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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO PROGRESS IN RAIL REFORM

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

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON THURSDAY, 12 NOVEMBER 1998, AT 9.35 AM

Continued from 11/11/98

MRS OWENS: Good morning and welcome to the third day of the Melbourne hearings relating to the Productivity Commission's public inquiry on progress in rail reform. The first participant this morning is the National Competition Council. Would you like to give your names and affiliation for the transcript.

MR WILLETT: Ed Willett, executive director, National Competition Council.

MS COPE: Deborah Cope, deputy executive director, National Competition Council.

MRS OWENS: Thank you both and thank you for coming and for the submission, which we have both read. Would you like to make any opening comments before we ask you some questions?

MR WILLETT: Yes, I thought I would make a few comments. I'm not going to repeat what's in the submission, but I thought I might provide some opening comments just to put some context around that submission and raise some issues that aren't fully addressed in that submission. First some general comments about national competition policy, because I think they're particularly relevant to what's happening in rail. We have in our national competition policy three general agreements on competition policy reform and four industry-specific agreements. It's notable that originally rail was not one of those four.

We have had governments agree recently to a rail reform agreement. That agreement is not part of national competition policy package and is not subject to the assessment process of the council in assessing whether governments meet their obligations under national competition policy. I think it's also fair to say that, because that is a recent agreement on rail reform, that process of national rail reform is not as developed as the other areas that are formally part of national competition policy in electricity, gas, road transport and water reform.

The consequence of that is that the role of the National Competition Council and national competition policy reform in rail has been much more limited than it has been in the four industry-specific reform areas. The council's role and competition policy's role has been limited to the role of the national access regime in Part IIIA of the Trade Practices Act and general reform obligations on governments contained in the competition principles agreement on structural reform and competitive neutrality. That's meant that there have been some limitations on the application of competition policy reform in rail compared to some of the other sectors, and I think those areas are picked up very effectively in the submission, so I refer you to that for more detail on those issues.

I thought I might make some general comments about access arrangements. It's still relatively early days in the experience of the national access regime in Part IIIA of the Trade Practices Act, but I think there are some comments that can be made and some lessons can be drawn at this stage. Part IIIA of course was established to provide a regulatory regime for natural monopoly infrastructure services. I think

there are a number of important things to note about how Part IIIA works. The first important point to note is that it's focused on the utilisation of spare and developable capacity for natural monopoly infrastructure. That comment reflects the fact that we are talking about regulation of natural monopolies, and the implication of that is that it is more efficient to utilise the spare or developable capacity of an infrastructure service rather than duplicate that service where someone needs to utilise that particular service.

The corollary of that is that it is open to an infrastructure owner to contract capacity, and that contracted capacity to other people is not affected by the national access regime, because if it's utilised that's not part of the spare and developable capacity of the natural monopoly infrastructure. Of course, if you're coming up against capacity constraints with a particular set of infrastructure and it's not more efficient to develop capacity of that infrastructure compared to developing a completely different set of infrastructure, then you no longer have a natural monopoly and regulation is not appropriate.

It's always important to bear in mind that all regulation has costs and that Part IIIA and any access regulation imposes costs on infrastructure owners, and it's always a matter of balancing the benefits of providing access on a case-by-case basis against the costs of providing access to the infrastructure owner, including the costs that go to incentives for investment in new infrastructure or development of existing infrastructure. Those sort of considerations are going to vary case by case and Part IIIA is designed, and particularly the declaration process, is designed to recognise that there are going to be different considerations on a case-by-case basis.

Essentially the regulation of natural monopolies and Part IIIA of the Trade Practices Act recognises that natural monopoly regulation has two basic objectives. The first is to facilitate competition in related markets, recognising that infrastructure services often constitute a bottleneck to the operation of competitive related markets, and that's well-recognised I think in Part IIIA. The natural monopoly regulation is also about efficient utilisation of natural monopoly infrastructure, and meeting those dual objectives will often require some balancing in the design of an application of access regulation on a case-by-case basis.

In particular, some relevant considerations are the cost of the natural monopoly service as an input or as a proportion of the cost of any end product. Where the cost of the natural monopoly service is low relative to the cost of the end product, that's likely to have implications for the appropriate design of access arrangements in that the objective of facilitating competition is likely to be more important than the objective of efficient utilisation of infrastructure. That would suggest that your access arrangements would be more prescriptive - might even be a posted-prices approach - because the gains from getting prices exactly right for the natural monopoly service are likely to be much less important than the gains from facilitating competition in related markets.

On the other hand, if the cost of the natural monopoly service is high, then it's

likely that the considerations that go to efficient utilisation of that service or that infrastructure are going to be more important, and getting prices exactly right or close to, as right as you possibly can, may be on par and will certainly increase in relative importance to facilitating competition in related markets. What that means for the design of regulatory regimes is that, where the costs of the natural monopoly service are relatively high, it's likely that you're going to want more flexibility in the regime to facilitate the negotiation of access prices to ensure that you get as close as optimal utilisation of the natural monopoly infrastructure as you possibly can.

There's another consideration that's probably going to be relevant here, and that's the number and size of participants in the related markets. Where you have a small number of large people seeking access to natural monopoly infrastructure services, then the transactions costs of a more negotiated approach to determining prices of the natural monopoly services are likely to be lower than if you've got a lot of players in the market all wanting access, and where you've got a lot of players in the market the transactions costs of that would tend to suggest that a more prescriptive pricing regime, business regime, is more appropriate.

Declaration under Part IIIA is in effect a pure negotiate-arbitrate model. Declaration provides an enforceable right to negotiate, backed up by arbitration by the ACCC if negotiation can't lead to results. What I've just said about the design of access regimes I think leads to the conclusion that a pure negotiate-arbitrate model is not always going to be the most appropriate access regime design in all circumstances. It may be that you will want more prescription than that in certain circumstances, and certainly the work in electricity and gas and our work in rail so far has suggested that you will want different levels of prescription in all of those industries, but in each you will need a bit more prescription than is available in the pure negotiate-arbitrate model. So I'll conclude my comments there and pick up any questions you want to raise.

MRS OWENS: That was really helpful, Ed. It's I think one of those areas that are very hard for those that are outside them to get their minds around easily and quickly, and I think your submission has helped and just what you've said then has actually meant that a number of the questions I had I've just wiped out. But can I come back to something just to clarify a couple of things that you said. One was relating to rail not being one of the areas that was picked up initially in the national competition policy. Why was that? What was behind that?

MR WILLETT: I'm not sure I've got a clear answer to that. The four industry-specific agreements that form part of national competition policy have quite a history, dating back to the early 1990s. I suspect the reason is probably that governments weren't ready at that time to reach agreement on reform processes for the rail industry, whereas they were in electricity, gas, water and road transport. So I think - and I don't have any information to base this on - it's just a matter of the history of government relations and how things have developed.

MRS OWENS: They'd been thinking about those other areas for quite some time,

whereas rail was not on the agenda, so to speak.

MR WILLETT: That's right. Do you have anything to add?

MS COPE: No. That's my impression but, again, it's my impression.

PROF SCRAFTON: I think if you go back to the early 1990s the rail and road reform took different directions. The road reform went in a direction that required cooperation of governments, whereas the rail reform was the establishment of NR, and that was seen as the sort of - if one goes back to the sort of pre-COAG days when there was a special premier's conference, it was called then, wasn't it?

MR WILLETT: Yes.

PROF SCRAFTON: The direction that the road took later in the nineties fitted more into the competition policy model, whereas the rail solution, if I could use that expression, was seen to be the formation of an organisation. It is interesting to this debate because at that time it was envisaged that the infrastructure and the operations would be an integrated operation, and it was only later when the competition policy came along - a couple of years later or whatever it was - that the decision was taken never to actually seed the infrastructure from the owning governments to NR. So I think in a way our question is more not so much, "Why was rail left out?" but, "How did rail get in?" I think in some ways road was an add-on to the infrastructure industries of gas, electricity and water because, interestingly enough, the road reform is not about infrastructure either essentially. It is about operations. So it's a slightly different situation.

But it is important to this debate because later on in 95, when the extra tranche of general purpose payments was tied back to the reform process, by then the road was in there. I'm not saying that's necessarily an answer to my colleague's question, but it does throw a bit of light on that early nineties history.

MR WILLETT: Yes. The difficulty they have is that the council has only been in existing since 1995, when this reform package was put together. I wasn't there, but certainly from very early on we recognised that the absence of a comprehensive rail reform agreement at that stage was a serious limitation in the prospects of rail reform, and it also put a lot of load on the national access regime to generate or drive some reforms in the rail area. It's no coincidence, I think, that most Part IIIA declaration applications have been in the rail industry.

MRS OWENS: Thanks for that. The other question I had was relating to your comment, when you were talking about how the Part IIIA regulatory regime worked. You talked about the utilisation of the speed capacity being a factor and ensuring that it's more efficient to utilise that than to duplicate. Then later you talked about trying to balance the benefits and the costs and one of the costs potentially could be the disincentive for new investment. Anybody who is going to come along to you and say, "If you do this to us, if you allow access, we won't invest in the future," how do

you actually decide whether that is a real situation or whether they're just having you on?

MR WILLETT: It's a matter of considering the evidence that is available to the council. You're aware, I think, that we conduct a public process generally in relation to applications for declaration and interested parties and in particular the application for access and the infrastructure owner will have particular points of view and evidence they would want to submit to us. We have particular criteria to apply in considering whether declaration is appropriate, including considering whether it will be in the public interest or contrary to the public interest to recommend declaration. Under those criteria we can take into account all the points that are put to us on whether declaration is appropriate, balancing the interests of the infrastructure owner against the potential beneficiaries from providing access or recommending declaration.

MRS OWENS: I might come back in a minute to the criteria but I've just got a few broader questions and then I'd just like to get your views on how some of those criteria actually work together. There is sort of a general view among some of the people that have been coming to us in these hearings and in submissions about these processes and the views tend to be that it potentially is legalistic, it's slow, it's potentially costly, it's complex and it hasn't been particularly efficient in achieving greater access out there. Things are sort of grinding to a halt or they're moving very slowly and getting bogged down. Do you want to comment about that?

MR WILLETT: Sure. I start off by pointing out that it was always envisaged in the Hilmer report and in the design of Part IIIA that declaration was not necessarily just an end in itself but also part of the environment for the negotiation between infrastructure and to the people who wanted access. What that means is that I don't think it's fair to measure the success of Part IIIA over the declaration process merely by having a declaration to then put in place because I think it is quite feasible that declaration could have been highly effective merely because it has facilitated negotiation between access seekers and infrastructure owners or facilitated the design of state and territory or national access regimes and not resulted in any declarations at all.

Certainly our work, as I pointed out in the introductory comments, would suggest that declaration is not always going to be an ideal regulatory arrangement for natural monopoly infrastructure. Having said that, I think there is some evidence of those sorts of things happening. Yes, we have a legislative access regime in Part IIIA and whenever you legislate, that's going to raise some legal implications and I think it's appropriate that since we are talking about, by and large, very large stakes for infrastructure owners and access seekers, I think it's appropriate that appeal rights ought to be available and when you make appeal rights available to an organisation like the Australian Competition Tribunal, that's inevitably going to mean that process will take longer than they otherwise would.

But having said that, I think there is some evidence that declaration is working to change the environment for the negotiation of access arrangements - and I'd point

to the comments about the rail operator SCT in their declaration applications, where they have been able to negotiate access on two occasions, despite the declarations that they applied for not being put in place. But I think declaration or the threat of declaration has also been an important driver in the design of effective state and territory access regimes and I think the experience we've had with New South Wales and its access regime and perhaps with Queensland and in the future, other states, is evidence of that. So I guess my broad comment is I think the comment that Part IIIA and the processes that are there are unnecessarily legalistic and lengthy is somewhat unfair. I think there have been within a 3-year period some significant results. I think we are now going to see, with some imminent decisions by the Australian Competition Tribunal on a couple of rail matters, a step up again in the role that Part IIIA is playing and how it's affecting the environment for utilisation of natural monopoly infrastructure services. As I say, I think those comments are a bit too harsh.

