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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON PROGRESS IN RAIL REFORM

MRS H. OWENS, Presiding Commissioner
PROF D. SCRAFTON, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT ADELAIDE ON THURSDAY, 20 MAY 1999, AT 9.30 AM

Continued from 18/5/99 in Perth

MRS OWENS: Good morning and welcome to this public hearing of the Productivity Commission's inquiry on progress in rail reform. This public hearing in Adelaide is the third of four sets of hearings. We have had hearings already in Sydney last week and Perth on Tuesday and our Melbourne hearings will be held next week. The hearings are designed for people to raise issues in relation to our draft report, Progress in Rail Reform, which was issued in March. They give people the opportunity to provide input into the final report, which is due to be released in August.

While people who provide information are protected in this inquiry as if they were giving evidence to a court, this is not a court of law. We shall try to make the hearings as relaxed as possible, despite the microphones. However, there are some formalities that we try to follow each time we conduct a public hearing. First, for the benefit of the transcript, we will ask you to introduce yourself and indicate in which capacity you appear, and I will come back to that in a minute. Secondly, information provided in these hearings is often used in our reports, so we ask people to be as accurate as possible and, if you find after the event that you have said something that wasn't quite right or you want to clarify something, you can come back to us after the event. Transcripts from today's hearings will be made available to all participants. I will introduce my colleague on my left; this is Prof Derek Scrafton, who is the associate commissioner on this inquiry. I think what we might do is get started, so if you give your name and the capacity in which you are here today for the transcript.

MS BROOKS: Yes. I am Jane Louise Brooks and I am a spokesperson for the Friends of the Belair Line.

MRS OWENS: Thank you, and thank you very much for coming. I think you have sent us a couple of submissions. I don't think we saw you the last time we were in Adelaide, but we are very pleased you could come this time. I know you have got some opening comments but I think both of us would be very interested if you would just give us a little bit of background on what the Friends of the Belair Line does or what the group represents.

MS BROOKS: We formed in 1995 following the closure of three stations on the Belair line. Our concern now is not only for the loss of those three stations but we also would like to see the whole line remain viable because we believe it is a very important community asset but, if it is under-utilised, it may become difficult for the state government to justify the expense of maintaining it, so we are putting a lot of effort into trying to encourage people to use it and, of course, we would like it to be made as accessible to as many people living near it as possible.

MRS OWENS: Thank you. I understand, Jane, you have got some opening comments that you were going to make at this stage?

MS BROOKS: Yes, I have, because I have got quite a lot of material to back up what I put in my submission. We do accept that the rail standardisation project was a necessary part of rail reform but we do know from the TMG report, which I have here and I have got a photocopy of some of it for you and information on how to obtain this report, that the minimum works considered necessary to run a reliable service on a single line were not agreed to and it has been our understanding that a major goal of rail reform is to encourage a transport mode or shift from road to rail and we feel that producing a poor outcome for an urban rail service does not appear to be compatible with that goal.

I have some material to back up that statement, that urban rail is a concern in the process of reform. I have got a rail facts sheet number 10 from the Australasian Railway Association. I also have a copy of a magazine article from Transit Australia, written by Ian Hammond, who tells in great detail the effects that the standardisation and the single-track operations is having on the Belair line.

MRS OWENS: Jane, can I just interrupt? Those documents - are you tabling those for us or are they just being provided as references?

MS BROOKS: I have got the originals but I have photocopied the Transit Australia article; the facts sheet, information about how to obtain the TMG report, which I can leave for you.

MRS OWENS: Good, thank you very much. We have got three tabled documents.

MS BROOKS: Right. We also feel that replacing the rail service with a bus is not likely to attract new customers and evidence for that is contained in these books and, of course, they are massive books, so what I have done is I have photocopied information on how you might obtain those books and, just while I am on that point, may I ask Dr Derek Scrafton a question?

MRS OWENS: You can try.

MS BROOKS: If the Belair line was shut down - and I gather that is something that you have advocated because I have a photocopy of an article from the Advertiser - what would you intend to replace it with?

PROF SCRAFTON: I think at the time that article was written when I was the director-general of transport in South Australia, my view was very clear, that in fact the existing bus services would provide the services, so that you would have those buses that come down the Belair Road and the buses which came down Goodwood Road that would provide the service. Whether there was any need for additional service would be looked at as it was when the Bridgewater extension was closed down, but my view at that time - and I am not in the job now so I don't have to have an opinion about it now, but it is quite clear that at the time the ridership on the Belair line would not have justified it being kept open, and the government decision to close the stations was in fact the compromise that was made in order to accommodate this project.

However, I should make the point very clearly, I think, for the record, that I was not involved in the decisions that related to the submission; that is, this matter of the single tracking and the way in which it was done. That was not something which I was involved in at the time; partly because the government was quite well aware of my views on the situation, just as you are now; that I don't think the line was justified and in fact at the time the Bridgewater extension was closed my view was that they could well have considered closing the whole line even then but, as you know, there was an enormous political furore at the time about the Bridgewater - and that scared the government just as much as the present pressure that organisations like yourselves and the local councils have put on in the recent past and I am sure that the current situation about whether the line would stay open or not is not a major issue, politically, at present. I could not see either party in Adelaide agreeing to its closure, but my view would be that the present ridership could well be handled by the existing bus services.

Whether that was acceptable - the point that you're making and the point which other reports make - that many people who ride trains say they won't ride buses. It is rather like the situation of saying that all the grain should go on rail, when in fact you have got areas like the Yorke Peninsula which have never had a railway and who are major grain producers, so it is in the metropolitan area that the large areas of the metropolitan area are only served by buses and that comparative benefit, or that comparison of the alternatives, does not arise for people, but you are quite right, that was my view at the time, very clearly.

However, I would have to say that in terms of this inquiry we are not involved with issues of particular services. We are involved with the policies involved and I think your submission does that quite well. I mean, your submission picks up the point very strongly that if you are going to do something you should do it properly, and if you are going to invest $8 million or $12 million or whatever the case might be, to do it in a half-hearted fashion is hardly appropriate, and I don't have any problem with that. Whether or not I feel it is a justified investment or not, is not really an issue for this inquiry.

MRS OWENS: I think the issue that we are concerned about is that if a government does make a decision, as has occurred in this case, the important thing is - there is no right or wrong on some of these decisions because the government is making a political or a social judgment about keeping a line open, and then probably making a budgetary decision about how much they are going to spend to do that. I think the important thing from our point of view is to ensure that whatever the government's decision is that it is transparent and that the rationale for doing it is transparent and the money that is spent on what is called "the community service obligation" to subsidise the community to keep that line open should be made clear. We're not saying there is a right or a wrong answer to it. We're saying the government has made that decision and so long as we know and it is made clear to the community what that costs the community, then I think we are reasonably satisfied. Would you like to keep going?

MS BROOKS: Thank you. We have been very concerned about the social impact of the station closures and the effect it has had on people's way of life. We did make a submission to SACOSS, the South Australian Council of Social Services. They wanted information about the effect that government decisions, particularly to do with public transport - that was one of the issues - had had on people. I have photocopied from this part of a survey that we carried out. We asked 15 different questions but we gave space for people to describe the effects that having their stations closed had on them, so I photocopied all those responses.

MRS OWENS: Thank you. I noted in your submission that you got 172 responses.

MS BROOKS: Yes, that was from people who attended a series of three public meetings and what I have photocopied for you does contain the information about when those public meetings were held, so that is another document.

MRS OWENS: Good, thank you.

MS BROOKS: We have been motivated to appear before this commission by a concern for social justice, a concern for the environment, and a wish to increase rail patronage in keeping with that goal of achieving a transport modal shift from road to rail. There has been quite a marked decrease in patronage in South Australia. When I prepared this submission the only evidence for it I had was from the TransAdelaide annual report and I photocopied that page and also the name of the rail manager, Mr Jim Sanford, and how to contact him if you wanted to have a copy of the annual report; that is my copy.

There is, of course, a lot more evidence in today's Advertiser about the drop in rail - or public transport patronage. I have some other documents which I will table. These are documents written by the Friends of the Belair Line, really arguing the case for having a rail service. So I will table all of those as well. So there's one - that's how to obtain the two books - and then five Friends of the Belair Line documents. They give information about all things we have been trying to do to encourage rail patronage and make people aware of the potential benefits of the Belair line if it was utilised to the full.

We hope that by drawing attention to this consequence of the rail reform process - that is, making it difficult for the Belair line to operate and maintain a reliable service, having to cut out stations - by drawing attention to that, we hope that care will be taken to avoid adversely affecting other urban rail services during the process of rail reform, and of course we're also hoping that something might be done to ameliorate the effects on the Belair line to make it more viable and easier for the government to justify keeping it open. That finishes my comments. Thank you.

MRS OWENS: Thank you very much and thank you very much for all those tabled documents. I'd hate to think what your photocopying bill was. It was very kind of you to provide all that information to us, Jane. You said at the end there that you were hoping something could be done to ameliorate the effects on the Belair line. What sorts of things would you like to see happen? More passing loops?

MS BROOKS: Yes. The trains used to cross with the old service that Millswood, Hawthorn and Clapham were included in. For a lot of the time they used to cross between Millswood and Unley Park. So we feel that if a passing loop had been put there where the terrain is flat and there's a wide corridor, then the service that we had before April 1995 probably could have been continued. Also in this TMG report it details that the current passing loops need to be longer. Because of the terrain, that is not possible with some of them, but if they were longer then the delays caused by the trains crossing would be reduced. So that's what we would hope for: that in effect there was more area of double track to give flexibility to the timetable.

MRS OWENS: Would you want to also see those stations that you mentioned reopened?

MS BROOKS: Yes, very definitely, and also - - -

MRS OWENS: They haven't been put to other uses?

MS BROOKS: No, all the infrastructure is still there. Another thing we'd like to see happen is at what they refer to as the Eden Hills passing loop. If you're coming up from the city, it's just the other side of the tunnel under Shepherds Hill Road. There is a passing loop there in what used to be a dump. There is new housing development going on in that area, and if a new station was put there where the trains often have to stop anyway, there is the potential for hundreds, maybe even a thousand, new commuters living in the new suburban developments up in the area.

MRS OWENS: You have brought this idea to the attention of the government here?

MS BROOKS: Yes. I'm currently circulating some of these documents, the one called The Belair Line: Too Good to Lose, and The Case for Inner Suburban Stations. I've sent out about a hundred of those, so I'm trying to make the suggestions as widely known as I can.

PROF SCRAFTON: One of the things that is very interesting is that this TMG report was actually prepared after the changes were made. Is that right?

MS BROOKS: Yes.

PROF SCRAFTON: In your submission you say it was commissioned to investigate improvements to increase the reliability of the service. Have you actually seen any improvements in that time since 1996 or 97 or whenever?

MS BROOKS: Yes, TransAdelaide has tried very hard to improve the reliability of the service. I know they have made quite a few changes to the signalling. There have been other technical changes which I couldn't explain but Mr Jim Sanford would be able to. They have tried retraining of the drivers so that they keep to the timetable

better. They realise the importance of it because if they hop off at Blackwood and have a cup of coffee and get the whole thing out of kilter, it affects all the other trains after them.

Also there's a problem with the track being slippery, which is not really to do with the single-track operations, but they are making quite a lot of efforts to make the service more reliable. But if there were more areas in which they could pass, then any hold-ups caused by slippery track, or people with wheelchairs getting on and off - because when that happens the driver has to get out, put out a ramp, the person gets on in their wheelchair, they have to fold up the ramp, then get back on the train, and then reverse the procedure when they get off. So you can imagine the delays that would cause, and if they miss their passing opportunity - obviously the more area of double track, the easier it would be for TransAdelaide. Also it would give them flexibility with the timetable. Maybe in the future with all the new people living up there, they might want to run a 15-minute service, but without sufficient areas of double track they just wouldn't be able to.

PROF SCRAFTON: All this was known before this decision was taken, which suggests that when the standardisation came in, the amount that was allocated to change the STA component of it, or the metropolitan component of it, was in fact driven by the budget. I think all of the things that you've talked about, the advantages of more loops or longer loops - I'm sure that was known at the time, but I think the primary budget allocation, if not all of it, came from the standardisation program, and presumably there's only X million - I think the figure was 8 million - my recollection was at the time - and they did what was best at the time.

I think you're quite right and I think your organisation does a good job of trying to encourage people to ride, and I applaud that. One just wonders about the overall quantum, given the fact that the same organisation, the same government runs parallel buses. It is not unique to the Belair line. It happens on the Glenelg rail lines, and the routes to the deep south and so on. But I applaud the approach that you take, and maybe you will convince the government that some investment for the next project or a future project might be spent on additional loops or longer loops.

The other point you make, that I think is important, is there's a lot of talk about there only being whatever it was, four loops, but in fact only two of them were new. The other loops were there anyway, so it was really no big deal. I think it might also be worth, for the record, just pointing out that all of these conflicts that we're talking about have nothing to do with freight. All of the freight is on the standard gauge and it's a separate operation. So the conflicts are all within trains. But the point that Jim has brought out is that if you get a problem with say an outbound trip in the morning peak, if it misses the cross, then everything in the rest of that peak service can be delayed, perhaps even exponentially.

MS BROOKS: Yes. What happens often is they just have to cancel a service to catch up. May I make a comment about the parallel bus services? There are some parts of the track where there aren't any parallel bus services, particularly if you want to go say between Millswood and Torrens Park. A lot of people use the train for that purpose. Also suburbs like Eden Hills are very hilly. They were originally built in the 20s and 30s based on the fact they would have access to the train, and it would be very difficult to take buses into those areas.

PROF SCRAFTON: That's quite right, I acknowledge that. I walk to the top of the hill. Incidentally, that also accounts for the fact why people have been reluctant to build that station at the loop that you talked about earlier at Eden Hills. It's because of the simple geography of the location. That's why it was never done in the past. It has always been seen as a superb location to put a station but just the local topography of getting back up onto - what is it called, Bellevue Heights?

MS BROOKS: Well, it's Shepherds Hills Road.

PROF SCRAFTON: Shepherds Hill Road, right. But now that more housing is going on down on the level at which the railways exists further round at Coromandel - what is it, not Craigmore - - -

MS BROOKS: Craigburn Farm.

PROF SCRAFTON: Yes, that's right - one can see that potential. As I said, the details of it are not ones that we can comment on particularly, but we can only wish you the best in your debate with the state government. I think there is a great difficulty for them. The very point that you raised about that excellent decision not to increase the fares that was made yesterday, and as a public transport user in Adelaide, I am obviously very happy about that. But then there is a conflict when they want investment money. You know, the treasury says, "Well, why are you not raising much of this yourself?" So your arguments in here are about the social validity, are they? The social necessity are the only ones that really can count if your arguments are to prevail.

I would just like to repeat, the great value of this submission to me is it says that if you're going to invest in railways, then there is no point in doing it in a half-hearted way. You've got to do it properly and in that way you will be able to generate returns. But this middle-of-the-road effort, which your submission and some of these reports obviously point out, are really ultimately failing everybody. You still have a costly railway but its performance is such that people will choose alternatives.

MS BROOKS: Yes.

MRS OWENS: I was going to ask you, Jane, just following on from something that Derek said, that the government today has announced that they're not going to put the fares up. What if you were successful in lobbying the government - maybe you don't call it lobbying - convincing the government that the investment should take place but the government said to you, "Well, what this involves - if we're going to invest more in our rail system, we're going to need to raise public transport fares. You can have it but it just means that we're going to raise public transport fares across the system"?

How would your members react to that sort of proposition?

