs across those passenger operators. Access charges

for freight users differ slightly, and include the ability to differentiate among freight market segments; and

- it is proposed that franchised passenger rail services will have priority over freight services in obtaining access to the rail network, although there will be some discretion to override this principle where its application would result in serious and unreasonable interference in freight business.

It is proposed that prior to or upon franchising access agreements would be entered between access providers and the new businesses.

## 9.2 Interstate Access Regimes

For access to interstate rail operations Victoria utilises the Australian Rail Track Corporation (ARTC) which has been granted a five year lease for the control of standard gauge track. Appeals against decisions made by the ARTC can be made to the National Competition Council.

Victoria supported the establishment of a national track body but the proliferation of other access regimes, such as the Rail Access Corporation (RAC) in NSW, detracts from the effectiveness of the one-stop access concept. For example, a Victorian interstate rail operator wanting to operate in NSW may still approach the ARTC and the RAC to see who will provide the best access deal, particularly for one-off use. The access charge will differ depending on how each scheme assesses the rail operator's elasticity of demand for the use of the track — that is, how they assess the operators capacity to pay.

## 10. Public and private ownership and investment

### 10.1 Ownership

Involvement in the operation of rail services is not considered a key Commonwealth or State role. Victoria is moving to divest itself of its railway operations. While in terms of ownership of infrastructure, the Victorian Government will continue to own the assets, the long term leasing arrangements it has put in place leave the private sector to operate, maintain, and invest in the infrastructure. The sale of National Rail Corporation is supported.

### 10.2 Investment

#### *Metropolitan*

Victoria considers that the private sector has considerable investment expertise from which Governments can benefit. In addition to basic investment outcomes required by Government, franchisees will be able to approach the government with new investment ideas for government funding or shared funding. During the bidding process potential operators will also be able to suggest alternative methods of achieving investment objectives and new or enhanced investments (for example, new rolling stock).

*Country Network*

Victoria's non-urban rail network is divided into intra and interstate operations (see Box 4 for a brief history).

**Box 5: Upgrades to Victoria's non-urban rail network**

Prior to the Commonwealth Government *One Nation* program in 1992 all rail lines in Victoria were broad gauge except for a separate standard gauge line between Melbourne and Sydney. The \$429 million *One Nation* program managed by National Rail included the conversion of the interstate rail line between Melbourne and Adelaide to standard gauge. The *One Nation* program achieved a standard gauge line but failed to deliver a quality network appropriate for interstate trains.

The Commonwealth Government decision to convert the Melbourne-Adelaide track to standard gauge resulted in Victoria having a two gauge rail network with the potential to isolate the broad gauge lines from Yaapect to Dimboola, Hopetoun to Murtoa and Maroona to Portland. These lines were essential for the transport of grain from western Victoria to the port of Portland. The Victorian Government decided to convert the western grain line and the line of Portland to standard gauge at a cost of \$20 million.

Further work to the value of \$5 million was carried out in 1997 to convert the line from Ararat to Maryborough to standard gauge and provide a dual gauge connection to the grain transshipment facility at Dunolly. This provided additional flexibility in the movement of grain from the broad and standard gauge sections of the network to the ports of Geelong and Portland.

Although VicTrack has kept the track operating as efficiently as possible, significant speed restrictions have been implemented to maintain safety. VicTrack has recently completed de-stressing the new track between Pura Pura and Maroona, and concrete sleepers will be installed on this track. Negotiations are continuing with the Commonwealth and Australian Rail Track Corporation (ARTC) for additional funding under the \$250 million Commonwealth funding program to complete track upgrades between Geelong and Ararat. If rail speed over this section could be raised to 100 kph this would reduce the journey from Melbourne to Adelaide by nearly two hours.

In its submission to the *Inquiry into the Role of Rail in the National Transport Network*, Victoria supported the proposition that investment and management effort should be concentrated on a National network. The interstate rail network should be operated as a single network, with consistent arrangements for investment and access rather than on a line or corridor basis. The major focus for Commonwealth investment should be on Melbourne-Sydney and Melbourne-Adelaide corridors. The \$250 million designated to improve the National network should be focused on these routes.

As iterated in previous work, Victoria believes the strategy for Commonwealth investment in interstate rail should:

- recognise role of Commonwealth as major driver of investment and encourage role for private sector;
- through cost benefit analysis, prioritise funding for projects;
- provide quality access consistent with needs of users; and
- avoid long term Commonwealth ownership of rail operating entities.

*Taxation Issues Affecting Private Sector Investment*

As noted above, Victoria considers that significant benefits can be achieved through the introduction of competition and private sector capital and management into the State's transport system.

Potential investors in transport, or in any other investment opportunity, require a market rate of return on their capital, commensurate with the risks of investment. However, in Australia, private sector investment in infrastructure is being unduly penalised by an excessive level of uncertainty regarding the Federal tax treatment of key transactions. That is, bidders are discounting their offers in response to unacceptable (and unnecessary) risks on the tax treatment of their proposals.