PROF SCRAFTON: If I could just follow that up, I don't think the people appearing before us were necessarily laying it before the organisations involved. But even as an example, the establishment of regimes and their certification, that seems to be a long process. As an example, I think every state that we've gone into, people have said, "We're busy setting up our regime and we'll be submitting it in due course," but when we read your submission, I think you only have received two - is that right - Queensland and New South Wales?

MS COPE: Two in rail, yes. There have been regimes certified in other industries. There's only two in rail.

PROF SCRAFTON: I think that's a good example. The way it was presented to us, you know, they're ready to sign this off and submit it to you. But in practice, weeks may have gone by since we had that discussion with them and there are ways in which they can delay the process themselves if we choose to do so. Maybe it's a matter of certain states waiting to see what happens to the certification of, say, the two that you've got. So I think it's important that we stress that it's the total process, rather than just the direct involvement of NCC or ACCC or the tribunal or whoever.

MR WILLETT: Yes, I recognise that, Derek. I guess, to be fair to jurisdictions too, it's still relatively early days in terms of designing access regimes. We're very conscious that it's important to get the design of these regimes right. We're also cognisant of the need to do what we can to help governments come to a position where their access regime is effective, rather than taking a very quick decision, "Having come to a view that the regime as initially designed is not effective, therefore we'll simply recommend against certification." I'm not sure that that helps too many people at all. So we've been very keen to ensure that the result we end up with is a well-designed, effective regime and a process that ensures we get to that result.

It has been - with New South Wales in particular - longer than we would have desired. I think to some extent that reflects the fact that it was the first rail access regime that was being designed in the country. I would expect that future processes

will take considerably less time than that.

PROF SCRAFTON: I guess that is an important comment because other participants have pointed out to us that barriers to entry are being erected by multiple safety and accreditation regimes in other parts of the rail reform process. So the access regime is an attempt to facilitate the process, not to erect yet another barrier.

MR WILLETT: That's been something we've been very conscious of and I think it's another area where the design of an effective state regime is a superior outcome to simple declaration, because in consideration of the New South Wales regime we have been able to deal with incompatibility or issues that go to incompatibility in standards and the problem of safety regulation being an inappropriate barrier to access regulation.

MS COPE: It's also probably worth noting that access regulation is not going to be necessarily the best solution to all those sorts of problems. Access regulation is about access, it's not about safety standards. It can only deal with them to the extent that it's a barrier to entry. It really can't deal with them in the sort of comprehensive way that the industry may be looking for them to be dealt with and that's more appropriate in the general agreement on rail. There is a limit to what access can do.

MRS OWENS: I think we understand that. Just coming back to this issue of wanting to see well-designed, effective regimes in place, have you got a view as to what a well-designed, effective regime should look like? Is there a sort of model regime as far as you're concerned?

MR WILLETT: I think it's fair to say that the extensive work we've done with New South Wales means that what we have there is what we consider a very good rail access regime.

MS COPE: What we will have there.

MRS OWENS: So do you set that up as a model and say to the other states, "Have a look at what we've got for New South Wales," and, "Why don't you just harmonise with this sort of arrangement?"

MR WILLETT: I think that's inevitably going to be part of the process. Certainly we have criteria to apply in considering the effect of the states' access regime that go to questions about ensuring that regimes are going to be compatible to facilitate national markets and the provision of services on a national level. So I think the fact that we are getting to the point of seeing New South Wales' regime as effective will mean that it will provide a starting point for consideration of effective access regimes with other jurisdictions.

MS COPE: That doesn't mean that they will necessarily be identical. There are likely to be specific differences in different states and territories because of differences in the systems that they're dealing with, the differences in their institutional structures,

which would mean that there would need to be differences between the regimes.

MRS OWENS: But I notice with interest in your submission that you've actually got quite a definite view about institutional structures as well. I guess this is part of your ideal model for New South Wales. You tend to be coming down on the side of separation as distinct from vertical integration as being the approach that you prefer to see in place. I think that would be a reasonable interpretation of what I've read, or is that not right? On page 1 you talk about:

The lack of confidence in the outcomes negotiated with a vertically integrated supply could result in an increased number of arbitrations under Part IIIA mechanisms, making it more costly to achieve benefits of competition -

which to me is a sort of an indication that - I mean, you go on and say:

The councils have reviewed that full structural separation allows greater confidence for upstream and downstream consumers -

and so on.

MS COPE: In the access, it's not black and white. There are costs of separation and there are costs of not separating. In the context of access, there are a lot of benefits with separation because you remove the conflict which exists with a vertically- integrated organisation where they are both a competitor and a service provider to people who want access. So if you're looking at the issue purely in the access context, then I think the benefits of structural separation there are quite large. There may be other offsetting benefits which mean that a government decides to keep a vertically integrated organisation, but from what we've seen from the access point of view, there are significant advantages of structural separation for facilitating competition in other markets.

PROF SCRAFTON: Again, what we have heard from other participants is that the opportunities for transparency are much greater under separation, that the organisations are forced to come some way in increasing their transparency and that in turn feeds back into your comment about the access regime where one would presume that greater transparency was a desirable outcome.

MRS OWENS: We heard from the ARTC yesterday. Another concern they had about vertical integration and access is that even if you design a reasonably good access regime around a vertically integrated system, you've still got the problem that the owners of the track can still find very subtle ways of excluding the competitors, just through scheduling and all sorts of other ways and it's very hard. They said, "No, access regime can actually get to the bottom of those problems." Do you want to comment on that?

MR WILLETT: It's certainly very difficult. Vertical integration certainly puts a lot more load on the efficacy of your access arrangements, because of the risks of the

service provider of the national monopoly service also having an interest in the related companies. So you certainly need, in an access regime where you have vertical integration, some measures to address those conflicts. I guess it's fair to say we haven't gone through a full process in the certification of an access regime involving a vertically integrated rail authority as yet, so it's a bit hard for us to say whether it's possible to design a regime that's going to deal with all those issues. But we're certainly conscious that there are a lot more issues to deal with when you do have a vertically integrated service provider.

MRS OWENS: I wonder whether that's another opportunity to be a bit more prescriptive, rather than flexible.

MR WILLETT: I think it definitely needs more prescription. You'd certainly want to make sure that pricing within the vertically integrated authority was - that there were some mechanisms to ensure transparency in those arrangements and to ensure that there wasn't the opportunity to, in effect, provide better internal pricing than would be available to other participants in the competitive market. So that inevitably means more prescription on the infrastructure owner and the service provider.

MRS OWENS: One of the other questions, in relation to this sort of ideal access regime, is the recommendation of the Neville committee, which really talked about reversing the onus. You mention in your submission, in the SCT case, for example, the fact that the premier of New South Wales sort of sat on it and so it was deemed to be not declared. I think the Neville committee has put in an interesting recommendation, saying, "Well, maybe the onus should be sort of reversed." Have you got any views on that or is that too sensitive? Have you responded to the Neville report at any time?

MR WILLETT: No, we haven't. I don't think I'd want to comment on that. It's an interesting suggestion. I perhaps note that I think generally in national competition policy we have a presumption against legislative restrictions on competition, unless net benefits to the community can be demonstrated and it can also be demonstrated that there are no other ways of achieving those benefits than imposing regulation. In this case we have the application of declaration and it raises some interesting questions about where the onus should lie, in terms of whether regulation should be imposed or not.

MS COPE: Particularly if that decision wasn't linked to the recommendation and you had a recommendation not to declare a service and in a deemed decision to have the service declared, you may not end up with the sorts of outcomes that you were looking for.

MRS OWENS: Yes, you can unravel the process quite quickly, can't you? Is that right? Can it undermine the decision?

MR WILLETT: I'm sorry, which decision?

MRS OWENS: Well, if there's an initial declaration decision on the part of the NCC and then that decision doesn't get acted on, unless you go through an appeal process there is potential for that decision just to be left hanging, isn't there?

MR WILLETT: Well, I think it's important to note that we make a recommendation to a decision-maker on whether a declaration is appropriate or not. I think Part IIIA does envisage that the decision-maker then makes a decision that he or she deems appropriate, with the sanction of review by the Australian Competition Tribunal if an affected party seeks that remedy. There is that protection there. It is envisaged I think that our recommendation is a recommendation and not an access decision.

Now, whether the fact that some of our recommendations have not proceeded to decisions in line with that recommendation by the decision-maker - and I think that is an important issue but there are a lot of factors you would want to take into account if we're coming to a view on whether those particular decisions were appropriate - - -

PROF SCRAFTON: There are a couple of related comments too. One of the decision-maker's decisions related to one of the state regulatory bodies, so it isn't just a matter of the NCC's recommendations, but also the independent state regulators have the same process in place. In that case I guess their recommendations were to the state premier involved and if he chooses not to act on recommendations, the same situation applies.

MR WILLETT: I'm not sure which - - -

PROF SCRAFTON: In Queensland there was a company neutrality case which was not acted on by the Queensland premier.

MR WILLETT: I think that's a different set of circumstances, where you're talking about the recommendation of a competitive neutrality complaints unit to a government on a policy matter or on a particular complaint. That is an area that we will take an interest in, in terms of governments' obligations in relation to the competition principles agreement in our assessment process. There are obligations on governments to set up effective complaints units for competitive neutrality. There are also obligations on governments to ensure that their decisions in response to the recommendations of those complaints units reflect their obligations under the competition principles agreement. So that's something we can address in the assessment process.

PROF SCRAFTON: The other thing I think that might be worth mentioning to you is that we had the Department of Transport in yesterday and they said that they expected the government to respond to the Neville committee's recommendations early in 1999, and maybe that's an appropriate time when this matter will be raised.

MRS OWENS: I was just going to seek clarification about some of the criterion

here - not so much what they say but how they're interpreted. When you're actually looking at an application for declaration, do you run through all those criterion? Do they all apply? You tick and cross them all when you look at it? This is the criterion you've listed on page 3.

MR WILLETT: Yes. The Trade Practices Act requires that the council be satisfied against all of those criteria before it can recommend declaration and also requires the decision-maker to be satisfied of those criteria, each of those criteria, before declaration can be imposed.

MRS OWENS: So what happens if it meets some of the criteria but not others?

MR WILLETT: It must meet all of them.

MRS OWENS: It has got to meet all of them, okay.

MR WILLETT: Yes.

MRS OWENS: Now, in terms of the first one, the one that - what is it, criterion 44G(2)(a), which is about promoting competition - if you're looking, say, at an application for declaration of rail service, do you take into account the potential competition with other modes of transport, such as road?

MR WILLETT: Yes. In rail, that's a very important consideration.

MRS OWENS: Right.

MR WILLETT: It has led to some difficult considerations, I think it's fair to say. In some areas road transport does provide a very effective alternative to rail transport. In other areas, particularly where you have long distances involved and/or you have the transport of bulk commodities or you have the transport of full container load freight, the council has come to the view that the costs advantages of rail services, efficiently operated, mean that road transport doesn't provide effective competition such that declaration would be inappropriate. In other cases that's not going to be the case. So it's a matter of looking at each application for declaration of rail services on a case-by-case basis and considering whether road transport does in fact provide effective competition such that a declaration would or would not be appropriate.

PROF SCRAFTON: I think that is a very useful role of the commission, because a lot of the debate is about rail competing with itself, whereas in fact in many corridors in many areas it is a comparatively small proportion of the total market. I guess also this relates back to the whole manner of process of unravelling the opportunities for competition - how much more clear then was it before, where rail simply did what it had always done and just hoped that somebody would provide the capital and that they would be allowed to go on forever, and meanwhile the road - or sea, for that matter - would get the business.