MS BROOKS: I can't really speak for all of them without talking to them first but my own reaction would be from seeing what has happened since the last big increase in fares where the multitrip tickets, the ones that were not concession, went up by $2. If that is what has caused this big patronage drop, obviously increasing fares isn't acceptable. But what I was wondering is whether or not the money could be made available from the federal government. Where did the money for the loops come from originally? I thought that was federal money.

PROF SCRAFTON: I think that's exactly right. I think the funding for the standardisation was a federal project and part of that fund was allocated to reorganising the Belair service in order to accommodate the standardisation of the main line. That's right.

MS BROOKS: So that is what I was really hoping. I certainly understand the position of the state government, they just don't have the money, but considering the point that only two passing loops were built, I would tend to think that there are still two more yet to come. Even if it took five years to fund them, that would be something to aim for, that eventually we got sufficient passing loops to at least run the service that we had before.

MRS OWENS: Have you collected information on whether there has been a drop in public transport patronage generally in those catchment areas, and people are going back to cars? Is there any data on that?

MS BROOKS: I think there would be but we don't have access to it because in today's climate of competitive tendering and things like that, that's commercially confidential. But Mr Jim Sanford may provide the commission with that information.

MRS OWENS: Good, thank you. I just have one other question I was going to ask you. When these decisions were being made initially to just have the single track and to invest in - have the four passing loops, did the community get consulted at that stage? Was there any discussion with the community?

MS BROOKS: As far as I know, there was a meeting held in the hills where people were assured that the service they were used to could be maintained but as far as those of us on the plains and the inner suburbs were concerned, we found out that our stations were to be closed three weeks - I think it was three weeks or maybe it was four weeks - before it actually was done.

MRS OWENS: Right. I've actually asked you what I was going to ask, Jane, and I thought that was a very interesting example you've given us of one of the possible downsides if it is not done properly, and I think it's important for us to note those sorts of issues that can arise. Thank you for that. Have you got any other comments you would like to make before we move on to our next participant?

MS BROOKS: Not that I can think of at the moment but I probably will as soon as I've gone out the door.

MRS OWENS: Well, you can talk to us if you stay around till morning teatime - we'll be breaking a bit later for morning tea - and we can talk over morning tea. So thank you very much for coming.

MS BROOKS: Thank you very much.

MRS OWENS: We'll now break for five minutes.

MRS OWENS: We will now resume. The next participant today is the Australian Rail Track Corporation. For the transcript could you please give your names and your position with the corporation?

MR MARCHANT: David Marchant, chief executive officer, Australian Rail Track Corporation.

MR EDWARDS: Glenn Edwards, commercial research manager, Australian Rail Track Corporation.

MRS OWENS: Thank you for coming and thank you for your second submission and for all the other involvement that you have had in the inquiry, including coming to our workshop fairly recently. We have both read your submission with great interest and, if you would like to make some opening comments, we would be happy to hear them.

MR MARCHANT: Effectively, yes, we have made a submission dated 11 May with regard to the response to the Progress in Rail Reform draft report and, in that outlined, I think in a reasonable amount of detail are some of our observations. I just wanted to emphasise a couple, if I may. We obviously welcome the report and its observations but feel that a little bit more analysis following through the structural suggestions of the draft report would actually add significant benefit to the public policy development and, in particular, the issue of the breaking down of the structural reforms between urban passenger low-volume regional railways and high-volume regional railways and interstate networks.

We are possibly suggesting that the final report would add a lot more rigour to the public policy debate for the recipients of the report if there was an attempt to try and break down what those literally look like in the Australian context and effectively may help the participants in the various views on vertical and horizontal integration to actually get some cognisance of that in the Australian context and, in that regard, we obviously made some observations with regard to the breakdown of the particular industry participants in the report and made some comments that we thought that joining AN and National Rail together distorted the picture and, more particularly, the largest parts of the recent reforms have been in the period after the analysis, and that is in the last two years.

Although recognising it may be very difficult to actually get data from the various participants which reflect the type of analysis the commission is after, another way of dealing with that is to deal with it by the structural reform analysis the commission is proposing and going back onto the track volumes and participants around that following through the section on structural reform in section 5 which, rather than being a post-analysis of what the present participants' efficiency in productivity and gain may be - which there may be some resistance to achieving - doing it from the process of the commission's observations about structural reform and looking at loads and volumes and what may fit within that categorisation may actually take away a little bit of the resistance that may come from individual operators sharing information and it may actually add some element to getting more focused conclusions around those break-ups. Not having had the benefit of seeing the responses from other participants prior to today's meeting I am not sure how others have responded.

MRS OWENS: We'll tell you in a minute.

MR MARCHANT: I would assume that effectively the existing vertically integrated operators would be obviously resistant to the structural reform and on a whole range of probably very well articulated grounds; and I would assume that, for example, in Western Australia and Queensland, using those as examples, there would be the issues raised of the difficulties of interfaces, and that is in the smaller regional areas that many of the low-volume regional railways end up having to use high-volume regional railways to get to a destination.

I actually think that those very grounds prove the point; that in fact there are multiple users in those high-volume regional railways and many of the high-volume regional railways are also part of the interstate network. It is the very point that in fact there are multiple users; it is the very point that there are multiple choices of pathways in a constrained sunken investment that actually reinforces the argument for separation. I would expect that the next argument that usually is put on this is that the interface costs are in fact extraordinarily high. Well, it is a catch-22 because, in many cases, they have argued and their governments have instructed them to be separated, even though they are owned by the same entity and, if the interfaces are higher in cost in that framework, then they must be higher for their owner, as well, because they are supposed to be treated on like terms.

So the efficiencies they allege that the interfaces - or the inefficiencies - create can either conclude that they have not properly separated within the one ownership and therefore there are in fact additional costs to other players who are not vertically integrated with them; the Chinese wall that the asset is separated from the above-rail even though it is under the one owner, and therefore the interface costs have become higher for any other operator but they're not higher for their owner, actually would tend to lead you to the conclusion that the Chinese wall separation hasn't been a successful separation, otherwise the interface costs would be no greater.

The terms and conditions of access, the risks with regard to the access and the concluding framework with regard to planning it should be no different between the vertically integrated access provider and the new entrant provider. If in fact there are higher costs of interface then that may only lead to the conclusion that in fact there are cost subsidies going on or that in fact there are hidden costs there that haven't been brought to book, so the very arguments that normally come out on this - the multiple users' argument; that is, you can't separate low volume from high volume for interstate because they end up criss-crossing - is actually only reinforcing the very separation argument.

Then the next argument which usually concludes from that is, "Ah, but even if that was the case, the interface argument is such that the costs of interface are in fact impediments." You can't have it both ways; you can't argue to separate it out to have open access and then find that your cost of interface are only higher for those people that you're not vertically integrated with, so therefore the cross-subsidy must be hidden. I expect that the argument would be that there are no subsidies and that government-regulated open-access regimes have overcome that. In that case, then, it is contradictory in its term, its substance and its content, and therefore you can't win that argument either way.

You are either going to argue that vertical integration is in fact the cheapest overall cost and therefore open access should not be a framework around it in multiple-use lines and it is in the multiple-use lines that I am actually concentrating on because, in our submission to the commission earlier and in our comments earlier, ARTC fully supported closed-circuit markets, such as urban transport systems, because effectively consumers don't have choices between competing operators; that in fact they're left within an urban network framework of which the operator rightfully is delivering a total service and above-rail and below-rail risks actually relate to how many consumers they can get on, having also suggested there is potential for franchising some of those to get competitive issues about CSOs because, effectively, they will always have some form of CSO, just as the public and private bus systems in urban areas do, both not only on the road but also in the direct costs of operating services for public policy reasons, so there is no real argument there between rail and bus in urban areas.

In low-volume regional railways we also supported effectively that in some markets the extent of the volume and the nature of the volume is such that having a more open competitive framework only in fact ruins the economies of scale of the market; Tasmania may be an example. I'm not exactly certain New Zealand is, although I am sure the people operating New Zealand would argue that it is, but certainly in those areas. The other point though is this: many of the branch lines in Australia that have been closed, if in fact they had been put into a low-volume franchise arrangement, may still be open today, because effectively part of the argument for separating these out is separating the safety regimes and risks so that they are purpose-orientated and many branch lines can never achieve the sort of standard of safety, engineering maintenance, etcetera, that puts them into a total system-wide framework, so the interstate standard or a large high volume regional standard of both maintenance and safety frameworks, would be very different to a branch line which may only have two or three trains on it a week and of which the whole maintenance regime could be costed on a different basis. The one-shoe-fits-all scenario is actually axed to the detriment of markets, so we fully support the structural proposals there.

What we are suggesting is that the commission, in its next round, see if it's possible to undertake some analysis of what that would actually mean with regard to the Australian market and possibly do some cross-analysis of costs and volumes between different high-volume regional markets. I expect that that would produce interesting results between say the Hunter Valley line and some parts of the

Queensland high volume coal bulk lines. Without looking necessarily at the participants you are actually looking at the productivity of the line framework and what could be yield from it.

So we are obviously supporting those recommendations and actually suggesting that the commission go further on them, but we are also suggesting that it's possible that some of the arguments against that separation can in fact be flawed by the very arguments themselves when in fact they can't have the best of both worlds and argue that they produce the same efficiency results and yet have higher costs. It doesn't hang well together.

We had some particular problems with regard to the productivity comparisons, which we have documented and put in the submission, but one in particular I want to raise because it effectively enables the industry to downplay the asset yield on some of its sunken assets; in particular, the performance between railways based on speed restrictions and therefore on time reliability. I, like others, will obviously argue that on time depends on which market you are in; in the interstate market we value on-time frameworks because of the nature of the commodities being moved. If in fact I was much more involved in the coal haulage or grain haulage then it would be about fitting into the logistical chain of both the grain producer or the coal producer and the next transportation mode, which is either ship or otherwise.

The real point we want to make is that the difference with regard to on-time arrival has been slightly distorted by the exercise of some track owners moving temporary speed restrictions into permanent speed restrictions and, by doing so, artificially invoked the reliability of the arrival but at the cost of the asset yield; that is, that the asset, a high-cost sunken asset, is actually not performing to its capital utilisation and it therefore is in fact under-yielding the performance to the operators and to the infrastructure system.

In some cases temporary speed restrictions to some markets have been made into permanent speed restrictions, providing a 90 per cent plus on-time arrival, but in fact the asset has been operating at well under the axle loads and speeds than in fact the infrastructure investment. There are models around, both M-train and E-train models, that do model what an asset's optimum performance, given certain frameworks, is. We think that some of the elements of the measurement should also be an element of yield against the asset.

The second reason ARTC is raising it is that we actually believe that the industry in transition - that many of the engineering risks that have been factored into these assets have not allowed the assets to yield performance at the degree that a commercial framework of risk management would have provided. I'm not suggesting here a safety risk, I'm talking about commercial risk of maintenance cost versus asset replacement. Many of the assets that both ARTC now either lease or manage or own - and some of those we're attempting to get wholesale agreements in - are able to produce significant more capacity, much higher axle load and speed than necessarily their engineering practices actually provide now. Therefore the asset is being under-utilised at the expense of the industry and of the operator, and a lot more effort needs to be made with developing better yield profiles for some of the capital invested, and the on-time delivery can distort the other part of the equation. That is, could the asset have yielded a better delivery time-frame than just what is presented in the timetable? So we're very keen on that.

We've mentioned that we think it would be an interesting exercise to see what the relative productivity gain-sharing has actually been, especially in the last few years. It's probably our view that the competition on the east-west corridor has produced most of the gains in prices and in consumers, with some slight gains to the service operators. But in an area where the industry is trying to make itself attractive to private sector investment, then a large analysis and understanding of where the productivity gains have actually gone may be of benefit to the next 10 years of industry reform and may in fact put in perspective what the beneficiaries have been of what some of the substantive productivity gains you've identified in your report are. But that's more an intellectual benefit than it is necessarily an industry benefit.

The next major area I wanted to touch on was with regard to auction, mainly because I think we're probably the only light on the hill advocating this in the industry at the moment, and I think that probably reflects where the industry is in transition. Following through the comment earlier that we would like to see the commission put some of its significant intellectual effort into the last couple of years of analysis and what has happened, the industry is very early in the stage of transition. If you see transition in six or seven levels or stages, you see the beginning of a competitive framework, the beginning of the reduction of regulatory substitution for the market, and then consumers starting to take a lot more power in the second and third stage, and by the fourth stage you see a lot more activity with regard to consolidation of products and of product differentiation, and by then you move through into stages 5 and 6 where you have a very vibrant competition and some consolidation after having multiple players.

We're not even past stage 1 yet. We are at the very early stages of an industry opening itself up to competitive forces. I am sure many in the industry, including some of the private sector investors who are only really operating on the east-west corridor, although advocating strongly and they have put a lot of investment in the industry, have put a lot of investment in terminals and leased a lot of investment in rail. The terminals actually have a pretty easy substitution cost because the land value framework is easy to substitute. There hasn't been significant investment on railway rolling stock yet, which is the long-term sunken type of investment. So we have got a long way to go yet before the industry starts to move down the competitive mode of a lot of equity at risk, and reflecting that in both rolling stock standards and in rolling stock investment and in starting to look at getting better yield out of that rolling stock investment.

I mention that with regard to the auctioning because, effectively, auctioning probably flies in the face of some of the views of people about "An industry in transition needs certainty." You know, "If we're going to invest our money in this sort of industry, then we want to have a bit more certainty that we're going to have 10 or 15-year contracts or paths to actually pursue that." That is partially correct. In the ARTC's case, we're certainly not suggesting that people can't contract with us for 10 or 15 years. We're quite happy to underwrite our debt with a 10 or 15-year contract, and we back that up by saying that you can in fact assign that contract, that the contract is assignable by the owner of the contract and therefore creates a secondary market in the contract itself. Therefore it helps to actually cap out where the asset owner may in fact start to take potential monopoly rents or frequency of service issues away from the contractor and the contractor can assign out to another player who wants to take that risk or otherwise, and therefore caps through the capacity constraint issue.

The auctioning system we are proposing - and we're not proposing to do this until after the privatisations have gone through, to enable the market to get the framework - can take a number of forms. One of them can be auctioning whole corridor paths, linking not only corridors owned by ARTC but wholesale corridors, and therefore they could be auctioned for 10 or 15 years. In fact, the difference in the auctioning process will be in fact the value placed by the bidders based on certain terms.

What usually comes up is, "Well, what about like for like paths?" We have a situation where we're operating on Friday - and I mention Friday in particular because the biggest peak on the east-west corridor is Melbourne to Perth, leaving Friday afternoon and getting to Melbourne on Sunday night or early Monday morning, and they have high value, in our view, because there's constraint. We can hardly get a path for a new player on a Friday afternoon - Friday night - but we're practically empty out of Melbourne on Tuesday and Wednesday. The argument for that being practically empty is, "Well, the end user market only wants the stuff there on Monday morning or Sunday night."

We have a capital asset there. The very argument about that capital asset is that in setting prices for it we shouldn't set those prices based on its spare capacity unutilised. That is, we rub it out for Tuesday and Wednesday, you don't pay the debt on that - right, rub it out - because that shouldn't be cross-subsidised by those who want the peak period on Friday in an asset-setting pricing regime. But then they don't want to have a value set with regard to those primary paths. They want those primary paths, not value on the totality of the sunken asset for the week; they want it valued on the only time they're using it. But the asset owner has to pay a debt on the periods that aren't utilised, and uses price mechanism in an auctioning process to see if in fact there is any elasticity about that.