Tax uncertainty needs to be clearly distinguished from the unavailability of tax benefits. Tax outcomes which are adverse but can be predicted with confidence, and acted on reliably, are generally not as damaging as circumstances where capital decisions have to be made on guesswork. Such tax uncertainty creates dead-weight costs which neither protect Commonwealth revenues nor assist State government sponsors of projects. For example, ATO unwillingness to provide advance assessments of the proposed tax treatment of key transactions may result in leading bidders withdrawing their tenders. If the project proceeds, a second-string consortium becomes the operator. As a consequence, the infrastructure may generate lower profit levels (to the detriment of Commonwealth revenues) and a lower consideration is paid to the State.

Victoria is concerned that some elements of the current Federal tax laws, such as the intent and application of Section 51AD of the Income Tax Assessment Act, and the uncertainty over the adoption of Schedule 10 of Taxation Laws Amendment Bill No. 4 1998 (first announced by press release on 4 August 1997), are undermining the clarity required by investors, and/or leading to unnecessary delays in investment decisions. Part of the problem concerns the need to keep tax law current with the way commercial transactions are structured (and the lead times in developing legislation), and part of the problem relates to ATO service levels. Regardless, the outcome is costly to the State, and in the interests of sustaining the microeconomic reform agenda, the Commonwealth needs to review the tax barriers to private sector provision.

**11. Competitive neutrality**

The two main issues associated with competitive neutrality are competition between government and private rail operators, and competition between road and rail.

**Rail versus rail**

Victoria is concerned that competitive neutrality issues may arise with the newly franchised rail freight operations competing against publicly owned interstate operations. There is potential for Government owned interstate operators to gain an unfair advantage over privately owned operators through competition distorting policies such as government subsidies. The Productivity Commission may wish to



investigate whether or not interstate providers have an unfair advantage through government support, and what measures could be taken to address this.

### Road versus rail

The Victorian Government supports efficient and transparent charging for all modes of transport. Over time, we need to move towards a situation where transport prices on all modes better reflect their full costs, including external costs, while still supporting overall the overall objectives outlined earlier.

Overall, if access is regarded as the full cost of using a system (periodic payments and use-related payments) it is unclear as to which mode is paying the most appropriate level of charges.

As a first step in establishing who pays their way, governments must know what costs are attributable to the various modes of transport. At the moment the water is muddied by a range of subsidies that apply to road and rail (as outlined in Table 1).

This would include looking at maintenance, upgrading, environmental and congestion costs between and within modes and comparing this with what charges are actually applied. This will allow governments to better attribute actual costs and establish a more efficient charging regime nationwide. There has also been much discussion about the application of the diesel fuel rebate between road and rail.

Table 1: **Competitive neutrality balance sheet — charges and taxes applying to road and rail**

Taxes levied on	Road	Rail
Access	x	✓
Fuel	✓	✓
Registration	✓	x
Sales tax	✓	x
Import duty	✓	½
Vehicle transfer fee	✓	x
Payroll tax	✓	✓
Company tax	✓	✓
Licence fee	✓	x
Safety	✓	✓
Other operating charges	x	x
Subsidies	x	✓
Noise	x	x
Pollution	x	x
Congestion	x	x

Note: x: charge or tax does not apply  
 ✓: charge or tax applies  
 ½: import duty does not apply on some large capital items  
 Source: Bureau of Transport Economics.

### The need to dig deeper

At this stage in terms of overall competitive neutrality, and also with respect to the diesel fuel rebate, it is unclear which mode pays its own way. The Productivity Commission may wish to investigate the different costs imposed on track and road for each mode, taking into consideration:

- the full external and social costs of each mode (including congestion, accident and pollution costs); and
- differences in costs between and within modes. For example, heavier trucks cause a relative larger amount of damage to the road network.

These costs should then be balanced against the range of taxes and charges levied on each mode, as well as the subsidies provided. Consideration should also be given to differences within modes — for example:

- the level of rail subsidy should be differentiated between urban and country passenger services, as well as freight operations; and
- do larger trucks pay higher taxes and charges than their smaller counterparts.

Finally, it may also be worth considering the markets in which road and rail actually compete. Each mode has comparative advantage in certain markets (for example, short distance multi-destination trips would favour road travel, while long haul high tonnage freight such as wheat or coal would most likely be rail-based), and competitive neutrality considerations are most applicable in markets where the two modes directly compete (for example, the Sydney Melbourne corridor).

## **12. Inter-governmental issues**

The effective operation of an interstate rail network requires the establishment of harmonisation of operating standards and practices. Victoria supports the establishment of a National accreditation body.

The move towards improved standardisation and harmonisation in regulations and operations across state borders is now well underway with both the Standing Committee on Transport (SCOT) Rail Group, Australasian Railway Association and the Federal Department of Transport taking initiatives in this area.

Victoria also supports the work of the ARTC to encourage uniformity in access, technical, operating and safeworking procedures. Although the ARTC is not a safety regulator it will help facilitate adoption of uniform safe working systems and technical standards nationwide.

## **13. Conclusion**

The continuation of the privatisation program will build on the reforms undertaken since 1992 with quality and value given new emphasis in a competitive, transparent business environment. The Victorian Government will build on its existing high quality service to create a prosperous, innovative and expanding rail industry. Its reforms will be underpinned by:

- minimum service levels;
- quality improvements;
- value for taxpayers;
- new rights for passengers;
- new opportunities for rail freight;
- transparency of performance; and

- competition in the sales process.