MS COPE: It's not a straightforward consideration and one of the key reasons for that is that it's difficult just to look at what rail and road are doing at the moment. You have to think about what would happen to the two if you had access on prices which were efficiently determined and whether that would mean that you've got a rail system which is able to provide a service at a cost advantage and therefore enhance competition.

MR WILLETT: In some cases you can see road and rail competing quite vigorously but there is the potential for rail to be operated at much lower cost and therefore much lower prices, and therefore the potential to significantly increase competition in the provision of freight services by providing access to that rail infrastructure service. So as Ms Cope says, you're not just looking at what's happening at the moment but you're looking at what is likely to happen if declaration was imposed.

PROF SCRAFTON: And access is very important in that, because competition may not be primarily on price, it may be on service - the points we raised earlier about the limitations on a potential new operator to provide a level of service that in turn will allow him to compete effectively, yes.

MS COPE: Access is not only about price. It's about what other terms and conditions and the requirements on the operator.

MRS OWENS: One of the participants that came to see us in Perth was Hamersley Iron. Now, you may not care to comment on this just at the moment. But I suppose they raised an important issue about the application of access regimes and these criterion to a privately run - a line which was constructed by the company. They see it as being an integral part of their production process. The product that is going on that line is all exported so it's not about - and the competitor is also in a position to do likewise and is in a position to construct their own line and they are prepared to do so. So the ultimate impact of not having access to the Hamersley line is going to be that the competitor is going to have to spend money building their own line. So, you know, it may not be a national monopoly, and competition at the end of the day might not be affected. Are there views about those circumstances, because I think they are a bit different from the other circumstances. Does the NCC have a position on those in general? You may not want to comment and I understand if you don't.

MR WILLETT: We certainly don't have a position because there's an application before us for declaration of that service of course and it's very early days in consideration of that application. I can't comment at all on whether the service involved there is actually a service for the purpose of Part IIIA because that matter is currently before the Federal Court. In terms of whether access is likely to promote competition and/or whether that service is a natural monopoly service or not, they're considerations that go directly to the most important criteria we have to apply, and they're certainly things we would look at very closely on the evidence that's available.

MRS OWENS: I think whatever happens as a result of that case will establish the

precedent for others in the future. I think it's probably the first cab off the rank, isn't it?

MS COPE: It will establish precedents to some extent but each circumstances is different and the issues that arise in each application tend to be different. So as we go through more applications, more knowledge builds up which allows people to understand the criteria in their application more, but I would be careful to say that one particular application is going to set what happens elsewhere in the future because each is considered on a case-by-case basis, based on the particular service somebody wants access to and the circumstances in that industry.

PROF SCRAFTON: Helen, I'd like to step back a little into this matter of transparency and the access regime. There was just one thing which I didn't get to ask a little earlier and that was that some participants have pointed out to us that even though you might have vertical separation and begin to appreciate the financial side, the cost side of doing business within the new organisation, there are still other ways in which the separated organisations can limit access. One of the ones that was drawn to our attention is if the protocols for actually operating the railway are not a public document - in fact, it has been suggested that in some places there are no protocols, that there's this sort of history of 150 years of people in signal boxes and a supervisor train controller or whatever it might be, determining which trains might have priority at any point in time. Obviously there needs to be a degree of flexibility in a complex network, but do you foresee that operating protocols or the principles of operating would be part of an access regime?

MS COPE: Yes, we do and it is an important issue for people running trains. There are two parts to where we look at that. One is that there are some policies developed within the infrastructure owner on how you allocate train paths, and then the second part is the ability of the arbitrator to then arbitrate on issues to do with disputes over the allocation of train paths, so that you've got both some information available and also a point to go to, to dispute the way that's being applied.

MRS OWENS: I'd like to just turn to the issue of how access prices are determined and I think Ed initially talked in some general terms about some of this, but a lot of the factors that you refer to on page 9 to 10 relate to supply side factors. Do you look at the issue of the demand side? Is the issue of Ramsey pricing one of those that you take into account?

MR WILLETT: It's a difficult question for me to address because by and large pricing issues in an effective access regime are going to be the problems of the arbitrator/regulator and what we do is ensure that appropriate arrangements are in place to get the right sort of pricing outcomes through those institutional arrangements. But having said that, the characteristics of a particular industry are going to be pertinent in the design of an effective access regime.

I mentioned some points at the beginning that go to how prescriptive an access regime should be for a particular infrastructure service. Another of those

considerations might be the different demand elasticities of different users and it may be that where there are those different demand elasticities that more flexible arrangements again would be appropriate in the facilitation of negotiated prices, it would be an appropriate mechanism to ensure again that you're getting optimal utilisation of particular services.

MS COPE: Another issue with rail which was relevant to that is the way the different systems vary across the country and the issue of when you're dealing with very similar types of freight on a very similar type of system throughout the whole of the network that the infrastructure owner owns, compared to areas where you've got quite complex networks with different levels of neutralisation on different lines and different types of operators operating on different parts of your system, and how you then develop pricing principles which are able to take the different utilisations across the system and the different operators into account when working out what are the best prices.

MRS OWENS: We had this general question which we discussed before. We started about negotiated price versus posted prices including auction and so on. Do you want to say more on that or do you think we've covered that?

MR WILLETT: I think we've probably covered all those points.

MS COPE: I think so.

MRS OWENS: I think we have and the potential for cross-subsidisation, you know, ensuring that companies operating in part of the system aren't cross-subsidising those on other parts of the system.

MS COPE: I think what's important there is that your pricing rules and your arbitrator's powers are not constrained by a system like ALCAP and that they're actually able to look at line sections, the particular service somebody wants, what's the costs over the line that they're using. If you actually have your pricing principles which enable you to address the particular circumstances of a user, what they want to do, what sort of priority they want and where they want to use the system, you're able to overcome those sorts of problems.

MR WILLETT: What that means, I think, is that the maximum degree of flexibility that you'd want to see in an effective access regime is a Baumol band approach to the allocations of cost of a particular service. By applying that Baumol band, you avoid the risk of cross-subsidisation of the costs of different services.

PROF SCRAFTON: That in itself is a phenomenal reform in terms of the way railways have previously been running, certainly the ways that they have avoided publicly declaring what those costs are. I mean, suddenly in order to comply with such a regime much more information becomes public than was the case before.

MRS OWENS: I just had one other issue I wanted to raise with you. I'm just trying

to remember whether you raised the issue of competitive neutrality. There's something on page 13 but it may - no, I don't think it's directly relevant but you talk about competitive neutrality principles and in this inquiry there has been two related issues, both being labelled "competitive neutrality". One is the issue of the new private operators competing with the existing government-run operations such as V/Line Freight, NRR and Westrail and so on. The other is the issue of road versus rail. If my understanding is correct, competitive neutrality is relating to government versus non-government businesses rather than two broad areas. I'm really picking your brains, Ed, on this one.

MR WILLETT: That's fine. Yes, I think it's important to distinguish the obligations on governments for competitive neutrality reforms and the question of competitive neutrality generally between road and rail transport. You're right. In terms of the competition principles agreement and the obligations in relation to competitive neutrality, they go to ensuring fair competition between public and private businesses and the requirements there ensure that public businesses don't have an advantage in a market that derives simply from the public ownership, whether that advantage goes to the fact that they're not subjected at all to the regulation that a private sector competitor is or the fact that they don't have - there's no tax equivalents or taxes applied to their operations or they haven't - - -

MRS OWENS: CSOs, or is that different?

MR WILLETT: CSOs, yes. CSO funding is an important issue and that was an important issue in a matter that was raised earlier in Queensland which is a competitive neutrality complaint by a bus operator, coach trains, against the CSO funding provided to Queensland Rail. That's an example where the competitive neutrality issue might raise some obligations on governments and mean that that has to be addressed in terms of the obligations on governments in national competition policy. But the broad issue of competitive neutrality between road and rail services really goes to the question of funding by governments of those services and those issues go beyond national competition policy.

We certainly recognise they're very important and we're very interested to see what you have to say on those issues because they're questions that we've had to face in declaration applications for rail services because as we were saying earlier, we've got a situation at the moment where we're looking at intermodal competition between road and rail in circumstances where we know road transport is working pretty well and there's a relatively high level of funding for road transport systems. But we don't think rail services, particularly below rail, below track services, are operating all that well and it's quite a difficult question to address - what would happen if we had both road and rail transport operating as efficiently - - -

PROF SCRAFTON: That's right, if we priced the infrastructure for the road carrier in a similar way.

MR WILLETT: That's right.

MRS OWENS: Yes, I think it is tricky and I think it is an issue that we can't ignore. I think we can't because of our terms of reference but we also can't because just about everybody raises it with us so it's a fairly fundamental question for us. I've exhausted my questions but I was wondering if there was anything else you'd like to say on the record before we close for morning tea, Ed, or Deborah?

MR WILLETT: No, I haven't thought of anything.

MS COPE: No, I don't have anything.

MRS OWENS: Okay. Thanks very much for that. I think we both appreciated that because we're still learning and I think each day it gets a bit clearer, so thank you for that. We'll now break for morning tea and we'll resume at 10.45.

MR ISAACHSEN: My name is Eric Michael Isaachsen, known as Michael, and I'm the director of Balance Research, which is basically a non-profit single person organisation.

MRS OWENS: Good. Thank you for coming, Michael, and thank you very much for the submission, which Derek and I have read. I understand you'd like to make an opening statement.

MR ISAACHSEN: That's correct. The two main competing modes of transport are very different in their use of resources. The historical fact is that the mode which uses more resources per unit of parts is offered to users with no defined user charge, whereas users of the other more efficient modes are expected to pay substantially. This of course is sending signals which ensure that the resource-hungry mode will be more and more in demand. No nation can afford to indefinitely support a more resource-demanding mode of transportation at a price systematically lower than a less demanding one, but that is what's happening.

The expectation of transport tasks is continuing to grow in line with the economy and population and eventually reaching four times the present levels. This is a device I have adopted for purposes of exposition. It enables me to point to the logical outcome of continuing the present policies, and conversely, the potential savings in resource terms of making a deliberate adjustment to address the failed market.

Many submissions I have read have pointed to the fact that railway operations enable savings in road-related costs, both direct and indirect, to states and local government and the wider community. Some have called for introduction of road user charging but they have stopped short of suggesting a direct means of equalising the pricing basis of road and rail. Many have pointed to railway investment and operating subsidies being justified because of improvements to community life, saving of accidents, reduction of wear on the road system, and these are often described as the social benefits of railways. Railway CSO payments are often explained in terms which include these factors, but these factors can be better explained as costs of the road system.

Balance Research has gone the extra mile - or extra tonne kilometre - by proposing an overt system of subsidy equalisation between the modes. By payment of equal subsidy to each mode, market distortion will disappear, the total subsidy cost will reduce and the total resource drain of transport will reduce.

The task of equalising the subsidies implies the need to lay bare the totality of overt and hidden subsidies currently available to users of rail and road. The aim of equalised subsidies is that the end user, in making choice of mode, will be faced with prices which reflect the true differences between the modes in terms of all costs imposed on the community. Although in principle the subsidy should flow to the user, in practice it will flow to the infrastructure and service providers to ensure more and better services. Reduced fares and tariffs will, I believe, play the minor role in user

choice, alongside service.

In terms of demand reduction, it is possible to argue that government should not subsidise transport at all. Once the total subsidy picture emerges, governments will need to make transparent decisions about levels of support. Governments will probably find it less unacceptable to impose collection of substantial road user charges if they have first ensured the provision of rail-based solutions adequate to meet the needs of the community for both passenger and freight. But for as long as it is not possible or politically acceptable to collect from road users the true and total cost of that usage, it will be advantageous to make the same concession to rail users.