The question that then poses is, "Well, what happens to me on Friday if some of my customers get attracted to this lower price on Tuesday and Wednesday?" Well, two things, one of which is that you may very well take that up by, say, operating services on Tuesday and Wednesday and find there is elasticity in the market that you said wasn't there. Secondly though, it provides for an enhanced capacity on the Friday, which is a constrained market. In fact we can't get people on, so there is a possibility of substituting other goods across. But in the end what we actually do start to see is what the value of the infrastructure is in periods other than the most preferable, the most attractive period.

In that framework you can have certainty. In that framework you can trade out one path against another because you've got contracts and you're able to assign it. So if you find that in fact Friday is not as attractive to you now as Tuesday is, you assign your Friday out and go into a Tuesday framework at a lower cost. That is market choice. I mean, you can't ask for the certainty of a 10-year contract and then say, "But we want to have the flexibility to get out of in six months, but we don't want to give you flexibility in a sunken asset to actually utilise the asset in slow times, but we don't want you to put that into a pricing regime either." So the economics of the industry, of a sunken infrastructure investment, is not reflected well in the way the operators think about the industry's economic cost.

In the gas industry you buy capacity - you buy capacity and you trade capacity. It's recognised that capacity has different values and different constraints. But what the other thing it does do is it gives a value to, in fact, constraints. A good example of that in the Australian context is Sydney. You can get about four trains in and out of Sydney during peak hours - four small size trains. A lot of effort has gone on in Sydney, I think, to enable larger sizes during those periods. It has reduced the number of paths but it has enabled longer trains to go out - a very substantial economic benefit. Who attained or gained that benefit? Who put the value on it? The reality is it was given to an operator. No other operator had a chance to bid for it, and yet three or four operators all want to go into the Sydney market. It's a very significant constraint. What value would they have put on that path to open up their market? They didn't even get a chance to look at it, let alone put a value on it.

If they had put an extraordinarily high value on it, hypothetically, you would have sent a very clear economic message that there is a constraint in that market that's valued very highly, and an asset owner - maybe not the present owner, but if you're looking for a competitive market, another asset service provider may say, "There's a chance here. This section of track is very significantly constrained, it holds up high-value framework. We think it's worth an investment, doing a bypass around, and therefore opening up the constraint," because you've actually put an effective value on the constraint to enable competitive infrastructure investors to see the attractiveness of overcoming the constraint. You have actually started to put a value on what constraints really mean to a market. You've actually started to put a value on the floor and ceiling prices of an asset owner.

Usually you get an argument about asset owners in this sort of environment where they want a market price - sometimes a euphemism for "Ramsey price" I think - and they say their market price is based on a commodity value. I don't know what expertise the rail industry has in commodity values, but obviously substitution pricing is one because you can easily work out that substitute pricing. This is in fact a method of market based pricing in which the market dictates that value, not the asset owner. In the end, the asset owner is the least able to actually give a fair market based price in a constrained market. The people who value the constraint are never the asset owners; they will always give it the highest and best value no matter what, if they can get away with it. But the very customers who are concerned about certainty haven't yet appreciated some of the economics of providing substitution product by constraints that enable putting pressure on going through those bypasses; they actually do put a value on the bypasses.

The commission would be well aware of this in other industries. The aviation industry is a very good example, where in airports there are constraints on how many landings you can do per hour, etcetera. Some of those constraints are brought about by engineering safety issues, some of them are brought about by a whole range of issues. Each of those in the rail industry you need to question, as we are presently doing, because many of the constraints are brought about by assumptions which are historically flawed or have historically changed. But the point is, there is a constrained time opportunity. A constrained time opportunity, if it is valued by the asset owner, allegedly on, quote, "market based prices" is in fact not a valuing of the asset against its sunken investment, it's a valuing of "What is the highest and best use I can get of that? But I will dictate it" - where auctioning actually enables the market to dictate it.

Auctioning has to also be seen in the light of the reverse of that spot pricing, pricing in the low-yield times in non-constrained environments, where you can have the exact opposite - significant discounting - to try and actually introduce frameworks. So there is a blend of those tools. I think very early in the industry moving through, the clear thing that comes through in the discussions on auctioning - and I haven't seen the submissions yet because they're not on your Web page, but I can assume some of the things that will come up on it - is an exercise that the industry has no value in the sunken investment. It actually really believes government should provide to it free. And effectively the debate about auctioning and setting pricing isn't a debate about proper economic value of the infrastructure assets, it's a debate of saying, "Why isn't it just free? We don't want to put a value to it."

The difficulty with that is that in the long term, the more you want to put investment in infrastructure, whether it be road, rail, water, gas or electricity - sunken infrastructures - then you have to actually start to put some benefit and cost in, and you have to actually put some value in. I am not arguing that governments shouldn't invest in these infrastructures and cream out or take out those that don't make a commercial return, because in the public interest they see in the long term the infrastructure will add value to externalities that aren't put into an MPV base. I actually think that that is good and I actually think that that should continue, but what it does is send very clear messages about what the constraint and the externalities and the values should be.

One of the real problems in public policy in transport in Australia, which the commission identified and I would like to see go stronger in its report on, is that the proper valuing of externalities between transport substitutes - road, rail, air, water, sea - is not done coherently, and that effectively that public policy investment, the blend of investment between the public investment and the private investment, have not been given economic signals which give values to externalities and values to, in fact, why the investment is worthwhile.

Auctioning and spot pricing give some messages around the difference of those values and government can then step in and say, "Well, we think the difference is this, but the constraint is making the price too high. We want to invest in overcoming the constraint. But we can see the difference of the value of that constraint vis-a-vis something else." They can't do that at the moment because it's not clear. So you get what some would consider ludicrous public investments into rail lines or roads that lead nowhere to produce nothing, because in fact there are no messages about the value around those constraints.

You see it in the aviation industry with regard to how many terminals there are and how many spots you can get in, and whether the value for a plane of 10 seats is the same value as one of 500 seats during peak hours. This exercise is about opening up debate. It's far too early for ARTC to commence auction. We're not suggesting that. What we want to do is commence a debate in the industry and move it forward. We want to have industry very much involved in working through that debate.

The last comment we wanted to make was with regard to the point I just raised, and that is that in 1991 the commission made a number of significant recommendations. The sad part of the draft report this year is that, not coming from the rail industry, having read the previous report and this report I feel a touch of deja vu in it and I'm sure the commission must feel the same, but I would certainly hope that in your report in seven years' time you don't actually have to repeat the 1991 report again.

My point is that there must be something wrong with the robust debate if in fact in one of the major transportation areas - Australia is a major transportation market, it's a country spread the way it is in such a geographic framework - that there obviously needs to be a lot stronger analysis and emphasis on getting the public transport and the transport investment right between modal sectors. The commission only just touches on the public policy issues there, where we think the commission should take a much more adventurous and bold stroke to say, "It is time to get public transport economics - both in value terms, externality terms - into a coherent investment package for the Commonwealth and the states." We're not suggesting in an ARTC sense that the governments should in fact - "the always investor" - but it should at least give the right signals about the method of investment and the blend of investment between modes and give those signals based on an informed economic criteria of incentives and disincentives.

At the present time it is sectorial, unconnected and lacks coherency in any framework at both a national and a state level. The commission's report, in our view, is not bold enough in that. I think the diesel tax debate is a fine example of that. We're seeing a debate here which changes ground. One minute the diesel tax is about off-road use and it's really about a substitute for access charges, and then the next minute, "Oh, it's just an ordinary tax." On either basis it is badly tuned, it is badly focused, and it sends the wrong messages, and it distorts the economic result. The diesel tax effect and its reform will do the exact opposite to the public investments being argued for in rail. It will in fact create the very disincentives. But I only use the diesel tax as an example because it's current. You can go through a million other examples and show that there is lack of robustness with regard to getting the right blend of investment.

Here we're not arguing for more investment in rail against road or otherwise, we're just saying get the blend right and the incentives right. The other part of that debate is section 51AD of the Tax Act. Here we are in the middle of a business reform debate and we think that the commission, in raising very correctly the need for proper analysis and incentives for private sector investments in this part of the transport mode, needs to go much stronger in some of the structural disincentives that are historically now out of date. Section 51AD was brought in to overcome state governments in the 70s being creative with regard to how they could rebalance their books against large sunken infrastructure investments, including rail, and that creativity was obviously at the expense of the Commonwealth tax revenue.

The creativity is now gone, the world has moved on. We've had national competition policy, you've actually got the states getting out of the very infrastructure issues that they were trying to leverage tax reform to get incentives from, and now you've got the commission and a million other people saying it's about time we made these things more attractive to private sector investment. What you've got is a structural tax system that in fact creates the very disincentive to correct a problem that has now passed, and some of those things are more urgent if, in fact, infrastructure investment is going to - especially in the rail area - become attractive on proper commercial grounds and on fair tax grounds to other forms of investment, because 51AD effectively means, in its present form and content, that the very things that people are asking for, the tax system doesn't treat equally; it actually stops the treatment of the expense versus the income. We think that those things need stronger articulation, especially in the light of the time zone the commission is reporting in. In general terms they are our comments on the draft report, apart from a very long paper which we've submitted.

MRS OWENS: Okay, thank you very much, David. I wonder does Glenn want to make any further comments before we ask some questions?

MR EDWARDS: I'm actually struggling to find a paragraph in here which David hasn't already touched on. The only one that I might add is something raised at the workshop in April regarding the suggestion that the commission might be able to develop some sort of a relationship between the amount of investment that has taken place in the network and the productivity improvements that have resulted from that. I think that would be particularly valuable to the argument regarding investment in rail, and might send a message to some of the regulators who, from time to time, are a bit prone to undervaluing the asset in rail by setting fairly low returns in their pricing regimes. So that's really the only issue that I could find that David hasn't already

covered.

MRS OWENS: Okay, thank you. I think there were some really useful comments that you've just made there and actually some of the questions I was going to ask have actually been covered as you've been going through that. It was a very detailed introduction. I was interested in a number of things you said, David, but I was particularly interested in your comments about structure and they can't have it both ways. You were talking about Western Australia and Queensland and you gave us some very, very useful material there because I think your guesswork on at least some of the comments we're getting back is pretty right.

There has been a lot of emphasis on the difficulties at the interface and so on, and we've been getting that, but we're also getting a similar response from New South Wales who are arguing it's far too complicated in New South Wales to divide up - set a structure the way we have. "It's too cut and dried. You know, it's too complicated. We have the high-volume lines that don't just carry coal. Everything is connected to everything else and, of course, we've got the urban area in Sydney," and we haven't taken that into account.

MR MARCHANT: I think those observations are easy to make, but I wonder if it's worth just looking at other industries for a second and reflecting on those interfaces. Firstly, in the road industry you have local government dealing with a whole range of roads, you have state dealing with a whole range of roads and you have federal government investment in a whole range of roads. For some unknown reason they actually do interconnect, and for some unknown reason they actually are all run smoothly even though you've got five or six different participants playing on them, excluding the private roads as well and the toll roads and the rest. So you are able to actually segment markets under different authority and controls and to have them working coherently.

But let's look at one other example in Australia, the electricity industry. The electricity industry is really made up of a whole set of grids and transmission lines with a whole range of input providers of electrons from a whole range of generating frameworks. Although people get excited about the spot market and the clearing house, you know, the great bulk of contracts in the electricity industry are fixed contracts that don't go through the clearing house. The amount of the market that goes through the clearing house is less than 10 per cent on any particular day. So the imagery that somehow it's all cleared through in a big framework is really a small segment of the market. But those electrons do actually flow to a whole range of participants through a grid under a whole range of different people's controls.

Those grids are under a range of different people's controls and they range from high voltage, medium, through to low voltage. They seem to be able to interconnect, they seem to be able to get the interfaces right and they do seem to be able to get their billing and structures right around it. That is an industry that is not as easily able to be segmented as the rail markets are. I mean, an electron doesn't tell the difference between a high-voltage smelter and your house. In the rail industry you can tell quite significant difference between large bulk-handlers, super freighters and passenger trains. You can tell quite a difference between the different commodities being moved, so the markets are able to segment quite well and still get those interfaces done.

In the Sydney example, probably one of the best things that could happen is if, in fact, the Sydney urban system and the freight and regional systems were looked at in different forms. You actually might get a greater strength about the need to separate some of the asset investment and the rules around them, because the Sydney market actually has dictated quite dramatically the rules on the rail freight market in Australia. It is not very well understood how that market can do that, but the reality is that the rolling stock in freight in Australia hasn't been dictated to by the needs of the dry, arid deserts of the Nullarbor, or the wonderful snowfields of Victoria. The configuration of the rolling stock, the largest single investment by an operator in moving commodities, by an above-rail operator, a loco, is in fact the configuration of that stock, the sway and curve of it.

Now, how has that been determined in Australia? It's been determined not by the US standards - large-volume framework with 8 to 12 per cent variation of spill on it, etcetera - it has been determined by the urban passenger system of Sydney. The curvature of the track there and the framework of the track has led to a situation that all the rolling stock standards in Australia are based on whether that rolling stock can run through the Sydney urban area - even if it doesn't, it's configured on that. The rolling stock standard of Australia is based on whether that rolling stock can go through the Sydney market.

What I'm getting at is, by having a one shoe fits all, what you end up getting a result of is that you get the lowest common denominator in a market rather than recognising the markets are different. It has had a huge impact on the economics of the rail freight industry. The separation of those things into different market components and the rest may, in fact, enable more rational judgments about investments and returns in those sort of exercises. The difficulty of interfacing is a constant argument about why everything should be under the one control in every industry. I'm sure that in 1965 the commission would have heard a strenuous argument from the aviation industry that if you move away from the two-airline policy and allow international players in, the interfaces will be horrific, the airlines won't be able to handle it, the aviation controllers won't be able to deal with it, and the economics of the industry will be decimated. It hasn't happened.

The other thing was they would have argued strenuously in 1965 that the government must own at least one airline because to be internationally competitive in the world market, governments have to be investors in airlines. It's not a debate any more. I'm wondering if some of these debates are not brought about by looking at what's happened in other industries, but by the desperation to stay the same.

MRS OWENS: May we quote you on that? I think we might go back - I think there's a few other issues that we need to touch on with you, and I know that time is running short, but I thought I just might clarify a few things that you raised both in your comments and in the submission itself.

One of the things you say in the submission was that you think we should be a bit more emphatic in our conclusions and recommendations. We often aren't very emphatic in our draft reports because what we're doing is really just trying to give some indication of the thought process and where we're going, and then once we get the participants' comments in then we firm up. I think in this case we probably will become more emphatic and we may have other recommendations as well. I think you might find that the tone may change and I think Derek would agree with me on that.

The second point you make there is that we've provided a statement of historical events and international experience rather than assessing policy directions in terms of the success or otherwise of industry outcomes and we tend to, I think, be very careful about attributing policy changes to what is actually happening. There's a whole range of reasons why we've been a bit cautious. One is just because of the problems we have in getting the right data. You know, a lot of data we've had is obviously of historical interest and not much more. Even if we do get the data there are lags in terms of introducing policy and seeing what happens so we've got the time factor as well, and then there's just a whole lot of other environmental things going on as well.

We have been, I think, somewhat cautious, but I think it's just a function of where we're sitting at the moment looking at this industry and we have data which only gets us, at the moment, up to 96-97. We're trying to get the 97-98 data at the moment and we're dependent on the railways providing some of that information to us, so we've been a bit tied or constrained in terms of what we've been able to do there. You say that you thought we should be making a greater effort to assess performance during the recent period. You know, we would love to and we've been trying our best to get the information.

What we did was we started last August, so we've done the best job we could do on the data we had, you know, back in August, and we've tried to update but we found that we weren't getting very far with 97-98 before the draft report came out and now we've got a deadline of August. We're just going to have to do what we can and say, "Well, this is going to be some interesting baseline information for somebody else in the future to come along, hopefully, and do the work that we would really like to be doing." But we're not just, in our report, relying on the data that we're collecting in the performance measurement. That's only one input among a number of other inputs. Do you want to comment, Derek?

PROF SCRAFTON: No, I think the last comment is the one that I would have stressed. It relates particularly to the point on the top of the next page which is the second page of text where it seems to imply that in our recommendations and conclusions we rely very heavily on that data analysis, and that's not the case. It's just one input. We pick up your point, and while the data is much earlier in the 90s, we would relate the more recent developments, the new company formations and the more recent reforms, the structural reforms, and try to build our recommendations from that. I wouldn't like to leave you with the impression that we would be overly dependent on the data chapter for the very reasons which you've highlighted and we would acknowledge that, but we would like to make that point to you.

The next point on that page where you talk about best practice, I think again, without sort of being ultra-defensive about it, we have this problem of accumulating data quickly and the US and Canada happen to be very forthcoming, or more forthcoming than other nations, but we do hope in the final report that there will be much broader experience from Europe, South Africa, New Zealand and so on. We had hoped to include the South American experience too, partly because of the sort of geography and the market size and so on, but I think the latest advice to us from our people is that that's not going to be possible at all. We apologise in advance for that, but you will find that it will be broader in the final report.

MR EDWARDS: Does what you've got so far, including some of these other countries, still confirm that, say, the US is world's best practice?

PROF SCRAFTON: I think in the system-wide analysis that we've done we have relied very heavily on that class 1 data. However, what we are doing, and it's with the assistance of other railways too in Australia, is we will get better access to the class 2 data which we had virtually given up on before. There is no overall system-wide class 2 source of data, but some of the US class 2s are apparently prepared to do some one-off sharing of their performance data with Australian railways and we're hoping to be able to tap into that. However, we must draw attention again to the difference between the 90s-wide system-wide analysis on the one hand, and what we can do in terms of particular companies or particular like organisations, if we could pick up your comments there. We will, to the best of our ability in the time we've got available, try to do that.

MR MARCHANT: Maybe some of those things can be substituted for other industry sectors who have like investment structures rather than necessarily always wanting to compare the railway industry with the railway industry. That's probably what I was trying to get into, electricity and other - I mean the railway industry is a sunken investment with constrained pathways. There are very many economic industries that are very similar, and they have made both structural reform changes and productivity changes that have benchmarks or lessons for the context in Australia. Maybe that's one of the things that is worth thinking through, in that the rail industry does tend to be slightly insular and see itself as an end rather than see itself as an economic activity with very similar frameworks. Maybe some of the analogies which, I think, the commission is trying to draw in its report, can be brought out of some other industry sectors to actually assist in getting a better appreciation of the commission's direction.

MRS OWENS: Yes, I think that was one of the things that we were trying to do when we mentioned NEMMCO and that is a possible model for managing the interstate network. I think what we were proposing, which I don't think you've really picked up in great detail in your submission, is that rather than going down the track that you've been doing down we could think about the ARTC or some other body just managing the network, not being an owner, and we were wondering if you had any views on that particular approach.

MR MARCHANT: I actually do think that is a worthy model to at least have consideration of within the owners and the asset owners framework, if in fact the objective is to try and get the best yield for development of pathways and frameworks around it. I actually think that would become easier when people accept that the industry is divided into a range of structural markets as you've suggested. Therefore it becomes easy to say, "Well, how best do you get the optimal management of that with the right economic messages to the players?" So I think it's worthwhile thinking through that, because in the end who owns the asset and the yield from it is one issue. It's how the asset is managed and utilised and leveraged that becomes a lot more critical to the industry's future in a competitive environment. Certainly from the ARTC's argument, owning the assets isn't necessarily the key to the game to getting a more competitive industry structure on the interstate line.

PROF SCRAFTON: Just following on, the next dot point was about this amalgamation of AN and NRC. This has been mentioned to us by others and we'll take it up with NRC directly next week. But again our attempt there, in the system that we used, was to be able to capture all of the traffic and not to lose it. It was not intended to imply in any way that by putting them together we were sort of creating a company benchmark. In fact it's simply get the total system put together. However, we'll talk to NRC about it next week, but we just wondered whether or not, in making the comment, you actually can think of a better way to do it. What we wanted to be certain of was that we never lost any of the traffic, even though it created a problem for us in that it moves between the New South Wales system, what is now FreightCorp, if you like, the old PTC in Victoria and AN on the one hand, and then later on it was all in NRC but then other parts of the market were still with the residual operators.

That was particularly the case, given that you had AN in existence for a period after NRC was formed. It wasn't as if it was a simple transition. So we were attempting to capture that and that was just the way that our researchers devised to do it. However, it obviously has touched a nerve in some organisations and we will have a chat about that later.

MR MARCHANT: Our comment wasn't one in the sense of feeling concerned about capturing it, and obviously it doesn't reflect much on our business approach. What we were more worried about is that people may interpret it as in fact a benchmark framework and there were other ways of capturing that data that are now probably more available than they were even six months ago. If I can use two examples in Victoria; in the due diligence documents for all the sales there is in fact an attempt, a history, of what actually those commodity frameworks are. So obviously V/Line Freight had an extraction of what their market was historically, etcetera. Some of that stuff has been disaggregated in assessments or estimates rather than in actual figures, that actually help break down those because they've been used in sale

processes to give bidders an indicative idea without being exact.

Secondly in the AN-NRC exercise, again the residual non-interstate effectively got sold to one operator, and effectively there were some historical numbers given there for that sale process, to give them an indicative idea of what that market would be. It may be possible to deal with the asset salespeople of the Commonwealth and the asset salespeople of the state of Victoria to enable it to release those indicative numbers, and although you may not get exact numbers you may be able to give indicative ideas of what those are, measured against the exact numbers you've got and come up with an estimated framework historically. Now, some of that data would not have been available when you were first running around, because in many cases I think some of the - certainly in Victoria they probably did a last-minute crunch from the data room to actually put that together, but I wouldn't want to be held to that.

MRS OWENS: I think it just becomes a function again of the time period we were looking at, and some of those sales didn't actually take place until after.

MR MARCHANT: And some of the documents would not have been actually in shape at that point.

MRS OWENS: No.

MR MARCHANT: Our suggestion is that rather than trying being exact, to use some of the later material to redrill backwards and come up with estimates of the outcome. The fear probably of some of the participants, and not exactly our fear, is that it may give a - although it wasn't presented as that - but others use the material and reinterpret it as a benchmark framework, and does distort the very interesting transition of NR through that period and what it did to each of the state operating frameworks.

MRS OWENS: I think we can deal with that qualitatively rather than quantitatively, and I think we've tried to do that to some extent. I think what we've tried to do in our performance measurement has been not so much to compare one railway with another railway, which I think the implication in what you've got here is that that's what you think we've been doing or people have interpreted it as being that. What we've been trying to do is look at how is the whole industry performing and how are individual systems performing. We've been doing it for a slightly difference purpose, so we're not there benchmarking railways.

MR MARCHANT: Yes.

MRS OWENS: Because we don't see that that is really our job. It is up to the railways to benchmark each other.

MR MARCHANT: Yes. That is kind of why we were suggesting flick that and go to your structural reform and do an analysis of what you think the history is based on the structure of the track framework and a rollover and get away from the individual participants, because it may make people less defensive and actually give you a better analysis of where the state of play is against the structural framework.

MRS OWENS: Yes. I have been trying to sit here thinking about how we do that while we have been talking. I don't underestimate the difficulty of doing that in terms of trying to get the information and get the data in that format, but we'll certainly have a bit of a think about it and see how far we can take it.

MR MARCHANT: Each of the track operators, even those vertically integrated ones, would normally have a gross tonnage by line segment, and eventually you get your configuration of between low-volume, high-volume, interstate, etcetera, and certainly on the interstate exercises there is a very clear differentiation being made in volumes there, which may be helpful to the track owners. It may actually just enable you to turn it around and look at it in a different way.

MR EDWARDS: I remember from the days at AN in the early 90s that pretty well it was an annual event for us to have to produce for - I can't remember which group it was - it could have been the Inter-State Commission; I don't know if they still exist even - produce a split-up of costs revenues by major commodity - interstate coal, those sorts of groupings. Now, I don't know, as I said, if that organisation or someone who took over from that organisation, exists, but that information may still be around, certainly for that period in the early 90s. Whether it was still continued up until 96-97 I am not sure, but that may be another source, that's all.

PROF SCRAFTON: One of the reactions that I had to reading that, and the proposal to try to get a better understanding of the different markets and that, is that you have industry organisations that often struggle to find a useful role and it would seem to me that this is something that an industry organisation could do and really highlight what is happening in its industry instead of having to sort of generalise from the top and pontificate about the need for greater investment from government or wherever - give us a real understanding of what the industry is made of.

MR EDWARDS: Yes.

PROF SCRAFTON: Far be it for me to say that but, I mean, it just struck me when I was reading that that here is a case where - particularly now that the industry is so diverse and is involved in different markets, doing different things, and you have to trade that off against the confidentiality needs. In fact there is no doubt, I think, that even some of the concern about the way that we have presented things is partly because you have individual organisations that are in the process of being sold.

MR EDWARDS: Yes, exactly.

PROF SCRAFTON: And so people want different types of analyses and they want to look at all the data.

MR EDWARDS: Yes. It's a shame that we only really go to a serious effort of trying to pull things together once every seven years.

PROF SCRAFTON: Right.

MR EDWARDS: We're getting on the statute of limitations there and a lot of these organisations can generally use that for not having the information. It should be something that is perhaps brought together on an annual basis.

PROF SCRAFTON: That's right. In some cases organisations have disappeared.

MR EDWARDS: That's right.

PROF SCRAFTON: Yes, that's right, and in fact that point has been brought to us by other people. At the same time all this is happening, your traditional data sources of ABS and the Commonwealth bureaus that collected this sort of stuff have been blown away or downsized or whatever.

MR EDWARDS: Sure.

MRS OWENS: Another issue that Glenn raised was this issue of linking productivity improvements and investment. We're still thinking about this as an issue and exactly how you would do it. We are going to be doing some econometric work and so it is a matter of whether we see investment as being an environmental variable or whether we see it as being a variable which you would say is intrinsic to the reform agenda. It is an interesting question: is investment in rail intrinsically part of rail reform or is it something that you would expect to happen on an ongoing basis? I don't know whether you have got any views on that, but it is one of those things that we are thinking about at the moment.

MR MARCHANT: I think there are two parts to that. Firstly, the commission is taking a photograph at a point of time in a transition mode, of which, quite frankly, historically, the investment was all government. I mean, there really hasn't been private sector investment except for one particular railway line in Australia, which is fully privately owned and is single purpose, except for recent applications to the NCC, so an historical perspective of that investment is obviously going to be reflective of whether investment decisions have been made based on clearly reflective outcomes or whether they have been made at the expense of getting infrastructure improvements and industry movement.

The reason to take a picture now is that in seven or eight years' time you would be, I would think, interested to know whether in fact some of the things about private sector investment and the blend of government and private sector investment have in fact tuned themselves to be more reflective of getting outcomes that are beneficial to the transportation mode and to the industry generally and with real yield. Some of the impediments to those investments we have touched on in the submission in 51AD and the rest.

The reason we are suggesting it is worth doing now is because it is a picture at time and seven years now another picture will need to be taken about what has actually flown through. Has the blend of investment been better focused or not better focused? Has it produced the productivity yield spread between the four components you have got there in a way which has actually induced a better value? And the value may not be just MPV value. It may be externalities, it may be savings and other frameworks or growth, or less demand in other modes at higher cost or lower cost, including externalities. So the suggestion wasn't one of trying to necessarily pin down and say, "Well, are there lessons to be learnt?" as distinct from, "It's a good window of opportunity to take to see if in fact there are lessons to be learnt seven years from now," and there is a large pitch in this sort of industry because it is emotionally attractive for people to want to spend money on things for the sake of spending it.

The industry has a huge range of emotional followers who are attracted to it for romance and other reasons, and even some of the industry participants who actually think investment dollars should be thrown at the best attractive thing they can come up with that night - and some of the rigour around understanding investment and yield - and I am not talking just about MPV yield, I am talking about the value yields and that can be externalities and a whole range of other things brought to bear on it - there hasn't been a lot of coherent, objective, intellectual effort. We thought the Productivity Commission report at this time in the industry transition may just advert to having people think a little bit smarter about how they go about transport investments overall and, by doing a rail one, it actually opens a debate about transport investments and infrastructure generally.

Looking at that and where the benefits have flown and not flown is an exercise in maybe learning some lessons about future investment in transport modes generally. It wasn't an argument that was being put forward to say, "Well, should the commission come to a view about whether previous investments" - 99.9 of which is government - "have been good, bad or indifferent?" as distinct from, "Are there lessons to be learnt about investments generally and does the commission have a view about optimal use of investment, blended government/non-government, whatever, in a transportation environment?" and we're probably pushing that line a little bit because we would like to see that sort of analysis done for transportation spending, generally.

MRS OWENS: Yes, I know you made that comment earlier. I think one of the things we have tried to emphasise is that there needs to be, whatever there is, a commercial approach adopted and so we are saying that raises a question then about what is the role of government in investing in rail, vis-a-vis setting up an environment in which the private sector can invest and then asking the question, "What does that all mean?" and I would say once you get into that new market, whichever stage that is in terms of your six stages, it could then be conceived as being part of the reform agenda. So, yes, we will be looking at investment, but we don't want to fall into the trap of looking at the $3 billion and saying, "Is this the way to go?"

MR MARCHANT: Exactly. Our point wasn't about taking a quantum and saying whether it is good, bad or indifferent. It was more about putting a coherent framework of thinking into what are the elements of transportation infrastructure investment, which comes out of a rail thing but it affects roads, it affects sea and it affects other things, and there hasn't really been a coherent framework put together by any reasonably objective group about public policy investment and private sector investment in infrastructure in the transportation modes. It has kind of been assumed that people will do it for commercial reasons ipso facto or the government will do it for public policy reasons, but there has never been an assumption that maybe a blended investment of government and private sector - which I think is going to be the inevitable outcome - can be undertaken but it should be undertaken based on reasonably clear public policy criteria and investment criteria, commercially.

It is a blend between those two elements and it is a blend between the externality benefits and the MPV benefits and the difference around that, but that decision is made in rail, road and other areas on a regular basis by state and federal governments but without a very coherent framework about heads of consideration and methods in which that should coherently be thought about and, if you are taking a picture of time of which part of it is inducing private sector investment, as well as government changing its position, then it is a pretty opportune time to say, "Well, it appears investments have been made on this basis, historically, and the commission has a view that an objective look at this may look at investments being blended through different forms of consideration."

Nobody has actually put any effort into that, and if you were looking for productivity gains in the end you would be looking at the best kick for the buck in a blended way between government and public policy investment and private investment, so it was really just a suggestion that it is a very opportune time to raise a debate about balance of investments and we're probably raising it - we are raising it - not just as a rail investment but that it's coherently about transport infrastructure investment considerations, which the commission has touched on in a number of places, but - - -

MRS OWENS: We haven't brought it together.

MR MARCHANT: Yes. The big gap is, "Well, what sort of heads of consideration should that investment blend take?"