The process of subsidy equalisation also carries the possibility of equalising the investment levels between the two modes. Governments and private investors will be happy to put money into rail against a guaranteed cash flow from equalisation payments to rail, or full road cost recovery. This is for two reasons: the transparent subsidy process will lay open the inherent efficiencies of rail and show that it really can control road growth. Governments really need to see that. Secondly, the resulting intermodal competitive neutrality will allow rail's natural advantages to attract a lot of business.

The bulk of the subsidy money will come from the same source as road subsidies. It will usually be cheaper to improve the performance of a road by building a railway for relief, and it will always be cheaper if this involves merely the upgrading of service on an existing railway. But there will be a need to blur the distinction between capital outlays and operating subsidies. That's because where you might have to spend 200,000,000 in capital to improve a road, what the railway may need is not capital but operating an annual \$10,000,000, which may still be less once it's capitalised.

The focus of transport planning must be on how to reduce the long-term growth of road demand, because that's what's eating up our resources. Nothing against roads. Roads will continue to be vital infrastructure and the route of last resort. They will continue to be upgraded for safety and quality but not necessarily capacity. People will still be able to choose road if that's what will best meet their needs.

Of course, good quality, safely engineered roads are of great importance to the community. Dangerous roads with poor services and alignment problems, not up to the standard for the permitted speed, will cause accidents. So will unchecked, aggressive driving. But it is a fool's game to expand road capacity whenever there is congestion. The expanded capacity will always be eaten up by new congestion at some stage.

This notion has fairly wide recognition but the mechanism does not yet exist to provide the rail-based means of relieving road congestion. The travellers who eat up the improved capacity of a road include many who would otherwise choose public transport. A lot of these would have been driving before the roads became congested. When it is relieved, they will revert to driving. In some years they may choose rail

again. Similarly for goods traffic. Shippers are not particularly interested in the mode used for their goods, just the service and price. If the road system is forever expanded to limit its congestion and then not adequately charged for, the road service and price will always be hard to beat. Road must be allowed to be congested at peak times. As long as a good standard of rail service is provided, people and goods will still travel satisfactorily and the political pressure will be relieved.

MRS OWENS: Good. Thank you very much for that, Mr Isaachsen. I was interested in your submission and in those opening remarks you made - but particularly in your submission you talked about future scenarios. I think what you were talking about here was the same. I'm always interested in the work that people do on these - you know, doing futures projects, and how you can look to the future and try and establish a potentially better future than if we just go the way we're going now. It can look quite dismal, so how do you change things. I've been involved in some of these futures exercises in the past and I always find them quite interesting. I'd like to come back to some of your opening comments in a minute but you talk in the submission about a target year.

MR ISAACHSEN: The page?

MRS OWENS: I'm looking at page 4. Earlier - and it might be on page 4 as well - you talk about the total transport task reaching four times the present level - this was back on page 1 - but rail will be doing well if it maintains its present percentage. I think the "four times the present level" was in terms of this target year. I just need to establish in my mind, are we looking 20 years, 50 years into the future?

MR ISAACHSEN: The target year is the year when the total transport task for the nation reaches four times its present level.

PROF SCRAFTON: But do you think that might be 2020 or 2050? Do you have a figure?

MR ISAACHSEN: If one had the proverbial crystal ball - but obviously four times, depending on the growth rate and how closely transport demand matches economic growth and looking at the economic growth forecasts, it's going to be an average growth rate of somewhere between 2 and 4 per cent, they hope. So it's going to be somewhere between 40 and 70 years that it reaches four times its present level.

PROF SCRAFTON: Earlier participants have pointed out to us that that sort of time-frame, particularly the 40-year example, is about the time that we may well have problems with oil supply.

MR ISAACHSEN: Indeed.

PROF SCRAFTON: So we've had other participants who have approached it from a rather different angle than you but at the same time have highlighted the long-term need for the railway. That raises the issue of, irrespective of what you do with the

railway corridors, you should protect them. Well, you don't talk about only railway carriages but all land and assets that might be used for transport in that longer-term future and not be taking short-term decisions to dispose of land and so on. I think that's on page 6, one of the dot points at the top of page 6.

MR ISAACHSEN: Yes.

MRS OWENS: There's actually an interesting article that we got in our press clippings this morning, which unfortunately I didn't bring down with me, but it's just a little snippet about something that's going on in Tasmania at the moment. There was a rail line to a mine, I think it was a manganese mine or something, and that was closed about 60 years ago. ATN is now proposing to - they're thinking about reopening a line to - - -

MR ISAACHSEN: I think there's a couple of examples in Tassie where ATN feels that they can run a train profitability.

MRS OWENS: Yes, but they're now meeting a huge amount of resistance from the locals and particularly from the farmers who have - that land has, you know, many years ago, become rural land and used for farming. So there's a real community backlash looking like it's about to erupt.

MR ISAACHSEN: It's one of the real spectres that haunt the idea of increasing rail to absorb the traffic growth instead of letting it go to road, is that increasing rail will certainly not please some people. If they're going to be near the rail tracks or near the marshalling yards, they will suffer. The total suffering may be less, because of the decreased road traffic - or anyway, compared to what it would have been - but the individuals who happen to be badly affected will scream, and already are. This is happening in not only Australia but elsewhere. So it is very much a community education need there for the long term. That's why the Balance Research project referred to in here has education as a really big part of it.

MRS OWENS: Yes. This happens everywhere you look. You often find the benefits are spread across the society and they would be spread by getting the trucks off the road, but then it's particular individuals that see that they're meeting the costs and they're the ones that speak loudest because they're the ones that - - -

MR ISAACHSEN: Yes, well, as much as people like myself call for the external costs imposed by road activity to be compensated for, as recognising the cost of road activity, that must apply to rail projects as well. If a rail project is going to make mayhem in someone's backyard, well, they should be equally justified to get compensation for it, as the people that we say should be compensated for all the trucks in their street. It has got to work both ways.

MRS OWENS: You talked about equalisation of subsidy in your opening remarks.

MR ISAACHSEN: Yes.

MRS OWENS: What do you see as being the subsidy to road - what are we equalising and what do you see as the subsidy to rail? I mean, there are some rail subsidies, like community service obligations and so on.

MR ISAACHSEN: Absolutely, yes.

MRS OWENS: So what exactly are we - - -

MR ISAACHSEN: There's a whole web of subsidies that go to transport and these come from all levels of government and they come from the wider community, in terms of putting up with the things which don't get compensated for. These are all subsidies. For example, the cost to the state government of public health programs which are made more expensive and have more implications because of road traffic - that's a subsidy to road but it's never recognised or taken into account. If there's a road traffic increase in the next few decades, traffic doubles or whatever, how much will the operating cost to the police department increase? That's a subsidy. I call for all those to be taken into account.

Then there would be hidden subsidies for rail as well as the overt subsidies and they would be similar - the cost of accidents, the cost of noise and so on. They've all got to be totted up. I don't think anyone - certainly not myself - can put a figure on these things at this stage, but I'm calling for serious research to lay bare the totality of all subsidies.

PROF SCRAFTON: Somebody told us yesterday that they thought the Bureau of Transport Economics was doing some work on - - -

MR ISAACHSEN: They have. They have published quite a lot of documents on it, but they don't really go far enough.

MRS OWENS: You're really saying that we need to spread the net very widely.

MR ISAACHSEN: Well, yes.

MRS OWENS: Quite a few of the submissions that we have had have talked about this road versus rail and talked about the sorts of things - that there are a whole lot of issues that benefit road. I've got about 10 listed here. There's payment for use of the infrastructure. The rail users have access charges. I suppose it depends whether you see vehicle registration as being an access charge or something else.

MR ISAACHSEN: Well, it's not a marginal cost so that's where the problem is.

MRS OWENS: Yes, and there's a fuel excise which - - -

MR ISAACHSEN: Which is a marginal cost but it falls unevenly, because the bigger vehicles may be more fuel efficient but per litre consumed they may do more

damage.

MRS OWENS: There is another issue that has cropped up there in relation to the GST and the reduction of the fuel excise. I don't know whether you've been following that.

MR ISAACHSEN: Absolutely. Well, that comes under the heading of demand reduction, or in this case demand promotion.

MRS OWENS: So there's fuel excise and there's sales tax on vehicles. In this case it probably goes the other way in terms of the sales tax exemptions on locomotives and so on but the vehicles pay sales tax. There's the overall level of investment in rail versus road and there's a significant discrepancy there. This is government investment and private, I suppose. Evaluation criteria are different for the two different sectors. There's one-stop shop access for road versus rail. There are not, you know, dollar subsidies but they can still have an impact.

PROF SCRAFTON: It can improve the efficiency.

MRS OWENS: And there's consistent access regimes for road and there's different access regimes for rail, national operating standard for road, they're uniform, and they vary across states for rail. Accreditation systems are different for road and rail and the safety regulations are different. So some of those you would call direct or indirect subsidies and some you would say are just different environmental or regulatory things. Are you saying that we need to take account of all those regulatory differences as well?

MR ISAACHSEN: I wouldn't necessarily count them as subsidies but they may be barriers which can be whittled down over the years at no particular cost. It's just a matter of legislators putting their heads together but this featured pretty heavily in the House of Reps report and I think personally it's a bit overblown as to its importance to rail.

MRS OWENS: What's overblown?

PROF SCRAFTON: The different standards?

MR ISAACHSEN: Yes, different standards between the states. They are problems. They do exist but I don't think they're as serious as some commentators say. The ones who squeal about them - I don't blame them - are the small operators who are wanting to start up and certainly from the point of view of having potential competition as a foil to the national rails of this world, I think it's important that National Rail be kept on its toes by competitors or potential competitors but over the decades there's not going to be that many people wanting to go into the rail industry and if each state has a reason to maintain its own signalling system or something like that, I can't see that it's an enormous problem in terms of the main issue that I am on about anyway, which is the total resource drain of transport will be reduced by rail and it could equally well

be reduced, as far as I can see, by having one Australia-wide operator, National Rail, going into every state and running the whole thing except for one thing, that they will become fat and lazy if they don't have competition or the threat of competition.

But really, they would be more efficient than a lot of small operators and there's also the aspect that National Rail has never seen itself as a universal service provider and that means a lot of small towns don't get serviced. National Rail goes through there, they don't give service. If there's a company with a siding there it won't get serviced. This may be changing, and I hope it does. But I believe that whoever is the main player in a particular geographic region or corridor should have that obligation of providing complete service to anyone who wants it, whereas a cherry-picker like SCT comes and just wants to run trains from say Melbourne to Perth, high frequency, high volume, minimal costs - I've drawn a parallel between this industry and the telecommunications industry which has a universal service provider requirement. The cherry-picker pays into a fund to help cover the cost of universal service and I think that could be applied to rail as well.

PROF SCRAFTON: Michael, one interesting feature in your submission on page 4 is you talk about not having the Commonwealth government fund the national highway system, in other words, of national importance. That's quite interesting because a lot of the submissions that come before us say that what we should be doing is the federal government should be providing a sort of equal amount or a large amount for rail in order to compensate. Yours is perhaps the only submission that we've got that says that that's not the way to go, that the Commonwealth should get out of funding the highways and what resources they do want to put into transport they should be providing to the states and the states should make the investment decisions.

MR ISAACHSEN: I think that's applied to rail too. The only exception - because I'm also saying they shouldn't be funding a national rail highway as the national road highway but they should be providing backlog funding because of all the damage that has been done to the rail network over the last 30 years. Once that backlog has been caught up, if there is equalisation of subsidy, rail won't need any further support, particularly at the intercapital level. The intercapital services on rail are the one that needs least support at all to get traffic off the road. It's very near to profitable. National Rail made a loss of - I don't know the figure - 50,000,000, 80,000,000 - something like that. It's not an enormous amount of money compared to the total cost and compared to the cost of accommodating that traffic on road if National Road were to close. It's very close to profitable. If they got some equalisation payment they would be making a profit and they would be only too keen to invest in further improvements to rail in the intercapital market.