MRS OWENS: Yes. Well, in your own circumstances how do you make investment decisions right now, given the uncertainty in this environment? What are you actually doing?

MR MARCHANT: I will break it into two parts, if I can. One is ARTC's own capital, which we invest sheerly and only on commercial grounds; that there are no public policy considerations in our own company's capital. We look at three or four basic things. One, will it improve transit time, which provides a competitive yield for offering paths or to enable operators to gain a volume from road? Secondly, does it improve reliability, which therefore provides confidence in maintaining market share or building it? Thirdly, does it improve the yield in two ways: can we improve the

capacity of the track - axle load, speeds, number of trains per hour, etcetera - to a degree which would get a volume; that is, revenue from increased capacity, not just theoretical; that is, will someone buy the capacity? That is in one part of the yield, and the second part of the yield is: will it improve the capacity of our operators to be able to operate at a lower unit cost - train length, axle load, speed - that therefore will enable them to be attractive in price terms to goods from other modes?

Those three things plus the issue of obviously safety, which we measure on the basis of how much the fines would be, what our insurance premium would be, or whether the CEO goes to gaol - and the third one is the most critical! I was joking. On measuring those frameworks - so effectively they are the four things that the company looks at. In our oversight of the Commonwealth's 250 million we have actually done it on six criteria: those four, excluding the safety one and the CEO, plus issues that will in fact sustain the Australian Transport Council's objectives of axle load, speeds - that is, the medium-term improvement objectives - and that actually becomes number 1 when we do the 250 analysis, and then we touch on those that are actually constraints to actually getting pathways moving, so you look at loops or Sydney area or things where there are constraints on getting capacity generally, where that market would unleash a higher volume framework.

So they are the six or seven things. I can actually send along the seven criteria, but I mean they're in this time and circumstance. The 250 is a significant but small targeted amount and therefore it's very easy to target against those six or seven criteria because I think the bids we got were a billion-odd dollars. The ARTC one is obviously very clear and coherent because of where we are in our first year and trying to get some runs to try and make the industry competitive. But when I look at that vis-a-vis blending public and private investment, vis-a-vis whether a 3 billion road extension Melbourne to Adelaide, vis-a-vis a 900 million one and another 500 million in rail, what would those two blends get of which private sector may fund both by 50 per cent given the right return framework? Then you actually have to measure a range of externalities such as what are the maintenance costs in the long term for one choice. what are the externalities in proper value terms between those choices?

Those sort of models are not sitting around. It's interesting that in the Transport Economic Centre there's only a couple of books dealing with real substitute policy transport economics. That's quite fascinating that there is such little work done on what is in fact the largest public sunken investment infrastructures. Given the progress of the reform framework, it seemed an opportunity to suggest that the commission put a nail on the mast and say, "Well, these things need to be looked at and this is where the commission thinks that some of the issues need to be bedded down."

MRS OWENS: I am just aware of the time and we've kept you over 20 minutes now. Is this a problem for you, because I had one more thing I wanted to ask about? I'm not sure about Derek.

MR MARCHANT: I'm in your hands.

PROF SCRAFTON: Just in relation to that matter of investment, the IPART handed down its ruling in New South Wales and we just wondered how you felt about that 8 per cent - that judgment?

MR MARCHANT: As a general comment, that decision is relative to a set of circumstances presented to a particular market, so I wouldn't want that sort of thing to become a kind of general rule framework, because effectively you do need to get attractive returns on investments once they're sunk, but in New South Wales the commission was looking at an area that had a sunken investment, had a high-yield return base on it, and was a very secure risk market. The IPART obviously came to a view that the market risk of the infrastructure owner was not as reflective of the risk of the above-rail operators and that in fact the infrastructure owner was in a high-yield basis and would be taking a beta risk much higher than what the risks are actually bearing in the market. I think you would get a different decision in different locations, so I don't think, if that is a general rule, it would necessary flow on.

I haven't noticed that in regulators generally anyway. I think they have looked at the marketplaces that have been addressed. I think a fine example of that - moving away from the rail industry bid so I don't get into too much trouble - is the gas industry in Victoria. The IPART - the regulator there and the ACCC came out with the distribution gas pipelines in Melbourne that are 7.34 or 7.5 per cent return. In that market context it's probably very reasonable. You had all those distribution pipelines running at about 100 per cent capacity. In fact, I think they were contracted for 105 per cent, so the market risk wasn't that high. It's a constrained market, so they were price takers.

On that very same exercise, looking at a gas pipeline from say Sydney to Melbourne, or Melbourne to Sydney, I'm sure they would come out with a very different market risk, given the volume of the market, the amount the investor was taking in risk returns and the rest - or Papua New Guinea to Brisbane. So I actually think that those things are better looked at on the market context they're looked at. If in fact the pricing mechanism in that market was different and there was a higher risk taken based on the commodity - if you are going to market-base your price, hypothetically, say against a commodity value yield, then you ought to market-base your risk. I'm sure if you did that in pricing terms in that market, you'd get a higher beta, but if you say, "Well, effectively it's a semi-tax. I'm not taking the risk. If coal prices fall 20 per cent, I'm not taking a 20 per cent fall out of it," then you'd expect a different risk beta.

I'm sure if we were looking at Sydney bypass freight route and a regulator looked at the price of that relative to the massive capital investment new, I'm sure they would come to a different view because it would be dependent on what the market risk of the investment is. You know, look at the assets in market. I mean, the only asset in the book is effectively the Hunter Valley asset. The other assets are booked at a zero dollar value, so the book is sunk. I think in that context you come to a different view of risk and I think the decision reflects that review of risk in that market. I don't think it would necessarily flow on to a decision you'd make in Western Australia, or in fact from Tarcoola to Darwin, if there was a market there to have a risk on.

MRS OWENS: What about your own market?

MR MARCHANT: Our own market? Firstly, I expect our beta is higher because essentially we are taking a significant market risk because of the way our pricing has been formulated. Having said that, to be very frank, on our prices we'd be very happy with an IPART decision, but that's because we've taken a different view of risk. We are setting our prices to try and establish a market growth. Our present prices don't give us a return in a depreciation sense that even covers our asset life renewal against any formula - DORC, historical replacement cost, any of the asset depreciation frameworks - because we've taken a commercial decision that we've got to set prices to help build a market and then we will be able to renew our asset. It's a different commercial decision in a very different market.

We're dealing with a long-haul sunken investment that has significant capacity but the capacity constrained in peak periods and significant spare capacity in non-peak periods. We're dealing with a market that is very very much in transition. That is, the road-rail competition is fierce, both on the east-west corridor and on the north-south corridor, on Melbourne-Albury, Melbourne-Sydney. So we're looking at a market that has a lot more variable plays in it. In the end our prices will go to a regulator and have to be justified but, if you ask us honestly, if the IPART had made the same ruling on the same DORC formula, then our prices would probably only increase by about 20 per cent, maybe 25, because we've taken it in pricing. That doesn't mean the risk decision is right. We have just taken a different view of where we are in the transition at May.

MRS OWENS: I think we've just about run out of time. I would have liked to have spoken about a few other things but we might just talk to you, if you'd like to hang around for a cup of tea and we can have a chat.

MR MARCHANT: Yes, sure.

MRS OWENS: Thank you. I think we might just break for 10 minutes and resume at 20 to 12.

MRS OWENS: The next participant today is People for Public Transport. Could you give your name and your position with the organisation?

MS DINGLE: My name is Margaret Dingle. I am the secretary of People for Public Transport.

MRS OWENS: Thank you, Margaret, for coming today and thank you for your submission. We've already had a submission from you, which we thank you for as well, and we've both read it and we have absorbed what you have in it, but we would be very happy for you to make a few opening comments.

MS DINGLE: People for Public Transport supports many of the findings of the report, especially competitive neutrality between road and rail, and we welcome better rail services and increases in rail's share of the task, all modes of rail transport, freight, inter-urban passenger, and urban passenger, regardless of ownership, and we certainly support you with the matter of the diesel fuel excise.

Freight obviously has clear economic benefits, but the benefits of passenger rail are, at present when it's not commercially viable, in the externalities and avoiding costs. We note that in Adelaide, the year in the report, there was zero capital investment in rail in South Australia. I believe there's now going to be 18 million on the Adelaide-Melbourne line from the budget. We've just had announcements in the local newspapers - $20 million for Portrush Road, probably to accommodate the trucks; $15 million road overpass at Gepps Cross, and they also did the Southern Expressway - so it looks as if they don't hesitate to invest in road, and there's a general perception that you've got a right to have a road past your house or farm; whether every individual road is profitable or not is not generally investigated, although traffic levels may determine how good the road is and so forth.

We note that privatisation in Adelaide doesn't seem to have been an unqualified success. I do have figures for the 10 years before privatisation where patronage went down overall, but it went up at various times; I think free transport of schoolchildren helped. There has been concern that the rise in fares may have caused this, but there are other problems such as frequency, conductivity between services. We consider that the Adelaide public transport system needs a thorough revamp to make it efficient - bus, tram, and train. There have been no extensions of the railway lines, no new tram lines, some new bus services - we think that the Adelaide public transport system could do better - whether it's actually caused by the privatisation or by simply poor planning we're not sure. We certainly haven't had a jump in patronage since privatisation started. I think that's all I'll say at the moment.

MRS OWENS: It might be pretty much the same in other states. I don't know whether it's privatisation or whether it's just general community changes in how the community is transporting itself or where it's living. I don't know whether Adelaide is like other urban areas where there's people - - -

MS DINGLE: Not entirely, I think, because I haven't got actually figures for more recent years, but I did have figures between 1981 and 1991 from Newman Kenworthy. Apparently in those 10 years the patronage in Melbourne and Sydney, the number actually rose - I don't know if that's per head or not, I've got it down somewhere - and Adelaide was falling but not as fast as - I haven't got it in this one. We think that the public transport system simply hasn't kept up with the town planning. In fact, there hasn't been very good town planning. They've tended to allow large suburban shopping centres and so forth, places that are not public transport - and the cross-suburban transport is generally poor and the rail feeder services are probably not all that could be desired.

For instance, I think it's Hallett Cove or Hallett Cove Beach, there's a feeder bus that meets every other train, including peak hours, so if the residents wanted to catch the train to work in Adelaide or Noarlunga or maybe Lonsdale and you live at say Trott Park or Sheidow Park there simply isn't the rail feeder bus to take you to the station, unless they get up really early in the morning, and I think there are other things that could be improved.

PROF SCRAFTON: Yes, Margaret, we hear a lot about the potential of rail, but what do you think the government could actually do on the ground in Adelaide to improve ridership on rail?

MS DINGLE: I think probably we couldn't put a new railway line through a heavily built-up area because that would be too disruptive. We could perhaps extend the Noarlunga line and maybe the - there's also talk of a rail line out a bit to the north where there used to be one, to places like Lyndoch. I've forgotten the actual places, but there's been talk about that. That could be done. We could in fact extend the light rail tram lines. There are certain small problems which could be fixed fairly easily. For instance, there's a tram line that goes over the railway line at Goodwood, but there's a 10-minute walk to get between the two, which is absolutely stupid. We could perhaps have a station at Bellevue Heights. We could possibly replace some bus services with rail feeder buses, reopen a few stations, not just on the Belair line.

If we had a 15-minute service and passenger attendance on all trains I think that would certainly improve it, because part of the problem is perceptions of unsafeness, especially at night. Of course the problem is with unmanned railway stations and people walking down the street and so forth. So I think there were some improvements that would not be terribly expensive.

PROF SCRAFTON: The matter of a station at Bellevue Heights was raised with us earlier by Friends of the Belair Line, and another one that has been on the agenda for a long time is the possibility of building the railway so that it links up to West Lakes rather than going down to Grange. But these things have been on the agenda for years and years and nothing ever seems to happen with them. One wonders whether or not there's a sort of ambivalence about the future of the railway in Adelaide.

MS DINGLE: I think that the government has been somewhat concerned with budgetary considerations and hasn't really been prepared to put money into the rail system or the bus system, and yet it has been prepared to deal with road congestion by spending a lot of money in fixing up some road, and I think this is probably a false premise; that they think they would save money in fact if - they would not spend any more money I think if they fixed up - if they made rail a really popular mode of transport they would save some road accidents, some air pollution and certainly traffic congestion, although Adelaide is not a severely congested city compared with say Sydney, Melbourne, London, places like that.

But I think in the long run we're going to have to look at improving rail. I think that the tram line should be extended. I think that light rail, being somewhat cheaper than heavy rail, and you don't have to knock down houses and whatnot to put it in, would be quite a good idea in some parts of Adelaide.

PROF SCRAFTON: That's interesting, Margaret. It just seems to me that in some ways part of the problem is the fact that the government has this range of solutions and can never make its mind up which one it's ever going to invest in, and you've made a good point; that it doesn't stop them still investing in the road network. They've got the same problem in the road area yet they do continue to invest.

The extension of the tram has supposed to have been comparatively high priority for a long time, hasn't it, and yet nothing happens. Even if they were to extend it from Victoria Square to North Terrace and give that better downtown distribution and a better link-up with the railway station - they know about these things. They've been on their plans since - I mean, I've been around 25 years and some of these things - a West Lakes extension was talked about when West Lakes was first built. The right of way is there.

MS DINGLE: Yes. I don't know quite how privatisation fits in there, because - I know you didn't ask me about it, but there is the sort of thing that the bus people tend to keep on their toes a bit because they know there's competition. But there is a certain perception that the real competition is at the beginning of the contract and then the thing is more or less set in concrete until the next contract comes out, and of course TransAdelaide has had undisputed ownership - I mean, running of the railway lines during this period.

I think we need ongoing planning and preparedness of government to actually put money into it, and to sort of boast that we've saved $16 million since privatisation but the patronage has fallen very fast in the last nine months but there's quite a few fare increases - is not entirely a good idea.

PROF SCRAFTON: But you got the good news this morning that they're not going to increase the fares next year.

MS DINGLE: Yes, well, that's a point, yes. But we think that fares are not the only fact, because People for Public Transport - I think it was late 1989 - actually did a fairly crude survey - we sort of nabbed people coming out of carparks and asked if they would like to take part in our survey, and some of them already did use public transport; most of them were sort of not really public transport users. We found that 60 per cent of them said they would use public transport if it were improved, and the most frequently mentioned improvement they want was frequency of service, and in fact frequency of service on many routes is very poor. It's quite good on some routes, but other routes, if you have an hourly bus service or an hourly train service, it's not a great incentive to use it. If you don't have a good feeder service to your railway station - or you can drive your car there - it's also not an incentive to use it.

MRS OWENS: I think you end up with more frequent services in cities with high population densities. They seem to go together, so it's always going to be a bit of a problem in smaller cities such as Adelaide. Probably most of the Australian cities, apart from Sydney, fall into this trap of not having the population density to support the frequency. But to me it does make sense that if you're going to run a public transport system you need to give people a good quality frequent service at a reasonable price, otherwise they'll get in the car.

MS DINGLE: Yes, well, I do acknowledge the population density is a factor, but Adelaide's population density is probably increasing. I wouldn't really want to see it all given over to flats and no backyards. But people were using public transport say in the fifties and sixties when they did have this same sort of layout, but of course there were families with lots of children and so forth and not so many people owned cars perhaps. But historically public transport has been used quite a lot when we have a fairly spread out city. This has changed. Parking in the city is quite cheap I think, and suburban shopping centres, it's generally free, which does make it a little tempting to drive the car to the nearest suburban shopping centre and park for free because there's virtually no - very poor cross-suburban and public transport anyway. There's the circle line and a few other buses.

I also think it would be good if there were some sort of bus connection or tram connection between the three southern railway lines actually; between Belair, Goodwood and Belair, Tonsley and Noarlunga. If the railway station were a bit closer to Marion Shopping Centre, certainly if Goodwood were made into a really effective transport interchange between the lines and the bus and the tram, I think it would improve the system.

PROF SCRAFTON: Certainly from a public transport point of view the growth of Marion has proved very difficult to serve. The bus routes do their best to get in there, but the fact that it is just too far from the rail is a serious problem, in sharp contrast to say Elizabeth or Tea Tree Plaza which are reasonably accessible from good public transport.

MS DINGLE: Yes, I'd agree with that. Also there may be a case for extending the railway line, the Tonsley railway line, over to the Flinders Medical Centre, which of course would involve crossing a very busy road, so we might have to do a tunnel or something, which could make it expensive.

PROF SCRAFTON: Could we talk a little bit about long distance passenger trains too. You refer to those in your submission.

MS DINGLE: Yes.

PROF SCRAFTON: You make a comment particularly - it's on page 1 - about the way in which the national commissioner praised passenger railways for increasing their fares, but the airlines of course reduced their fares and the airlines get the business. But are we seeing any changes in South Australia since GSR came in? How do you feel about the quality of service that they provide?

MS DINGLE: I did go to Melbourne once and it wasn't all that good, because one of the carriages didn't have any water to it for some time and it sort of delayed the train. Basically when I actually caught the train to Melbourne - that was late 97 - the quality was more or less as it has always been, but they have refurbished the carriages since and I haven't seen the refurbished carriages or ridden in them. They have cut out a couple of nights. I think although it doesn't really make a lot of difference of the length of time on an overnight train, because, I mean, you don't want to arrive in Melbourne at 5 o'clock in the morning or anything.

I think improving the railway line between Melbourne and Adelaide, not only will it have economic benefits from making freight faster, but also it would make it perhaps possible to have a daytime train ride to Melbourne and will also make the journey a little shorter. I think GSR is possibly in a bit of a bind. I think they're expected to make a profit overall, and of course the Melbourne line is probably not making a profit. It's a good cheap service if you want to go overnight and sit up all night - doesn't cost you much - it's not bad. I think if there are daytime services as well it would possibly prove popular. A whole lot of people are driving their cars to Melbourne and it has the convenience of course when you get there that you have got the car. But you can put it on the train.

MRS OWENS: And it's quicker.

MS DINGLE: And it's a bit quicker. I was surprised, actually, to find that somebody said that even if they did upgrade the line that trucks would still be faster, but I always sort of assumed that trains were potentially faster than road transport.

PROF SCRAFTON: The problem is that stretch through the Adelaide Hills, isn't it, plus the very slow entry into Melbourne, because the standard-gauge line has such a tortuous entry into Melbourne.

MS DINGLE: It is slow into Melbourne and I think that is probably - I mean in the morning coming back I actually enjoy the slow ride through the Adelaide Hills - but that is what you call emotional rather than economic - because it's nice and scenic. Yes, certainly I think if they could speed things up a bit, it would probably improve the passenger outlook, and certainly I think cheaper airfares have probably eroded it to some extent. Also I think the route is perhaps a mistake, because they're bypassing Ballarat. When I went to Melbourne a number of years ago there was a carriage full of a callisthenic team going to Ballarat, and there were other things like that going on in Ballarat, and I think the fact that it bypasses Ballarat may have eroded passengers in numbers to some extent.

PROF SCRAFTON: Yes. I saw a reference in the last few days that they are going to build a platform at Geelong though, whereas at the present time it goes around the edge of Geelong and doesn't stop. They are going to try to improve the patronage from Geelong by putting a platform on the standard gauge at North Shore there. The other thing that I saw they had done there is they reduced the fares for sit-up; they are going to offer a certain number of $30 fares every night on the Overland which might help, you know, the backpacker market and people like that who have traditionally taken buses and so on. Maybe they can capture some of that too.

MS DINGLE: Yes.

PROF SCRAFTON: Anyway, GSR are going to appear before us in Melbourne, so we can ask them directly what they have done and how they're looking after South Australians.

MS DINGLE: Yes.

MRS OWENS: I was going to ask you about your comments on your second page of your submission about contracting out, and you say that there are some advantages in that it fosters improvement through competition. But then you go on to list a number of problems with contracting out. You feel it may be a way for the government to reduce spending. I suppose that's why they do it because they're trying to save money. But you also express concern about the problem it raises for the public with not knowing who's responsible, who to complain to, delays in implementing innovations and lack of coordination.

MS DINGLE: Yes.

MRS OWENS: I read into your comments today that you probably would say that the problems with contracting out outweigh the benefits or are you more ambivalent?

MS DINGLE: From the point of view of patronage, if you can attribute the drop in patronage to contracting out, probably the problems do outweigh the benefits. They haven't shown a clear benefit from contracting out. I have noticed that they've introduced new bus services. They have been actually making an effort. I don't know what Serco has done but TransAdelaide has introduced a few bus services.

I found it a peculiar thing that with the buses, the TransAdelaide and Serco buses are on different wavelengths of radio, so if you get on the wrong bus and one's a TransAdelaide and the one in front or behind that should have been on is a Serco, the driver cannot radio the other bus, and obviously if the buses are on different wavelengths, the train cannot communicate with both TransAdelaide and Serco buses. Up at Elizabeth they've got Serco buses going to Elizabeth and TransAdelaide trains.

It is quite a useful thing if you're a passenger, if your bus happens to be a couple of minutes late and has to meet a train or vice versa, or if you've got on the wrong bus by mistake and the other one is just ahead of it, that the driver can radio and say, "Please wait for this passenger to transfer", but when you've got different radio frequencies this is impossible.

They had a problem with buses that used to run right through but there were different depots at each end of the line, and some buses - that's right, buses that didn't run through. For instance, the southern ones used to go out to Elizabeth or something, and the Elizabeth used to go out to Lonsdale, the southern suburbs. Then TransAdelaide got Lonsdale and Serco got the outer northern suburbs, and therefore they all had to turn around in the city and there were buses everywhere. They actually are fixing that problem by making the routes a figure 8, so we don't have that problem.

I found myself that I didn't know whether to write to the Passenger Transport Board or the operator. I think you can do both but I get the general perception that there is a bit of buck passing, you know, "This is the responsibility of the Passenger Transport Board" and "No, this is the responsibility of the operator." I have also heard TransAdelaide bus people saying, "Well, we'll put this to the Passenger Transport Board that we'll change the routes or the timetables in such-and-such a way", and also if they want to make some major improvement they may sort of save it up for when the tenders come out. I think the tenders have been reasonably inflexible; they sort of set the conditions for the next three to five years, whatever it is. Although there can be changes between the tenders, I think that is a disadvantage.

If I had seen bus frequencies, train frequencies increase, capital investment and an increase in patronage under privatisation, I would have said it's a good thing. I think the jury is still out on privatisation but it doesn't seem to have done a lot so far, although there have been some minor improvements which I must admit to and welcome.

PROF SCRAFTON: I think your comments on problem with innovating and the fact that in order to innovate the operator has to go back to the PTB and the contract has to be changed, I think that's a good comment. Far from encouraging innovation it tends to stifle it, and it can come from all sides. You made the point that an operator might have a good idea, but if the tender is about to be renewed, they sort of keep it in their back pocket and roll it out at the appropriate time. Alternatively, they might come up with a good idea but it might mean that the contract price would be slightly high, in which case the PTB then looks at its budget and gets all uptight. I think that's a good point. Aside from whether they get done and how much they cost, it's the length of time taken in actually being able to implement a good innovation. I think you should take that up with PTB because I think that sort of flexibility should be built into the process, into the contract.

MS DINGLE: Yes. There's another matter - I mean, I'm not very cognisant about labour conditions, and obviously I don't object to getting rid of irrational work practices, but there is a danger of course that with trying to have a cheaper tender, that there would be a race to the bottom with labour, wages and conditions, and I don't think that's a good idea.

PROF SCRAFTON: Well, that's where the $14 million savings have come from. I don't think there is any doubt about that. You're quite right, there are winners and losers, and a lot of the losers are in the employees.

MS DINGLE: Yes.

PROF SCRAFTON: I will just make a comment really on something also that Margaret made. A lot of the comments that you make apply particularly at nights and weekends when the service is really poor. We could look out of the window here at this convention centre and we can see a fairly good daytime train service, but at nights and weekends it's sort of once an hour on each route. The point that you made, for instance, that if you were on a feeder bus and you missed the train by two or five minutes, it's 55 minutes to the next train coming.

MS DINGLE: Yes.

PROF SCRAFTON: Whereas maybe in the peak, if there's another one in five or 10 minutes, or 10 or 15 minutes it's not so critical, but in the off-peak it's important. I will say that tomorrow I am talking to Serco on a rather different matter, and I will raise this point that you have brought up about the fact that their buses cannot communicate with the TransAdelaide train controller or whoever, because I think that makes a nonsense of having a feeder route in the first place, if you can't have a simple link made like that. That surprises me, and I will put that to them.

MS DINGLE: Yes, and the actual hourly night and weekend - Sunday services actually came in, I think, about 92 or 93. In fact there was quite a large drop in patronage then because it was also at the same time that they withdrew free school fares, which TransAdelaide said was the reason. But I think that the hourly - all buses and trains actually go once an hour at night and on Sundays. It would be better if they had a half-hourly minibus or half-hourly train. Of course they have been having Sunday shopping in the city but they still have hourly services into the city.

MRS OWENS: So the service provision hasn't kept the pace with what is going on elsewhere in retailing.

MS DINGLE: The routes are rationalised also; they don't go to where they go in the daytime.

MRS OWENS: That was really very interesting for us. I don't think that I have anything else I wanted to ask you about. We had a lot of interest last time we were in Adelaide from the bicycle groups who said there was a very direct link between the use of bicycles and the use of public transport, and the use of bicycles can increase the catchment areas for public transport facilities.

MS DINGLE: Yes. I think there has been a problem with bicycle knockers, and also I think the trains only take about four bicycles per train. I mean, the bicycle institute has a good case and I think they should have secure bicycle park and facilities at railway stations and a facility for the train to take more than four bicycles. If you could have bicycles on buses too, that would be a good idea; if you could attach them to the back of the bus or something.

MRS OWENS: Thank you, Margaret. Have you got anything else you'd like to say?

MS DINGLE: Not really, thank you.

MRS OWENS: Thank you. We will now break and we are resuming at 1 o'clock.

(Luncheon adjournment)

MRS OWENS: We will now resume this afternoon's proceedings. The next participant today is Dr Ernest Easton. Could you please give your name and in what capacity you're appearing today for the transcript.

DR EASTON: Ernest Easton. I'm appearing in an individual capacity. Anything else?

MRS OWENS: No, that's fine. Would you like to at this point just make some opening remarks before we ask you some questions.

DR EASTON: In brief, I'm very interested in asset valuation and in doing so I don't favour in general any particular method of valuation, but I think that method of valuation should be determined by the nature and characteristics of the asset, and certain other considerations which I'll raise, particularly in regard to the difficulty of assessing replacement value, except in respect of assets that are replaced in toto at a specific time, and I will indicate the difficulties that will be experienced in revaluing the assets that are not replaced in toto and renewed from time to time, particularly where those renewals of like by like are charged to maintenance, and also the difficulty of indexation and the pitfalls of indexation in interim periods between revaluations. I regard indexation as the worst of all possible worlds insofar as indexation by the CPI for instance doesn't take any account of productivity-induced gains on the part of a supplier, nor of technological advances that improve performance of a unit or asset.

I'd also like to comment on the quite violent fluctuations in the past of real rates of interest, much more violent and pronounced than fluctuations in nominal rates. It's often claimed by people who should know better that real rates are reasonably constant. The opposite is the case. I'd like also to make brief reference to transparency and the importance of transparency, particularly for government monopolies or quasi-monopolies. In the competitive situation transparency is not such a paramount consideration because it may have to look after itself.

I would also briefly like to refer to identification of CSO payments, and lastly, to stress the importance of passing on benefits of productivity gains to the customer and the situations that will arise if that is not done. That's more or less - - -

MRS OWENS: I think that's a very useful summary of some of the key issues you've got in your submission, and I'd like to thank you for your submission and for your earlier submission that you gave to us a few months ago. I'd also like to thank you for meeting up with us yesterday, and you'll forgive us if we do cover some of the same ground we had in our conversation yesterday, but I think it's important to get some of your views clarified on the public record, and I think that you have probably more than anybody else in the whole of Australia a lot of insights on this particular topic which I think we're both very pleased to have.

I know in your submission you have pinpointed a few aspects of our report that you're concerned about, but you also raised some issues of possible misinterpretation yesterday, and so we'd like to make sure that we get this part of the report as right as we can get it. I think one of the points you made right at the outset was in relation to asset valuation and you said that what method you use will be determined by the nature of the asset, and I think that was the sort of approach that IPART was adopting, and I think the question is which assets - to which parts of the network do you apply different methodologies? I was wondering if you'd like to clarify for us your views on that.

DR EASTON: Well, I think the characteristics of the asset that should be taken into account include longevity of the asset. In other words, who can be sure in 50, 60 or 120 years' time - and 120 years' life is mentioned in the IPART report for certain components of the infrastructure - who can be sure that that rail mode of transport will happen at all, or if it does happen that it won't be into some convoluted or amended form which is embarrassing, where the present method is just unrecognisable.

The second one is - I think it's important - most rail systems - and I accept RAC in regard to infrastructure access - charge replacements of infrastructure, where like-by-like replacements are involved to maintenance. This has been a continuing practice of Victoria, to my certain knowledge, Western Australia, Australian National prior to its demise, and QR, and I think SRA. Where replacement of like by like takes place, the asset is being continuously renewed, to efficiency, improvements and upgradings, and additions, of course, are charged to capital at values then current, and in such circumstances revaluation seems to me to be a dicey factor. On top of that, in infrastructure, on what do you base the revaluations? There are no major constructions of new routes taking place in Australia, and in most cases, apart from the upgrading of the Melbourne-Adelaide route, they consist of relatively small additions.

You construct an additional passing loop and it costs say X dollars per kilometre, but how can you be sure those same costs per kilometre will extend to a construction or complete replacement of 250 kilometres? I suggest the costs per kilometre will be very much less in the latter case. That is the difficulty. When you're replacing a motor car, just to take another extreme, you replace it as a total unit. You're not progressively replacing it, you're progressively maintaining it to ensure it gives the necessary service, but you're not replacing it as a unit, and when you do you do just that. On the infrastructure you're continually renewing and replacing it, and the costs are brought to account obviously at current values - if they're upgraded - and in the case of IPART even they're not upgraded. Am I making myself clear?

MRS OWENS: Yes, you are.

DR EASTON: That is the reason I, in conjunction with a number of other fellow economists - I'll mention Freebairn, Stephen King rather reluctantly, because he thinks it's the best of a bad bunch - have come to this party, and in the USA, which has had great experience in controlling the regulated firms, this is the precise method

- the historical cost method - adopted for the rail infrastructure, and the IC, until its recent change, had been around for 75 years, which is a long period.

MRS OWENS: Are there any rail assets that you can think of where you might adopt another approach, like the DORC approach?

DR EASTON: In regard to infrastructure assets?

MRS OWENS: Yes.