It's the non-intercapital market on the same corridors, in most cases, that is the real worry - the Wangarattas, the Goulburns, the Alburys have very limited service from there to the capital city or between towns. So if you wanted to consign a container load or 50 container loads of goods from Wangaratta to Goulburn, quite likely you'd have difficulty getting it through on the rail because the sidings and

facilities have been down-graded or totally removed in many cases throughout the countryside other than for bulk commodities - which of course raises another point. The consolidated statistics for rail in each state or nationwide says how the total volume of goods going by rail has increased and they've reached new peaks and it's wonderfully efficient.

But if you take out the commodities which have to use rail - if you take out the mineral flows and the coal flows which are not contestable by road to any great extent - then you're looking at general goods going by rail, it's a very different picture and it's a very desolate picture. Without doing something about that, the road traffic will grow and grow and grow as I've foreshadowed and rail will, as I said, be lucky to maintain its percentage. If rail doesn't increase its percentage road and rail will both grow to four times. I don't think the community really wants road to grow to four times and is looking for a solution. It will become a political hot potato but what I'm worried about, it mightn't become a hot potato until 20 years' time, by which time more and more damage has been done. It has got to be looked at now.

MRS OWENS: So who looks at it now?

MR ISAACHSEN: Probably the new transport planning body that is being talked about.

MRS OWENS: The National Land Transport Commission.

MR ISAACHSEN: That's the one, yes. Probably they look at it. In England they have the Strategic Rail Authority which is doing the same job and it's only just starting so they haven't got a track record yet but they have to look at the road and rail scenario.

PROF SCRAFTON: That's a good parallel though. The Strategic Rail Authority was not put in place until they had some sort of crisis. That is the rather sad aspect of planning, that people don't deal with it until the damage has already occurred and that's one of the things that your submission is trying to point out, that if you leave it then it will just be more difficult and particularly if you let the asset decline.

MR ISAACHSEN: Yes, the previous government in England set up all the private railway operators - freight and passenger - and the rail track companies to provide the tracks. They didn't foresee, 5 years ago when they set all this up, how things would pan out and there is an increasing demand for rail which is good because they've decided not to build major extensions to the freeway network but that's just making a crisis. They have failed to go the extra step of giving additional subsidy to rail operators and rail service and infrastructure providers to be ahead of the demand. You've got to look ahead of the demand. They think they are in England looking ahead of the demand but I say that they're only looking 10 years ahead, not enough. Still, it's a step in the right direction and as you say, once they began to get into difficulties, the new government has set up this body, the SRA, which can only do good if it goes far enough.

MRS OWENS: But it hasn't really got going in any - - -

MR ISAACHSEN: No, it only started a few months ago.

PROF SCRAFTON: It was an initiative of the incoming Labour government a year ago.

MR ISAACHSEN: Correct.

PROF SCRAFTON: You mention in your paper also that if given the limited investment and so on, that you would prefer to see a fund - relating to that, you would get better return for funds which go into improving the existing system rather than necessarily building new lines or extensions or so on and I just wonder how you feel about the way in which investment in railways is being spent now, given that you have all these high profile projects - - -

MR ISAACHSEN: What's being spent now? There's things in the pipeline but I don't know there's much being spent right at the moment except for coal lines and heavy mineral traffic. I believe it's extremely important to upgrade the existing lines but of course there is always scope for new lines and I think the mere fact, if it ever happens, of the availability of subsidy equalisation - don't forget equalisation doesn't necessarily mean the rail subsidy goes up. It could be that the road subsidies are cut out, but that's politically difficult and probably won't happen. Whichever way they're equalised, once that happens investors will come out of the woodwork to build new lines anywhere across Australia like the ATEN proposal through the outback.

It's perfectly viable so long as it doesn't have to face road transport which is heavily subsidised unilaterally and the very fast train from Sydney to Canberra and hopefully extended to Melbourne could be providing an additional track which, although it would be dedicated to passenger service, ultimately in practical terms the two tracks will provide relief to one another, particularly in the event of breakdowns and congestion and that sort of thing. It can only do good and there's supposed to be no net cost to government, no net cost to the taxpayer and it will be so long as you have a broad enough definition of cost.

In addition to the statement that I already made at the beginning of this hearing, I've got a few comments that I've added in to the original document, just a few explanations and amplifications.

MRS OWENS: That would be useful because I was going to - I don't know what they are at this stage but I was going to see if you would run through some of your - - -

MR ISAACHSEN: There's probably one or two points on each page.

MRS OWENS: Okay, that would be very useful because I had a couple of questions on each page.

MR ISAACHSEN: On page 1 at the bottom, the last paragraph about growth outcomes not being acceptable, it really covers what we were talking a moment ago.

PROF SCRAFTON: That while we're making plans we need to plan for it now.

MR ISAACHSEN: Yes. By the time it becomes unacceptable and becomes political, governments by that time will have rediscovered rail as a substitute for road and air growth but it will be impossible to achieve the needed outcome if the action waits until the problem is that acute. If you've got questions on the particular page do you want to come to it at the same time?

MRS OWENS: Yes, okay, I think we'll do that. I wanted to clarify, when you were talking about intergovernment on page 2, intergovernment land transport strategy, and I think we've just covered that too, whether that would be the National Land Transport Commission.

MR ISAACHSEN: It would be, yes. This is just, you know, my formula for it, which I haven't finished putting documents together about it but it's the direction I'm wanting to - - -

PROF SCRAFTON: There is machinery now but it tends to be ineffective. I think that's the point. What we're looking for here or what you're suggesting here is that we need to have an intergovernmental land transport strategy which is effective. We've heard participants and we mentioned in talking between ourselves before that there have been efforts in the last 10 years to try to do this but unless there is a commitment and a comprehension of the long-term significance of what is being done, you just get a succession of reports one after the other which is a problem that we face even in the work that we do.

MR ISAACHSEN: Yes, well, there certainly have been a lot of very fine reports from this organisation and its predecessors, and many others, and they're all on the shelves.

PROF SCRAFTON: Although, as somebody pointed out to us yesterday - I think two participants did yesterday - that if you look back and do a little check list, which we will be doing in our draft report, we think about the current problems and the future problems as you have done. But a lot of changes have been made since 1991. It's amazing, the number of Industry Commission rail reports prepared. But you're quite right. I mean, that's - - -

MRS OWENS: Yes, the Australasian Railways Association actually did a three-page check list on the recommendations from the 1991 rail report and went through and divided the recommendations into those that were implemented by the rail industry itself and those that were meant to be implemented by government, and just went through and did a bit of a check on what was achieved and what wasn't achieved.

MR ISAACHSEN: I've had a bit of a look at it.

MRS OWENS: Yes, and I might refer you to the transcript because we had a bit of a discussion about each of those, because we did question where they'd said that access regimes had been put in place. We questioned that. I mean, it's true that we have been moving in that direction but - - -

MR ISAACHSEN: Some other witnesses might have thought they weren't quite in place yet.

MRS OWENS: Yes, exactly. Can I just ask you - just coming back to the inter-governmental land transport strategy, that would involve local government as well as the others?

MR ISAACHSEN: Absolutely. I think they're a key player, particularly when it comes to persuading people to change their habits.

MRS OWENS: Yes.

MR ISAACHSEN: Because they're the level that really knows every individual and certainly the local companies that shift goods. Just in that section, talking about studying the costs, the third paragraph, Cost Must Include all Forms, talking about average cost is misleading and that's all we get from a lot of commentators and a lot of reports say the average cost of this and that. I have at times read that every train traveller is being subsidised by, say, \$2.43 per trip because the subsidy was 486,000,000 and there were 200,000,000 trips - and that's what they tell the public and they say, "What an enormous subsidy to go to rail travellers." But a great part of that cost is on the network cost and the basic service structure.

If the patronage were to double, the subsidy needed for the extra trips might only be, say, 50,000,000, 50¢ per trip, or maybe even zero if the marginal costs were equal to fares. As against that, what would be the marginal cost of that increase of a further 200,000,000 trips going to road? This would be related to continuing the urban sprawl with its additional infrastructure of costs, not transport infrastructure but general urban infrastructure costs from urban sprawl, on top of the obvious road related costs like accidents, policing and so on.

In the previous section, Driven by Market Distortion, another factor that distorts the market - it's inevitable but there is a difference between road and rail in regard to safety standards: the far higher safety standards of rail, more expensive vehicles, more expensive operational systems, rigorous training and no scope for individuals to beat the system. It's an enormous difference in cost. If road had to comply with that sort of safety standards, you know, they'd be out of business. My next comment is on page 3 if you haven't got anything - - -

MRS OWENS: I had some questions on page 3 but we've discussed them as we've

been going. So whereabouts on page 3 are we?

MR ISAACHSEN: The fourth paragraph, Maintaining Effectively Subsidised Transport. This is about demand reduction. The subsidy for rail and subsidy for road need to be very closely looked at because there may be a link into the matter of transport subsidy from world trade policy, which is being looked at. The issue of defining subsidies in services is very much a live issue in WTO negotiations and it's very important, quite essential, to be sure that subsidies to road operators are identified as well as subsidies to rail operators. We don't want them to come along and say, "Well, WTO says you can't subsidise the rail." We're already subsidising the road. It has got to be made clear.

MRS OWENS: That's a very useful point. I don't think we've actually given WTO a lot of thought in the context of this inquiry. But you've just raised an important point in my mind, thank you.

MR ISAACHSEN: At the bottom of page 3, talking about investment and that Balance Research do not support calls for the National Rail highway to be Commonwealth funded as such and so on. I would just like to say that I think once the inter-capital links have caught up to what they would have been under better past policies, no ongoing funding will be needed, and in the case - - -

MRS OWENS: But you mentioned earlier about inter-capital links.

MR ISAACHSEN: Yes.

MRS OWENS: What happens if they're not viable, or do you think they will be?

MR ISAACHSEN: They will be totally viable. They will be goldmines.

MRS OWENS: Once you've equalised the subsidies.

MR ISAACHSEN: Well, certainly with equalised subsidies and certainly even - - -

PROF SCRAFTON: Just with the capital infusions?

MR ISAACHSEN: Certainly with the capital infusion which I regard as a catch-up or backlog payment rather than an ongoing investment need. Any future investment needs will be met by the users, because once you've built that track up to standard it will beat road. Don't forget - I mean, I'm sure you wouldn't have forgotten, but it was not that many years ago that the government of the day was considering duplicating and electrifying the whole way from Melbourne to Sydney. Now, if you had a 160 KPH electrified train service for goods traffic the stuff would be in Sydney in less than 8 hours and it would have unlimited capacity in terms of the next few decades. There would be no need for road expansion whatever.

MRS OWENS: Can I ask you just before we get off it, the backlog funding that

you're talking about, are you talking about the same level of backlog funding as, say, the Neville inquiry?

MR ISAACHSEN: Something like that, yes, 3 billion or something.

MRS OWENS: So 3 billion.

MR ISAACHSEN: I mean, obviously the scope to look at going beyond what they've talked about. They've talked about what's really necessary to bring it up to reasonable fast freight train standard in today's service. I might be inclined to go a little beyond that in terms of what it would have been now if policies had been different over the last three decades and if policy had been different, well, it would be even better than the standard that is now considered the minimum. I mean, the \$3 billion brings it up to the minimum standard. It's not necessarily the standard or the capacity to prevent future road growth and to do that, probably at some stage you would have to at least have a double track.

Now, the question of electrification is really outside this because the trade-off for electrification is not in speed of service, it's in terms of emissions mainly, more than anything else, and that's another issue and I feel - well, it's also in terms of resources, of shortages of liquid fuel in decades to come. That will justify the electrification, if it ever does. But at least if there was a double track all the way from Melbourne to Sydney it's going to cost a lot more than the 3 billion, but it will save far more than that in road expansion, road maintenance and all the nasties that come from that.