DR EASTON: The DORC approach would make more sense, and I use that word deliberately, if renewals of like by like are a capital charge, but if renewals of like by like are a capital charge, you automatically are revaluing the asset as those renewals and replacements take place. What is the need for DORC in such an aspect? The historical cost records are available. To the best of my knowledge they're available in detail, as I think I indicated to the commissioners yesterday. If they're not available in detail, you're stuck with some dilemmas, and those are the circumstances in which a modified DORC approach may be defensible. If it came to a choice between DORC and deprival value, I'd unhesitatingly prefer DORC because deprival value, as has been mentioned by a number of economists, is subject to creative manipulation of values, particularly for a monopoly or quasi-monopoly. Again I think I've been quite involved, but for infrastructure generally I would generally prefer a review of the nature and characteristics of the assets, the fact that it's never replaced in toto, the fact it's - the earthworks may never be replaced at all. The concrete bridges may never be replaced at all. Tunnels may never be replaced at all. Leaving coal and minerals, subway structures may never be replaced at all. What's the justification for valuing at replacement value if the assets or substantial slabs of it never have to be replaced?

MRS OWENS: But what about the tracks and the sleepers?

DR EASTON: I did raise that. IPART designates the life of the rail on that Hunter Valley route as 12 years. The present tonnage conveyed over it is about 70 million tonnes a year. Say that grows to 100 million tonnes a year, in which the track would have to be upgraded substantially and improved substantially, in any case, but staying with the 70 million, that's 840 million tonnes as a capacity. I'm not a civil engineer so I can do no better than quote opinions of other people, but Mitchell, BHP, and he's one of the top officers who's been concerned with the Mount Newman railway - on the basis of his research and experience and the experience of American railroads which he took into account, he's estimated the life of the rail - good bond rail - at 2500 million tonnes. Now, that's about 30-odd years at the capacity of the present level of railing over the Hunter Valley route. But 70 million tonnes is not rail over the whole of the Hunter Valley route. At the section at Ulan, which is a substantial section, about 122 K's of 274 K's, 10 million tonnes are the railings. So that gives a life of 250 years, yet they've used 12 years as the sort of average life of the infrastructure in their depreciation table I think on page 44. I can't follow it. That would be true - a shorter life, in my opinion, 30-odd years, in IPART's view 12 years, I don't know how you can reconcile those two, I wouldn't be so bold as to do it myself. But that applies to the section only from Whittingham South where the

Mount Thorley traffic enters the main line, that's 75 K's. North of that, the life of the rail is, by any criterion, greater. I can't see how they can apply a 12-year life to the whole of the track.

MRS OWENS: So do you think that IPART has got it wrong?

DR EASTON: On the face of it, yes. I don't think they've considered that factor. Yet in other sections of the report they've got it right, saying you have to have sector-by-sector treatment of the route. In assessing the life of the rail you have to have sector-by-sector treatment.

MRS OWENS: You agree with that?

DR EASTON: I agree with the sector-by-sector valuation completely.

MRS OWENS: That's in relation to depreciation, estimating depreciation?

DR EASTON: There were a couple of other aspects on the depreciation. I note that they had the life of tunnels and concrete bridges at 120 years. I say, it's indefinite. 120 years is forever almost. But I can't understand one other aspect of it. They give earthworks a life of 20 years. I may be mistaken but I thought that they valued earthworks at zero.

MRS OWENS: Well, that's what the - - -

DR EASTON: As part of the current valuation. But if you look at the table on page 44. I think my memory is okay - - -

MRS OWENS: It's certainly better than mine.

DR EASTON: Earthworks they say there, or other - they say other.

MRS OWENS: Other?

DR EASTON: Other, 20 years, and then in a footnote it includes earthworks.

MRS OWENS: Yes, that's a strange one. We'll have to ask them about that one.

DR EASTON: I don't follow it.

MRS OWENS: Yes. Have you brought this to their attention?

DR EASTON: No.

MRS OWENS: Yes, it's interesting that a number of their participants have actually accepted or were supporting the DORC methodology, including the Minerals Council.

DR EASTON: Yes, I've had arguments with the Minerals Council on that. I suspect, and I would reiterate, I suspect that they preferred that to deprival value and they settled for the lesser evil. I may be wrong. I repeat I suspect. I don't make that as a statement. But the Queensland Mining Council supports historical cost as you probably know. Indicated in the black coal report the Queensland Mining Council is quoted as supporting historical cost. Of course under the more general question, the ACCC, in its final decision on the gas to Victoria, came down in favour of DORC for the gas lines, but it emphasised that every case has to be considered on its merits and characteristics and so forth, and their decision in this instance is not to be taken, and they emphasise the words, "Not to be taken as a precedent for our other decisions," or other decisions. I've discussed this with them and one reason for the decision, which they mentioned in their report, is the lack of availability of accurate information on historical cost in relation to it. I don't think that's true in relation to railways, as I showed you some figures yesterday.

I would strongly suggest that two vital weaknesses of replacement cost are that you can't revalue all the time and if you index in between you may have astonishingly inaccurate results. That's the first one. In support of that I mentioned what happened with wagons in New South Wales, where in 1985 they bought 75-tonne coal wagons for $130,000 and they bought another batch of wagons, 95-tonne capacity, in 1992 for 125,000. The 130,000 indexed over the seven years would translate to $221,000. They bought the capacity of those 75-tonne wagons for 95,000 in 1992 and the wagons were better wagons requiring less maintenance, and being capable of operating a little more efficiently. The argument for replacement cost is often advanced that it has to compensate during periods of high inflation, but if you have interim revaluations solely on the CPI, which don't take account of improvements in productivity nor of technological changes which induce better performance, it leads to extraordinary results.

Even if those deficiencies are rectified at the next revaluation, the customer has still got to put up with the cost for up to five to seven years. The Railroad Accounting Board in the USA advances substantially the same argument, and they could probably do it much better than I have done. I don't think that historical cost is the answer to everything. For instance, in certain assets where they have market value you have to take market value into account, otherwise you may be retaining assets or even engaging in business when you shouldn't be.

MRS OWENS: Our colleague here says the price index is based on a specific price index, not the CPI. It's a rail-specific index.

DR EASTON: Yes, I realise that's a fair comment. But what index would you use? Would you assume that the price, say, of locomotives or wagons supplied, that the supplier would have the same average increase in yearly productivity as the railways do, would you assume he follows the national average in the industry or would you make any one of a host of other assumptions about that improvement in productivity? During periods such as the present, of relatively low increases in inflation and low increases in wage costs and prices of materials, I would suggest that there would be a tendency, in many industries, for the cost of production to be lower than it was previously. But how do you evolve that factor? I think you've mentioned in your draft report the improvements in rail productivity as averaging 5 to 8 per cent over a period. Would you assume the same increase on the part of the manufacturers of, say, rolling stock in this instance? What do you assume?

I think your system of revaluation, based on a host of assumptions which are necessarily subjective in the final analysis, doesn't compensate for the fact that historical cost values - I don't mean the indexed historical cost values, I think that's nonsense with all due respect to IPART. I think it's quite nonsense. Historical cost values per se, or actual cost as in the terms in which the ACCC uses it, they're identifiable. There's no argument about them. As the RAPB said, the compensation is giving a nominal rate of return, not a real rate of return. I think I said on a previous occasion that if I ran a railway system, in regard to rolling stock, I'd be pumping for historical costs in my own interests, because the financial outcome would be much better. That's not an argument for historical cost or against it.

Replacement costs and real costs, in a period when productivity is improving, don't necessarily work out to the disadvantage of a customer or the advantage of a supplier - that's the point I'm making - but you have to take those into account. You have to technological improvements into account. How do you do it? What subjective decisions do you make?

MRS OWENS: I suppose from the operator's point of view, the other way of thinking about it is that if there are going to be significant replacements such as the one you mentioned before, doing the investment between Melbourne and Adelaide and putting in the new concrete sleepers and new ballast and so on, it's a question of how do you pay for that. I mean that is not maintenance.

DR EASTON: No, the replacement of timber sleepers by concrete sleepers is clearly a capital expense in anybody's language and that should be charged as capital and the asset revalued to that extent. Timber sleepers, take a case where they're completely written out, depreciation, they're of nil value on the books, and you put in concrete sleepers; the full cost of laying those concrete sleepers is a capital charge. So you've automatically got a revaluation of the route. That happens in the railway books.

MRS OWENS: One of the other circumstances we're facing now is the greater involvement of the private sector by not just operations but the - - -

DR EASTON: By building in access or buying access.

MRS OWENS: Well, they can buy access or in some - - -

DR EASTON: No, by building a route or buying a route.

MRS OWENS: Well, in the case of V/Line Freight, that has been sold as a vertically integrated entity and that entity, called Freight Victoria, has purchased V/Line Freight. I can't remember the amount, but it's something like $160 million, and I would presume, as part of that 160 million that they have valued the assets at more than zero.

DR EASTON: I don't know what they've done in that case. I don't quite follow what you are saying.

MRS OWENS: I still worry about the lumpiness of when you do actually have to make major investments in track and sometimes it's very lumpy investment, or somebody else purchases that business.

DR EASTON: But in any system, investment can't be avoided at some time. If you are replacing timber sleepers by timber sleepers, that's, to me - and has been regarded by public and private railways in Australia - consistently a maintenance charge. If you're replacing timber sleepers by concrete sleepers, that's a capital charge. That's an upgrading of the route. It's adding to its value. If you replace a timber bridge by a concrete bridge, it's adding to the value of the infrastructure and it's probably capitalised. So if you upgrade or add passing loops or spare lines or what have you, you're upgrading the route, you're increasing the capacity of the route, and that's properly a capital charge, but if you just rip up a kilometre of timber sleepers and put a kilometre of timber sleepers in their place, you're not upgrading the route.

PROF SCRAFTON: The only question that I had was: you acknowledge that different asset valuations are appropriate for different purposes. Can you have different asset valuations for say performance monitoring as distinct from access pricing?

DR EASTON: As distinct from?

PROF SCRAFTON: From using the same technique for both purposes.

DR EASTON: I go along with the ACCC completely. I think that it's horses for courses and I think their words were well chosen. The decision on method is not to be taken as a precedent for other cases. I think it's at page (xx) of the report but my memory may be astray. I go along with that. For instance, if a railway as part of its infrastructure owned yards and operated yards in the centre of a CBD, if you don't put a value on that, a current value on that, you won't make the right decisions as to whether to retain those yards in their present place or transfer them to some other place.

PROF SCRAFTON: And sell them.

DR EASTON: It may be higher operating costs but you could get a capital gain out of that. Replacement cost or current value or market value - they're the only ways to go. It would be ridiculous to value that as historical cost, in my view. That's an extreme. On the other hand, I feel that a tunnel or a concrete bridge or a cutting - it's plain ridiculous to value that at other than historical cost. They will never be replaced as such.

PROF SCRAFTON: What about if you were going to deepen that tunnel, for instance, for double stacking? I agree with your comment about the tunnel in general but what if you were going to change the configuration?

DR EASTON: You will create a new asset. For instance, the Adelaide Hills: you change the tunnels, you write out accounting-wise the value on the books of the old tunnels and add to the capital cost the capital valuation and the asset valuation, the cost of installing the deepened tunnel. You're creating a new asset. Once you create a new asset, revaluation - or not revaluation. It's the current valuation of a new asset and the getting rid of the old asset from your books. I stand open to correction but I'd defend that before a gaggle of accountants.

MRS OWENS: Can we just come back to the IPART report again. IPART, on page 39, says it's generally the view that:

> DORC is not the most reasonable valuation methodology for setting a maximum allowable revenue of a utility. However, DORC may have greater merit for use in setting ceiling prices in the context of the Baumol model.

So that's their judgment and they've run through, on pages 37 and 38, a range of reasons as to why they think it is possible. They've addressed all the concerns that people like yourself have got with using that methodology. I don't know whether you've had an opportunity to look at their arguments there.

DR EASTON: Yes, I reread them last night. I understand that they're following Baumol's ceiling price ideas, which are Baumol's views. Baumol is a well-respected rail consultant, probably the most well-known rail consultant in the USA, but his views are his views. I don't disagree with the concept that the ACCC has: the maximum price is set by DORC; the minimum price should not be below DHC. That's the depreciated historical cost. Wollongong University, Institute of Transport, to which I've referred - not necessarily in that document but in some documents, including the thesis - said that there was a case, since investment infrastructure represented sunk costs, that in terms of welfare economics they should have no value at all.

They concluded that the original investor, in this case the taxpayer, was entitled to a return on his original investment, so they went for historical costs, but they argued that there was a case - and there is a theoretical economics case - for sunk costs being valued at zero. I don't subscribe to that. I subscribe to that return on the original investment theory. Not theory - it's commonsense. When commonsense conflicts with the economics theory, follow commonsense.

MRS OWENS: Not a lot of economists agree with that.

DR EASTON: Don't quote me to the universities on that.

PROF SCRAFTON: There was one thing you talk about in your submission. You talk a lot about the US and Australian experience. Is there anything that we can learn from anywhere else - from Europe, for instance?

DR EASTON: I have a sketchy knowledge of what's happened in the UK in recent years but it's not a deep knowledge. I have a good knowledge of what's happened in the USA. Why I take the USA model very seriously is because competitive private enterprise operates all the railways. That RAPB report that I've quoted ad nauseam - the membership of the committee was such that it comprised an executive vice-president of the Association of American Railways. The American Railways subscribe to this principle of asset valuation unhesitatingly. They have never challenged it. The American system is such that everybody has access to it.

PROF SCRAFTON: To everybody else.

DR EASTON: So that the access fees and valuations of assets for this purpose play a large part in that. I never slavishly follow American models but I think in this case they've had the benefit of experience over many years. America is the home of free enterprise and, if historical cost was to be seriously challenged, it would be there. But apart from railroads, America has never entertained the CCA principles. They just laugh at them. I've mentioned Anthony and Wriston . I've chosen them because they were writing at the time that CCA was right at the top of the banner headlines in Australia and to a certain extent in England. So I don't think we can disregard the American experience with regard to valuation of infrastructure in particular because of the extent to which access and inter-access took place.

PROF SCRAFTON: Yes, I think your point is well taken. In any case, in Europe you have this transition from these government-owned railways and so on, but I was thinking more recently, for instance, in Britain where you've got private companies operating over a privately owned track authority. I just wondered what asset valuation techniques that Rail Track might have applied in setting its access prices.

DR EASTON: In some writings I don't quite follow what values they're applying.

PROF SCRAFTON: That's an interesting comment.

DR EASTON: I hesitate to comment on anything about which I am - - -

PROF SCRAFTON: No, I think your response is quite valid because there has been a lot of debate and a lot of argument about both the setting of the prices and the - - -

DR EASTON: There's been a lot of toing and froing. I haven't read recent documents. I've read extensively documents about two or three years ago - a series of documents. I was - not confused; that's not the right word - but I wasn't sure.

PROF SCRAFTON: It's too late for us, I guess, in this inquiry but you should look out for the - at the present time there's a review of Rail Track and its prices I think by the regulator, isn't there, so it will be interesting to see what he says.

DR EASTON: I don't think there's been any review by an independent regulator. I would regard the ACCC and your own commission as independent, but you are not a regulator.

PROF SCRAFTON: No, that's right.

DR EASTON: But the ACCC would be an independent regulator. With all due respect, IPART, and the QCA more recently - I've talked to the QCA a lot. I didn't know they existed until they rang me.

PROF SCRAFTON: I think they're fairly new in relative terms.

DR EASTON: They annoy me almost weekly. So there's been no review by a completely independent regulator. I'm not suggesting that IPART's thinking is coloured by the fact that they're a state organisation, but the Queensland Competition Authority - some of the staff there are ex-Treasury economists and so forth and so on and they may be tinged with a shadow of their previous rulings.

PROF SCRAFTON: I think in our discussions with these organisations I'd have to say they try very hard to maintain their independence but, you're quite right, it's very difficult. It's not so much difficult for them to maintain their independence in the reviews. It's what happens to their recommendations that often - - -

DR EASTON: I think if I were in IPART or the QCA I would take cognisance of the USA experience for the reasons I've stated, and European experience - in fact British experience, if that's cognate to the matter - but to the best of my knowledge and belief they haven't done it.

MRS OWENS: IPART has come down with a report on this issue and they've very clearly made a judgment about which way they think it should go.

DR EASTON: Yes, they've made judgments between indexed historical cost, which is an abomination on the face of the earth. It's the worst of all worlds - indexed historical cost. Indexed historical cost and replacement cost are adjusted periodically between valuations by indexation. I think they haven't compared historical cost with replacement cost. I can't understand why. I had never heard of the comparison of indexed historical cost and replacement cost before in those terms, although indexed historical cost is just usually written out as worthless.

MRS OWENS: But I presume that they looked at all the possible methodologies and - I mean, I can't talk for my part - but I presume that they have excluded some and decided to narrow down their analysis.

DR EASTON: I have never seen it narrowed down to those two comparisons before. I have never seen indexed historical cost raised as a possibility before.

MRS OWENS: But does it really matter what the asset valuation methodology is so long as it is applied consistently by, in this case, the owner of the asset that is doing the charging?

DR EASTON: The customer has to pick up a tab if it is too high.

MRS OWENS: But if the customer is not complaining about it and saying they agree with this methodology, is there a problem?

DR EASTON: If the customer is not complaining in that case - but the customer in Queensland is complaining.

MRS OWENS: Yes, but this is for - - -

DR EASTON: No, no, no, I mean, I think, therefore - it gets you back to the case-by-case: if the customer accepts the price, well and good; you can't do anything about it. If the customer is happy, that's okay. The customer is happy with anything - the customer - you leave aside the question of the contingent inclusion, but - monopoly rent, which is to be phased out in the near future. There is a monopoly rent element in the charges, which you know - - -

MRS OWENS: Yes.

DR EASTON: A monopoly rent element has been broken down from probably about $1.50 to about 40 cents at the present time, but I'm not arguing about that. If the customer accepts it, so be it.

MRS OWENS: Yes, and I think the other aspect of this IPART work is that at least there has been a process - and you talked about transparency in your opening comments - at least there has been a reasonably transparent process that has led to this report and that, I would have thought, should be supported, even if the report doesn't come to your conclusions.

DR EASTON: My criticism is not on the fact so much of their final conclusion but on the fact that they arrived at that conclusion - no, I will rephrase that. I don't think one can arrive at a conclusion until after one has considered the alternatives, and they didn't.

MRS OWENS: We don't know that. I mean, what they put - - -

DR EASTON: Their report indicates - I'll say that - the report indicates that they didn't, because they say, quite clearly, that the choices between indexed historical costs - - -

MRS OWENS: No. They said that's what they looked at in the report. I mean, it doesn't mean to say that there weren't staff beavering away behind the scenes, looking at all the other options.

DR EASTON: Doesn't that imply that they didn't look at anything else?

MRS OWENS: No, I don't think so. I mean, we often look at lots of things that don't get into our reports.

DR EASTON: Yes. I have got the report here.

MRS OWENS: We sort of try and refine what we're doing to make the task manageable.

DR EASTON: You don't have to discuss anything - - -

MRS OWENS: But anyway, this isn't an inquiry into the IPART report. I think what our interest is - we are not going to be in a position to actually decide one way or the other what is a proper methodology.

DR EASTON: No, I don't suggest you are but, in their case, they - I think your function - correct me if I am wrong - would be to say that there are several alternative methods and so forth and so on, which may fit one case, just as the ACCC has done virtually. One method might suit one case, one method might suit another, but I can't understand why they picked on indexed historical cost. If you have indexed historical cost it may not - if the historical costs don't contain any gold plating - which they don't in most cases - indexed historical cost and indexed replacement cost are the same thing.

They're not quite clear in their depreciation table: many of those assets will have been written down to zero. I get back to earthworks: even on the Hunter Valley line, the tunnels and cuttings and what have you are probably more than 50 years old anyhow, so they have been completely written out to nil values, and to apply depreciation again - once depreciation is applied and the assets written out, can it be reintroduced and written out again?

MRS OWENS: But they do - as recommendation 8 on page 30 says:

> For the purposes of the New South Wales Rail Access regime, the existing corridor formation vested to RAC in 1996 should be valued at zero. Corridor formation assets and land subsequently purchased by RAC should be valued at actual cost, indexed annually for inflation.

So they have actually said that.

DR EASTON: We discussed this yesterday and I accept it fully.

MRS OWENS: Yes.

DR EASTON: But when you turn to that depreciation table on page 44 they say that other assets, which includes earthworks, which is part of the corridor formation, has a life of 20 years and can be depreciated accordingly at 5 per cent.

MRS OWENS: Yes, but the recommendation doesn't reflect that and I suppose what is important is the recommendation that they come up with.

DR EASTON: But the table laughs at the recommendation, or the recommendation laughs at the table.

MRS OWENS: If it is like our processes, they probably had two different authors in two different parts of the report, so I wouldn't be - nothing surprises me.

PROF SCRAFTON: And they do say on the table - - -

DR EASTON: That's my point: anybody reading table 44 would say that they're depreciating earthworks at 5 per cent per annum. Anybody reading the other page would say they're not depreciating earthworks at all. You can't depreciate from zero values.

MRS OWENS: We are not here to answer for the IPART report.

PROF SCRAFTON: And they do say - - -

DR EASTON: I'm not really here to criticise the IPART report but I am merely illustrating my point; that - - -

MRS OWENS: The other issue that you raised both yesterday and in your opening comments today - and I will just find them again: you mentioned the real rate of return and the violence of fluctuations in real rate of returns and the fluctuations shouldn't be more than - - -

DR EASTON: Can you have a look at page 44, Treasury table? I have brought that because it is not Ern Easton speaking; it is the Department of the Treasury.

MRS OWENS: This is Treasury Economic Paper number 14, Financial Monitoring of Government Business Enterprises and Economic Framework - - -

DR EASTON: Page 44. It shows the nominal interest rates and real interest rates - - -

MRS OWENS: I don't think that is the right page.

DR EASTON: Isn't it? Sorry about that.

MRS OWENS: It's page 44 of the IPART report.

DR EASTON: That's not the right page, but this is.

MRS OWENS: Okay, page 27.

DR EASTON: That was just to illustrate that real rates have been negative twice in - post World War II. They have been negative in 11 years and have a maximum negative rate of minus 14.8 per cent and in the 50s and the 70s they were negative for five consecutive years and the experience has been repeated in the USA. It is not unique to Australia. I'm not aware of any European figures, so I can't comment on that, but what happens if there is a negative rate of interest? What happens to the real rate of return? The real rate of return under the CAPM formula can be negative. Would, say, the RAC or Queensland Railways or any other railway system, or any other utility - gas, electricity - accept a negative rate of return as measured by the CAPM formula in those years?

I don't know, and to say that this situation cannot recur again is tempting fate. In that regard, I remember distinctly a deceased secretary of the Treasury, Sir Roland Wilson, saying - when I and a few other people were present - we were talking about inflation in 1951 and 52, and he made the statement, "It will never recur again - inflation on that scale, or anything like it, will never occur again, because we've learned how to keep inflation within the bounds of 4 or 5 per cent at most," which the history of the late 50s and 60s reflects, but what happened in the 70s? What happened in the early 90s?

MRS OWENS: I suppose with a negative rate of return, if it is a publicly owned railway track the government then has to, I presume, put more money in, and it would have to be a transference CSO and, if it is privately owned, it is no longer viable.

DR EASTON: That, I suspect, is one of the reasons why privately owned companies - how many privately owned companies have accepted CCA principles?

MRS OWENS: We don't know. We were asking you before if you knew about what was happening in the UK.

DR EASTON: I tried hard over about three years to find one and I wasn't successful - one of any stature. Prof Scott Henderson of Adelaide University, who was president of the ASCPA for a period, said that on a survey that he had conducted there were fewer than 1 per cent of companies in Australia that adopted CCA principles, and they haven't been adopted in the USA at all, and Phillips, the progenitor of CCA principles many years before they are even breathed in accounting circles - in other than accounting circles - in the early 90s they abandoned replacement cost and reverted to historical cost treatment, plus market value, where appropriate, and they said that they would abandon it - one of the senior executives told me

personally that they had abandoned it because it was too time-consuming and far too subjective and they were making too many wrong decisions.

Having said that, I'm not a fanatic about historical cost. I think there are some cases in which the nature of characteristics of the asset lends itself to a treatment of other than historical cost, but please not deprival of value.

MRS OWENS: And not in rail?

DR EASTON: Not deprival value.

MRS OWENS: And not in rail?

DR EASTON: Not deprival value.

MRS OWENS: No, but I am saying you can't think of any circumstances in rail - in the rail sector?

DR EASTON: Yes, I've I mentioned one - the rail yards in the centre of a CBD - extensive rail yards. You would have to value that on current value, otherwise you could make wrong decisions. You could continue your operations there where it might be economically profitable to build new rail yards a little out of the city area and sell the other railroads. That's a decision which - that is not only for pricing but for purposes of making economic decisions, it would be necessary to consider those - it would be futile to consider those yards as valued as written-down historical cost. It would be crazy. You would have to take current value into account.

MRS OWENS: Would the same apply - I'm not sure what the station is called here in Adelaide but there is a station where the interstate trains come in now; they used to come into the station here - Keswick. Would the same apply with that station?

DR EASTON: I think for the purposes of making a decision as to whether the - both assets should be valued at current value for the purposes of making the decision.

MRS OWENS: Yes.

DR EASTON: Of course, the use of any method of valuation which may be appropriate in making economic decisions may or may not be appropriate also for pricing - I think this is generally recognised - but I think a decision on the transfer should be made on the basis of the current value of assets, or market value of assets if you like, but please, not indexed values.

MRS OWENS: I think we have just about covered all the questions we had. Were there any other questions that you wanted us to ask you, or was there anything else you'd like to say?

DR EASTON: About depreciation.

MRS OWENS: Depreciation, that's right.

DR EASTON: If a rail system - and most of the rail systems do that, except RAC for the moment - if in infrastructure you charge all replacements of like by like to maintenance, or you can raise an expense, and if it is recognised that the infrastructure has to be maintained in an efficient condition - that is a fact because you can't let the infrastructure run down otherwise the traffic would be going off the lines. If those considerations apply and at the same time you revalue the assets, if you charge depreciation, aren't you charging the customer twice? I asked this question of the ACCC staff this morning and they couldn't answer it, and with justice to them, I couldn't answer it myself. But my gut feeling is particularly if you revalue you are charging the customer twice.

If you don't revalue and you regard depreciation as a method - a means of spreading the original cost of the asset over the life of the asset, if you like, a taxation approach - I think depreciation is perfectly proper. But I doubt it under replacement cost valuation - unless replacement of like by like is a capital charge and not a maintenance charge. I think in fairness to IPART - and I think that they're hinting at that - periodic maintenance should be capitalised. Do you follow me?

MRS OWENS: Yes.

DR EASTON: I think it's an important point. The Queensland Mining Council has raised it with the Queensland treasury on a number of occasions and treasury has rejected the argument but I think it is a consideration worth exploring.

MRS OWENS: Yes, a very interesting point.

DR EASTON: It's a very interesting point. I wouldn't labour it.

MRS OWENS: Is the ACCC going to look at this? We could always find out what they're thinking and talk to them at some stage?

DR EASTON: I don't know. I corresponded with some people in America at Harvard and Yale on the matter. I did recap some of their conclusions.

MRS OWENS: There's another PhD thesis in that one?

DR EASTON: Yes, I know. Please, not again. I noticed in the Australian this morning, only 26 per cent of people who start PhDs on a part-time basis successfully achieve their objective. The other point I would like to cover, if we've got time, is productivity. I have set it out pretty clearly. Do you have any questions on that? Do you disagree with my thinking?

MRS OWENS: We talked about that yesterday, about passing on the benefits of productivity gains. No, what you said seemed to sound quite reasonable to me.

DR EASTON: The underlying point is you might get your initial charges to the customer right - I'm talking about a monopoly or semi-monopoly situation - but if your escalation formula is incorrect and doesn't correctly reflect the movements in cost, the customer is being short-changed, or the supplier is being short-changed. I would mount a case also for escalation clauses never applying to capital charges. The futility of applying it to the capital component of costs following the price is illustrated by the movement in interest rates. Interest rates in the 70s and probably beyond that, the beginning of the 80s, were about 14 per cent.

If you escalated that by the CPI movement, you arrive at about 20 per cent today, which is manifestly absurd but if you escalate the capital component, the capital charges inherent in your prices, you arrive at just that result. A 20 per cent interest rate on an interest rate at 6 per cent. It can operate in strange ways. I emphasise that the whole of the productivity must be passed on eventually to mimic the competitive situation in private industry. It's not sufficient to have a CPI minus X formula where X represents only part of the productivity induced cost savings, because in the end the result I've just mentioned will be achieved, although not to the same extent.

My last point on that is that in periods of low inflation - and I mentioned this before - productivity gains may exceed, and probably will exceed - in the railway field they will exceed because the railways are still operating well below best practice levels. That's another aside. All the railroads accept the performance of Burlington Northern Railway, I think it is, as best practice standards. That's a US Rail railroad. So we look to the USA as achieving the best practice in performance. Why not look to them as achieving best practice in regard to asset valuation of railroad assets? I know that's not logical.

MRS OWENS: We are also, I have to say, as well as looking at the US looking at various countries in Europe, including the United Kingdom and performance measurement and we're looking at New Zealand and South Africa, so we're not just looking at the US.

DR EASTON: No. I have looked at New Zealand. I have done some jobs for mines in New Zealand, and the main coalminer in New Zealand was at the time in a fifty-fifty partnership with New Zealand Rail so I had an enormous amount of information available to me.

MRS OWENS: You would have, yes. That would be cut off now though, wouldn't it, because of Tranz Rail?

DR EASTON: I don't know anything about this; that's eight or nine years ago.

MRS OWENS: Okay, I think we might close at this stage? Have you finished? Have you anything else you'd like to say, Dr Easton?

DR EASTON: I'd like to just make a very brief reference to transparency. I think the railroads throughout Australia should be more transparent in their dealings with customers in monopoly and quasi-monopoly situations only. You can't be transparent with customers and need not be transparent with customers in the competitive situation. The Queensland railway back at Mackay particularly where the only traffic is coal traffic. I think there should be complete transparency with the customers. I don't mean divulgence of individual contracts with individual miners, but transparency as to methods of valuation, rates of return.

MRS OWENS: I presume you're implying in that case that there isn't transparency at the moment?

DR EASTON: Ask the Queensland Mining Council or any Queensland mine. New South Wales is not perfect by any means but there is greater transparency in New South Wales to the best of my knowledge.

MRS OWENS: I think we had a discussion about this issue in our last hearings.

DR EASTON: I think I did raise it. That's all I have to say.

MRS OWENS: Okay. Thank you very much. Once again, thank you for all the effort you have put into giving us a submission and for coming today. We now conclude our hearings here in Adelaide and we are adjourning to 9.30 on Tuesday, 25 May in Melbourne.

AT 2.22 PM THE INQUIRY WAS ADJOURNED UNTIL
TUESDAY, 25 MAY 1999

INDEX