Just expanding on that a little without trying to duplicate, yes, the highway could never aspire to an 8-hour transit from Melbourne to Sydney or it should not anyway. Some truckies might do it but they shouldn't be. This improved service, that's the double track, would be capable of absorbing all inter-capital growth for some decades. The only further capital investment would be needed when the expanded railway is nearing saturation and at that time it would have to be decided whether the government would pay for that or whether the operators, because the inter-capital traffic is going to be a goldmine. Once it improves service over road it will be a goldmine.

The operators will probably pay for that, but the thing is at that time we might be looking 30 years down the track. The government might decide that they would rather not just improve the capacity of that railway but have an alternate railway as a back-up. It could be a railway via the east coast down through Nowra and through Orbst and Bairnsdale, or there could be a railway through the middle like the ATN group proposed and the government might decide to invest in that for security reasons. But as far as just capacity growth, I don't think there would be any further investment required - quite likely that the private capital would do the upgrade.

But truly inter-capital traffic probably accounts for less than half of the total transport demand on this corridor. The non inter-capital or wayside rail services have

been allowed to wither on the line. Many stations have lost most of their facilities and restoration of these wayside services will automatically follow when the availability is there of equalised subsidy payments. But some backlog investment would still be necessary to restore the lost facilities.

PROF SCRAFTON: There is evidence that those sorts of traffics are being sought out by some of the smaller operators, some of the niche operators. Already there's evidence of that being leaked out.

MR ISAACHSEN: Yes, that's right. I mean, you look at Austrac which runs from the Riverina into Sydney. Now, some people describe that as a short line because their actual operating territory is only a short line from where, Junee to Griffith or something. But it's not a short line operation in the classical sense because - - -

PROF SCRAFTON: It doesn't feed the lines.

MR ISAACHSEN: It doesn't feed a line.

PROF SCRAFTON: It actually runs on it.

MR ISAACHSEN: It runs its mainline services. There has been talk in the last couple of years of debate with the House of Reps committee and previous inquiries about short lines being encouraged in Australia and Austrac is held up as an example of it. But really any branch line that is under threat or has been closed and wants to reopen, they should be able to pick up traffic on that line and have an interface at the junction, and that is with the universal service provider that I mentioned before.

PROF SCRAFTON: Right, you mentioned that.

MR ISAACHSEN: That obligation, if it's not written into the rules when National Rail is sold or FreightCorp is sold and so on, then I'm afraid it won't be done because it will be an additional cost to them and that will prevent quite a lot of traffic from adopting a rail solution. It will force the increase onto the road - as long as these operators are able just to run between the big towns and forget the branch lines. So we don't want that happening.

MRS OWENS: Do you think it will be written into the rules?

MR ISAACHSEN: I don't think it has been thought of.

MRS OWENS: Don't you?

MR ISAACHSEN: I don't know whether you can correct me there, but I've never heard any mention of such things. But I think that short lines are important and that's not what we have in Australia to any extent at this stage.

On page 4 I've just got a very brief comment about the rail-based futures

approach. In the second paragraph of that, "The prospect of road traffic ever reaching four times" - and government could make rail sufficiently attractive, as it says there. I'd like to say that I believe that governments could make rail sufficiently attractive to absorb the growth, probably at no net cost to government and certainly at no net cost to the whole community. It depends just how wide you spread your net of what is cost. But I do believe that this rail system could absorb all the growth for the next time to come, but of course it is ultimately going to be a compromise. It may absorb quite a worthwhile amount of growth but under current indications I'm afraid it's only going to absorb its own share of the growth.

PROF SCRAFTON: I think that's a very important contribution of this period. That is, that a lot of the effort that has been made in rail reform might well result in railways just keeping up with the game, if we could call it that.

MR ISAACHSEN: I'm afraid so.

PROF SCRAFTON: Not actually using its competitive ability to actually capture the - - -

MR ISAACHSEN: I might add that in the main paper which is still in preparation an important part of it is, private railways which don't carry public traffic at all, like the sugarcane and the iron railways, should also get a subsidy equalisation payment if the work they're doing is contestable by road. If a major ore mine is going to set up I don't think that it applies because road is just not viable. But if you get a new sugar farmer and he has the option of using road or the option of spending \$1,000,000 on putting in rail, if he decides to do that he's keeping his trucks off the road to quite a large volume of trucks and I think that the state road authorities and the local council should reward them for doing that, which at the moment they don't.

PROF SCRAFTON: Not that we've heard anything about the sugar tramways, but those that are there seem to continue, but do you see new ones or railways shifting from one - - -

MR ISAACHSEN: You see expansions of the existing networks as farmers come on line with a new farm or a new acreage. This is only by reading the sugar mills' report. I must say I haven't been up there, much as I'd like to. But they have to bear the cost of it. They work out that it still is cheaper for them to do that than to use the road. But that's still not enabling them to be rewarded for saving the local authorities and the state government millions and millions of dollars. Recently they needed a crossing, a rail crossing across a highway, and they were made to spend I think \$3,000,000 on making it grade separated just for the seasonal traffic. That should have been given by the government because - - -

MRS OWENS: I suppose the government is going to say, "Well, they're going to do it anyway so we'll save our money," and - - -

MR ISAACHSEN: Of course they are, but in general - I mean, there will always be

marginal cases where they decide not to go on rail.

PROF SCRAFTON: Yes, that's right.

MR ISAACHSEN: Because they're not going to get any recognition and it's of only marginal saving to them, or none in some particular case - depends how many miles of track they want to - - -

MRS OWENS: The government is never going to be able to identify those marginal cases.

MR ISAACHSEN: They could probably work out some kind of ad hoc basis for doing it, or do it on a tonne-mile reward even, you know, 1 cent per tonne-mile.

PROF SCRAFTON: Particularly given that governments do that all the time. Using the grade separation example you used - you know, if a bridge falls down or looks dangerous in an existing metropolitan situation, the government will not hang around arguing about who should pay for it. They do the job first and then the bills get sorted out later - you know, maybe a local council working with the state government and the railway organisation. But there are precedents for solving the problems.

MR ISAACHSEN: Yes. But now they've started the new sugar industry in the north of Western Australia, and as far as I know they are going to use road transport only for that. Who knows whether they might have decided to use a more environmentally friendly means of transport? I don't know whether the road they're using are private roads, but if they are that's one cost saved by the government but there's still the cost to the community in other ways. I think it would highly desirable for any kind of activity which puts traffic onto a more environmentally friendly system to get some kind of reward or recognition.

MRS OWENS: If you'd like to just run through the rest of them. We're just running out of time, Derek has pointed out.

MR ISAACHSEN: Sorry. Under RBF Outcomes, just explaining - I've said rail traffic will have grown by factors of up to eight times or 30 times, and you might have wondered how I get these figures. Just to look at the arithmetic, if rail is carrying 25 per cent of a certain corridor's flow and road 75 per cent, that's 100. Let's call that 100 units. In some decades the total flow may be 400 units, and if government policy were to adopt what I'm talking about they would want to retain the road traffic at its present level and let all the growth be absorbed by rail, putting money into rail, not road, because you put less money in. So the total task will eventually reach 400 units but the highway demand is pegged at its present level of 75 units. So the rail is then carrying 325 units, 13 times its present level. If a corridor carries only 5 per cent on rail, that figure comes out to a factor of 61. It becomes meaningless when you get to the very low levels. That's how that arithmetic works out.

MRS OWENS: Thank you.

MR ISAACHSEN: On page 5, rail freight re-established in most country towns. A new paradigm is needed to assess what is the rail demand. In the past, and even at the present time, railway operators look at their own loadings and decide whether to increase or decrease services. This would be valid on an already busy railway, but to assess the demand for services on an under-utilised line, typical country branch line situation, it's essential to be looking at the total traffic in the corridor. If there are 2000 cars each way per day but only one or two trains each way, it's not very informative to look at how many people are using the train.

Halfway down the page, talking about captive travellers and non-captive travellers and what levels of feeder buses and cross-town services are needed, I believe there are in fact millions of families in Australia who would be glad not to own a car so long as their needs could be adequately and safely met by public transport, and innovative services are needed. These might be combined rail and hire-car, combined rail and overnight parking, combined rail and shopping delivery services, that sort of thing.

PROF SCRAFTON: We've had a lot of submissions too from people who say combined rail and bikes.

MR ISAACHSEN: Absolutely. Under the Rail-Based Futures Functional Policy, the second point, about for as long as it's not possible to collect road user costs, to "adjust the rail charges to ensure the same level of subsidy" - of course, that's oversimplification. It's not just a matter of adjusting the charges, because much of the subsidy would in fact go to infrastructure and service providers.

Just over the page, protection of assets: it's not only land but valuable infrastructure and equipment that should be saved. For example, Victoria's government is not using its one and only electrification of a country line. 60 kilometres of this electrification have been dismantled and the remaining 40 kilometres are due to be dismantled shortly. That goes from Pakenham out to Traralgon, now to Warragul, and they're going to cut that back. Obviously there's some chance that electric trains will be warranted again in a country service, and they've destroyed a lot of that asset and they intend to do the rest. I think they should have another think about it.

PROF SCRAFTON: Could I just ask you a question about that? Was that because it was due for replacement? Very often the electrifications are not - the point at which they're abandoned is when major maintenance or replacement is due. Is that the decision - - -

MR ISAACHSEN: I can't give a definite answer of that, but certainly parts of it would not be due for replacement. Perhaps the contact wires are worn out. Maybe some upgrading would be required if they were going to run a fair dinkum service on there, but the cost of installing this plant is enormous if they have to put it back. But

I'm worried about intergenerational equity, because it will be the next generation that's got to pay 200,000,000 to put that back.

Unwanted locomotives are scrapped while they're still serviceable because the operators, mainly governments, think, "Well, traffic is going down. We've got some new locomotives. Why would we want more locomotives?" But if traffic happens to go up a little bit and there are opportunities there for branch line operations, which are now viewed rather in a "down" attitude, these old locomotives, although they're not as efficient as the new ones - they use more fuel, put out more smoke, but if you're using them in every small way at least the locomotives are there. If someone says, "I'd like to use one. I've got four wagons to bring in from somewhere to somewhere else," you send out the old loco. You don't have to wait and say, "We can't give you service for 4 years because we'll have to buy some more locos to do this."

About the universal service provider, which is mentioned in this, it is said that National Rail refused to carry certain traffic types earlier in its career. It possibly didn't suit their chosen methods of operation. Possibly the margin wasn't in it for them. Some of that traffic went to road and some went to innovative operators, but only for very long hauls. So National Rail, as the state railways had done, turned back certain traffic opportunities because they didn't have any pressure. I believe now National Rail is only too happy to carry vans, but at some stage, so it's been recorded in evidence, they wouldn't carry vans. SCT came along and hired 200 vans and ran their trains and now National Rail are happy to carry vans. I hope that's true, but that's what I've heard.

The program of public education - I'd just like to add that this should include a new emphasis on railway technology and railway management in tertiary studies and a reinvention of something pretty simple, enthusiasm for railways at all levels of education. It's totally gone.

PROF SCRAFTON: We haven't got time to talk about that, but that is a very important topic. There is a perception of railways in the community which will not engender the sort of changes that you want to see unless it can soon all be changed.

MR ISAACHSEN: Yes, that's right.

PROF SCRAFTON: There is on the one hand the attitude - the old steam trains - and on the other extreme you've got the concept of new high-speed trains and Maglevs and so on, but the guts of the railway, what the railway does in its everyday business, is not understood.

MR ISAACHSEN: No. That's why I've chosen to make a big point about education. The other point I'd just like to draw on - I haven't heard it mentioned anywhere - I've called it, "Why the community subsidise urban rail or urban transport." What is the value to the community of having a commuter rail or transit system? "Okay," they say, "it's to keep cars off the road, to keep cars out of our suburbs and minimise local pollution; avoid the need to build more and bigger main

roads and reduce the road toll; control urban sprawl and blow-out of public infrastructure in greenfield suburbs; promote a higher-density living; and all these things."

By means of "political evaluation" the avoided cost of these detriments reflect into the amount that government is willing to pay for that avoidance. Availability of suitable transport for those unable to drive is also a consideration but maybe a by-product of the more pressing needs. So if the subsidy paid for railway infrastructure and operations is, say, \$1 billion per annum, that is the lowest valuation put on the benefits of the railway. The final thing - I'd just seek your indulgence - is to comment on a couple of findings of the House of Reps committee.

MRS OWENS: Please do.

MR ISAACHSEN: It's not anywhere in there; it's just something that occurred to me last night - well, it occurred to me when I read that report, but occurred to me to mention it to you. I've got a few reservations about their recommendations. While the overall thrust is excellent, just what the nation needs, there are some details which warrant a comment. One is about double stacking of interstate freight. They've made quite a strong mention of this, but in the very long term the need for it may not be that apparent, particularly if there are ever going to be double tracks between the capitals, because the main benefit from double stacking is to have shorter crossing loops. Of course, on double track that really doesn't matter at all. Also there is a conflict between double stacking and the long-term need for electrification. I don't think you can have both.

PROF SCRAFTON: You probably could but you'd certainly have to plan for it, as you said. The clearances you would require are enormous.

MR ISAACHSEN: The clearances would be enormous, but whether you can have a locomotive with a pantograph that high - - -

PROF SCRAFTON: Long enough, yes.

MR ISAACHSEN: I don't think it's been tried. The other thing that they've made very strong mention of is fuel tax hypothecation. They don't like it. They feel very strongly against - - -

MRS OWENS: I think they're not saying they don't like it; I think they say it doesn't happen.

MR ISAACHSEN: That's right, and they recommend that it be more clearly struck out of the legislation to make it perfectly clear that there is no such thing. But I think there's a bit of a weakness there. They recommend very strong against any perception that fuel taxes are road taxes. They could have recommended to make them that way, but they recommended to make it totally clear that they are not road taxes. The reasons for their conclusion are perfectly valid from a parliamentary point of view.

However, this does little to change the natural perception in the minds of road users that they are paying a tax for driving. In turn, this makes them feel that they paying for the road, no matter what Mr Neville says happens to the money. They see that railways receive subsidies but they don't see that road operations also receive subsidies because, as far as they can see and feel from their pocket, they are paying.

The alternative suggested in the above document, in the Balance Research suggestion - Intergovernment Land Transport Strategy deals with this area - could be considered, in which the whole of the fuel tax, less the obvious deductions, is paid to the states for transport-related purposes. The deductions would firstly be the part of the tax which is the equivalent of the normal sales tax, then the amount spent by the Commonwealth and any amounts paid under tied grants. The balance would be divided among the states on some equitable basis - they'll probably fight over it - and it would be found, I suggest, that states already spend more than this amount on transport-related matters, including policing, hospitals, public health, urban transit, road-building and maintenance and grants to councils for all the above. So this scheme would not involve any increase in payments, just identification of some part of the existing flow, and at the state level it would not involve any changes in outlays but allow a public focus on the real cost of transport.

That's it.

MRS OWENS: Thank you very much for that and thank you for all the time you've spent with us. It's longer than we anticipated and I hope - - -

MR ISAACHSEN: I'm sorry about that.

MRS OWENS: No, I'm hoping it hasn't held you up.

MR ISAACHSEN: No.

MRS OWENS: I think we might close now. We'll resume at 1 o'clock with the Queensland Mining Council.

(Luncheon adjournment)

MRS OWENS: This afternoon our final participant for this round of hearings is the Queensland Mining Council. Would you each give your name and your affiliation for the transcript.

MR KLAASSEN: Thank you. Ben Klaassen, economist with the Queensland Mining Council.

MR LEACH: Noel Leach, manager of government relations and corporate head of BHP Coal but appearing as a member of the Queensland Mining Council.

MRS OWENS: Thank you both for coming and thank you for the submission and I should say that the commission is also very appreciative of BHP in terms of the contribution which you've made to our inquiries in the past and you made a submission to the black coal inquiry. As you're aware, that final report hasn't yet been released but we're hoping that it will happen any time now. So there are some issues that we'll discuss today that obviously will have been picked up in the final report of that inquiry but you're welcome to reiterate any concerns you've got if you want to reiterate them again. We may not, in our report, be duplicating a lot but we may reinforce. So thank you for coming. Would you like to make any opening comments before we ask you questions.

MR KLAASSEN: Yes, we might make a very short opening comment just pulling out some of the key aspects of our submissions and for this inquiry we would like our submissions to entail the document we understand you've previously read which is our submission to the previous black coal Productivity Commission inquiry and the letter sent to the commission dated the 10th of this month. As we pointed out in that more substantive submission to the previous inquiry, rail reform is particularly important for the Queensland Mining Industry and the coal industry in particular. We support moves over the last 5 years in Queensland to more commercial efficient pricing of coal rail services but reform has not gone far enough or happened quickly enough in our view and that perception was supported by the draft findings of the previous black coal industry inquiry.

Building on the findings of that inquiry we would expect would be one of your key objectives, given that a lot of good work was done in the previous exercise and just to bring the commission up to date with developments since that inquiry and since that earlier longer submission, since then the state government has conducted an internal departmental review of the structure of Queensland railways and unfortunately, in our view, decided to preserve Queensland Rail as an integrated entity and we believe that was not a pro-competitive decision and cast doubt upon the Queensland administration's commitment to effective delivery of access - even-handed rail access. The commission's draft report of course was released and we're assuming that the final report will have recommendations similar to the draft report, supportive of the need for the development of a comprehensive rail access regime in Queensland and for that access regime to have certain transparency qualities which inspire confidence in the pricing approach and in efficiency and the fairness of that pricing approach.

The Queensland government recently lifted its moratorium on coal rail access. That was a regulation which replicated the moratorium in the Commonwealth Competition Act. That was a positive development but needs to be kept in perspective. We believe it was primarily motivated by the perception that the prospective coal haulage market had been secured to QR by the fairly recent conclusion of a number of long-term rail contracts and that's a major issue I would like to come back to. The Queensland government has submitted its rail access regime to the National Competition Council seeking a recommendation in favour of certification and we can talk about that if you wish. Most importantly, Queensland Rail has produced a draft rail access undertaking document. This document is pivotal, in our view. It is the document which will describe in detail the terms and conditions under which rail access will be offered in Queensland.

It's a credit to Queensland Rail that they produced the document for consultation with major stakeholders such as the Mining Council earlier than they strictly needed to. The formal process is that they produce the document and submit it to formal public inquiry under the auspices of the Queensland Competition Authority but they have added another step, which is talking to us and others. We've been engaged in intensive consultations with Queensland Rail on the undertaking over the last few weeks in particular. Those talks are going well. We don't expect to agree on all matters but if nothing else we hope that those talks will produce a much better level of understanding on both sides of our objectives.

In closing the opening statement I would just like to come back to a point mentioned earlier and that is the issue of the long-term coal haulage contracts already existing in Queensland in respect of - or between the coal companies and Queensland Rail. A lot of this debate about the design of an access regime could be academic for quite some time unless tonnages are in some way freed up from existing coal mines and made available for prospective coal operators other than QR to compete for. We believe those contracts - and this is a policy matter, as we see it - need to be broken up, separated into their access infrastructure and haulage components and for the latter components to be made contestable to produce that market. I have nothing more to say. Noel, is there anything you would like to add?

MR LEACH: No, nothing to add. That covers it fairly well.

MRS OWENS: Good. Thank you very much for that, Ben, and you've mentioned a few things that we probably will come back to in a moment. I got the general impression from what you've written that there have been a number of steps taken by the Queensland government, one of which was to introduce these freight concessions and the other was these long-term contracts. I'm just wondering to what extent you view what Queensland Rail has been doing as trying to shore up their position in preparation for competition to make it more difficult for other competitors to come into the market?

MR KLAASSEN: I believe that Queensland Rail has taken advantage of the

moratorium or the perceived moratorium that was to exist until late in the year 2000. They have taken advantage of that extra period of incumbency to secure or rather renegotiate long-term haulage contracts that were always due for renegotiation in this period towards the latter part of this decade. I think the original Queensland government's insistence on the coal rail moratorium in the Commonwealth legislation was motivated by that strategy. In addition, I believe that the recent package of limited short-term concessions that Queensland Rail has offered to the coal industry is probably a genuine attempt to be more responsive to the market in the particular circumstances prevailing at the moment in respect of coal but as we say in our letter, it is peripheral to the main issue. It doesn't go far enough.

PROF SCRAFTON: Yes, what's not clear is why the coal companies would sign these contracts which seem to be diametrically opposed to what your idea of what they should look like, that, you know, the fact that the contracts are not unbundled and yet the companies have signed up. Is it a function of timing? Is it a fact that they were signed before the competition policy began to take effect? I mean, the way you spoke there suggested that some of them were fairly recent.

MR LEACH: I think it has been very much a matter of timing and governed inasmuch by a lack of any suitable option to take. In negotiating those contracts, and I know my company in particular have renegotiated some in the last 18 months to 2 years, we were very, very keen to have short-term contracts that would allow us the flexibility to take advantage of competition when, and I guess if, it came about. With the moratorium lasting until the original date in 2000, it was obvious that it would be some time beyond 2000 before practically speaking you could have a third party up and running and that was evidenced by the fact that there was no access undertakings in place so very little prework could be done to speak to third parties because no-one knew the ground rules and the terms on which access would be granted. Of course, once you get to that stage you have a very significant time lapse before a successful third party could acquire the necessary rolling stock to actually begin moving your coal..

So whilst those contracts were signed, the time factor was critical in doing it and also, as I mentioned, whilst we wanted short-term contracts, QR was adamant that long-term contracts would be all that they would look at. While some shorter periods were talked about, the pricing signals were such that you would virtually rule out going to any shorter period. They were significantly higher priced to certainly force everyone down the long-term contract road.

PROF SCRAFTON: Thanks for that. Could I just follow that up with another feature. You mentioned in your introductory comments and also in the letter that you saw the unbundling as being a policy matter. But Queensland Railways is always trumpeting the fact that it's a corporatised organisation so why couldn't they make that decision themselves?

MR KLAASSEN: You're right. That's a good point. They could, at least in theory. I suppose the reference to a policy matter is our assessment of the

Queensland political scene. It's difficult to go much further into that. That might be a question of course that needs to be put to QR.

PROF SCRAFTON: Yes, I guess that's right. It's perhaps a little unfair. It's just though that you're the ones in your letter that drew attention to the fact that there seems to be this distinction.

MR KLAASSEN: You're right.

PROF SCRAFTON: On the one hand they're very proud of the fact that they're a corporatised, vertically integrated organisation with all the benefits but when there are potential benefits to clients they seem to have - if I could sort of paraphrase all we've just heard - got you coming all ways and that seems to be the issue. But that does help us to understand the long-term significance of your policy thrusts. Could I just pick that up a bit further. One of the other encouraging things in your letter is that although the network access group is within the QR organisation and with all of the potential hazards that that could incur, the tone of your letter is very encouraging about the sort of discussions you've had with them, which suggests that at least the management of the track access organisation is attempting in all sincerity to operate as freely as the managerial and government controls would allow them to do so within the constraints.

MR KLAASSEN: That's our perception. We've had good talks with the Queensland Rail network access group which we appreciate and we'll make the most of. It detracts somewhat, but doesn't completely negate, the basic fundamental conflict though, of course, that under access, invariably, the chief executive and the board of QR will be making decisions about growing the business on the one hand and decisions about admitting competitors whose objective is to take away their business, and meshing those two, as we said in the letter, we think will cause them headaches.

PROF SCRAFTON: The old Commonwealth involvement in railways does give an interesting model there, because the track access organisation was originally within AN. However, there wasn't the complication there in that a lot of the traffic the Track Access Corporation were managing those tracks. Australian National itself had very few traffics left on because National Rail had taken that traffic. Nevertheless, the operation of the organisation gained a lot of respect for its ability to operate despite that control from them, the management and the board and the government. Now, of course, we have out of that the Australian Rail Track Corporation. So maybe if that model or that succession of events was to occur in Queensland your initial discussions with them might just be the first step. If we use that AN model it might take us back 5 or longer years.

MR KLAASSEN: A lot of it is going to depend on what backs up these discussions. It's a different matter to have good, frank talks and to prescribe intentions and undertakings in words and to have that backed up with real disclosure that allows verification of the things you've talked about. That transparency aspect is one of the key areas that we're still getting to in a more serious way in these talks.

But, yes, given that we appreciate that QR has the structure that it's got now, is going to be that structure for some time to come, we expect, then it's a matter of making the best of it, but it does put a greater onus on some of the things like these probity guidelines which are being developed; like transparency; like the nature of the proposed access agreements that QR says it is going to develop between its network access group and its haulage arm.

MRS OWENS: Can I just go back one step to these contracts, the long-term contracts, just before we move away from that. There is a question about how easy it is to actually go back and look at contracts once they're signed. There is a potential there to renegotiate a contract, is there? If you wanted to unbundle it, you can go back and do that?

MR LEACH: With the agreement of both parties, yes, that's correct. Both parties can always agree to go back and change the terms. Historically we've found it very difficult to convince Queensland Rail that contracts should be reviewed. They've very much taken the position that, "You've signed that contract. That's it. We are under no obligation to go back and review it." I believe at this present time that they believe that their existing contracts are watertight and if they wish to enforce them they can do so for the full duration.

MRS OWENS: Also I think what you're trying to do by unbundling - you're making very transparent the - you need to be able to understand the costs of the infrastructure and the costs of the haulage components, and that's actually opening up something that has never had to be opened up before. So you I think meet even greater resistance from QR and perhaps that's why you do need the government as a third party in all of this, if you were going to sort of break that nexus.

MR KLAASSEN: Yes. The reference earlier to it being a policy matter I suppose reflects the fact that we expect that, if there is to be a positive decision on this, it would have to come from government as the owners of the entity. The transparency point you make is a very good one. We look to New South Wales where, even though competition actually hasn't arrived and it's been a pretty tortuous process, the simple act of separating the railways, unbundling contracts, promoting transparency and knowledge by the parties, has led to decreases, we understand, in freight rates over time. It has thrown things into the light, imposed moral suasion on the parties. QR's best friend for the last decade and a half has been non-disclosure. In respect of coal, it's been non-disclosure, and it's something they've understandably fought very hard to retain.

PROF SCRAFTON: Yes, it's part of a very complex interrelationship problem. There are a lot of interrelated problems within QR. As soon as they begin to open up in response to the sorts of changes you'd like to see, it will expose all sorts of perhaps even inefficiencies elsewhere that traditionally the coal industry and the coal revenue has propped up. I think it's all part maybe of a much bigger cultural and financial or accounting change that they're going to have to face up to in a bigger picture.

MR KLAASSEN: Yes. QR will tell you, "We've been corporatised. We calculate our CSOs correctly. We do not cross-subsidise across the organisation and the rules are there to see in black and white." Our point is: if that's the case, put the numbers on the table that demonstrate that. We don't think that the level of disclosure does that.

MRS OWENS: The other day when we were talking to Rio Tinto they seemed to be still very concerned that there may continue to be a monopoly rent component, even though there's a policy that that's going to disappear, just because of this lack of transparency it's very hard to actually gauge whether there's a monopoly rent or not. Do you want to comment on that?

MR KLAASSEN: Yes. As we described in our submission to the coal industry inquiry, we have what we think is fairly strong indirect evidence that current rates - that's current commercial freight rates as defined by QR - do contain significant monopoly rent elements. We don't know for sure because we have to rely on expert opinion and comparisons with overseas railways, which are never perfect of course, but the indications are to us that there are excess profits contained in the freight rates.

MRS OWENS: Would the fact that there's been a 1-year moratorium on freight rate concessions be an indirect indicator of that? Does the fact that there is a flexibility to have a moratorium on freight rates indicate that there may be some degree of flexibility in there?

MR LEACH: I think that's a very good point, and it's certainly crossed our minds. We certainly would like the flexibility to be able to take a hit as QR have indicated they're willing to do now, and I think this is what your point was - that there is a cushion there out of which they can give these concessions without doing their own financial position any great harm. That's true. I think the issue of monopoly rent, as you mentioned - but without the benefit of transparency as such that monopoly rent can be levied in so many different ways that it's virtually impossible to detect. It can be done through over-inflated assets or over-inflated rates of return or purely an inappropriate allocation of costs between the various sectors within QR. So that's why we keep coming back to transparency as an absolutely critical issue.

MR KLAASSEN: We see potential for monopoly rent to be collected on the basis of the best looking, most rational pricing principles you can imagine. Because of what Noel says, the avenues for tweaking levers there, disguising over-inflated assets here - you can end up with the same result. Hence, unless you see the numbers, it's something you can't rely on.

PROF SCRAFTON: In some of our earlier discussions we've heard passing comment about the extent to which the coal companies have actually made capital contributions to the infrastructure in Queensland. Will you tell us a bit about that? Is that a long-standing thing and does it vary over companies and different lines?

MR LEACH: Ben can speak for what was then the Utah contribution to the rail

network in central Queensland, which was very much the establishment of the coal network. A very similar position was experienced by subsequent companies that came along afterwards and developed new mines. The coal companies, and Utah in this case, provided the funds to build the railway line and also provided the funds for the purchase of all the rolling stock. QR repaid that. That was treated as a long-term loan by QR and it was repaid, but to service that repayment a levy was struck and added to the rail freight rate, and from that levy the repayments were made. So essentially the companies contributed twice and got it back once. On completion of the repayments of those long-term loans the levy stopped, so it was very obvious it was a super levy just to raise the extra funds to pay off the original capital that was contributed. Ownership at all times vested in Queensland Rail. That's a very, very brief synopsis of it.

PROF SCRAFTON: Yes, it's interesting. I guess it's commonplace to you, but it raises the question of why didn't we just have a private railway like the iron ore railways in the north-west of Australia?

MR LEACH: This goes back a long time. I believe legislation prohibited that in Queensland.

PROF SCRAFTON: Right; simple as that.

MR LEACH: So it wasn't a choice of, "If we can't get a better deal from the government we'll do it ourselves." There was no other alternative.

PROF SCRAFTON: There was no option.

MR LEACH: No.

MR KLAASSEN: Yes, and my perception - and again it's reading back over what other people have said - is that, with the commencement of Moura in the mid-sixties as the first hard coking coal export seller to Japan, I think the government sniffed the wind basically and knew it was on to a potentially good thing and that high rail freight rates and obligations on companies to develop rail freight infrastructure was a good way to deliver a growing and assured return to the government that wasn't subject to the vagaries of the coal market and to have private companies, which were perceived to be very well-off, to fund economic infrastructure in the middle of the state.

PROF SCRAFTON: So in that case there must have been some replacement equipment or replacement locomotives. Have they always been paid by QR ever since or are there cases where companies actually had to pay for the second round, if I could call it that?

MR LEACH: Yes. It's been a moving feast to a large extent, and again I could only comment from the experience of my company. Some of the original rail haulage contracts also contained provisions for levies to be imposed at various periods in the future specifically to replace existing rolling stock. I might add, those provisions are

no longer there, and similarly we should note that perhaps 5 years ago, probably around the corporatisation stage, QR began to recognise the contributions of companies and include a capital credit in their rail freight calculation. But again, without transparency, the appropriateness of that credit compared to the original contributions was very hard to gauge and again, because it was based on written-down values - that capital was 20 years old - I think the true impact of that was lost.

The situation today is quite different in that large main line construction or significant main line construction, if it occurred today, would be funded by Queensland Rail. But of course there's very little of that required. Specific lines or spur lines to the mines themselves off the main line, though, are still required to be funded by the company, but ownership vests in Queensland Rail.

PROF SCRAFTON: Even of the branch lines within your own boundaries?

MR LEACH: Yes.

MR KLAASSEN: So the assets that are at risk, I suppose, of being stranded in a way are still funded by the company but owned by the railway. An important distinction in the historical context is that until corporatisation, the companies did not negotiate rail freight arrangements, commercial arrangements, with Queensland Rail; they negotiated them with state treasury. So that corporatisation shifted the locus of control to QR and was at least the starting point for cleaning out a lot of these anomalies, but of course there's overhang and there's this uncertainty about what does that single figure on a piece of paper which is a company's capital credit really mean? How is it made up?

In Queensland we went through the same sort of thing with the Port Authority corporatisations but it was a much cleaner model. In that case, where there were similar issues in respect of the Gladstone Port Authority and the Ports Corporation of Queensland, assets that were funded by the companies either through direct up-front contribution or through special levies to service loans. They were identified and fenced off and taken out of the calculation for rate return requirements.

PROF SCRAFTON: Thanks for that. I'm sorry I sort of dragged you into that squealing but it has been mentioned a few times to us and I just wanted to understand that setting. The last point that - - -

MRS OWENS: Just before we get to that, I was just going to ask Ben - in terms of the Gladstone Port example, are there any details about that?

MR KLAASSEN: We can get you details. We can get, I think - I would have to check with the companies that constitute the port users and the Port Authority of course but I expect there will be a register of assets which are attributed as being industry funded and publicly funded and a value presumably.

MR LEACH: Yes, I think an even better example than Gladstone or a cleaner and

clearer one is Dalrymple Bay coal terminal.

PROF SCRAFTON: Which is a Ports Authority, is it?

MR LEACH: Yes, and negotiations are actually currently under way with the Ports Corporation to renegotiate some agreements that expire at the end of this year. They have been very up-front and I'm sure - I would need to just to clear they won't mind this information being provided. They have actually provided the negotiating companies with their asset base and with their calculation of the user contributed portions and have indicated they will only be seeking a greater return on the actual Ports Corporation funded share of the assets. So that information we can provide, I'm sure.

PROF SCRAFTON: That example was mentioned to us by Rio Tinto too and what is interesting to us is that the Ports Corporation is also a Queensland statutory authority and yet we talk about these things as being policy issues and we've got two statutory authorities operating in different ways.

MR LEACH: That's a good point - yes, in different ways.

PROF SCRAFTON: So that's why that example would be of value to us.

MRS OWENS: Sorry, Derek, I interrupted. You were going to ask another question.

PROF SCRAFTON: No, that's okay. That was what I was going to ask. I was going to pursue the Port one. That was my query. No, go ahead now.

MRS OWENS: Sorry about that. There is another issue I was going to raise and that's about contestability. I don't think we've talked about the contestability as of yet but you talk about the rail moratorium and the lifting of the moratorium - this is on the third page of your letter - as not establishing contestability of road haulage and that you need these other things to occur to have contestability, a comprehensive and effective rail access regime and the unbundling. We've talked about the unbundling and we've talked to some extent also about the access regime. So from where you sit you don't think there's any contestability in the Queensland system now?

MR KLAASSEN: Not effective contestability. There's notional contestability because under the law in Queensland a company, prospective train operator, can go to QR and seek an access price and access arrangements and presumably get some sort of answer. We're not sure actually what answer will be given in that case but our perception is that whereas there are companies who might be interested in the coal business in Queensland, without tangible arrangements about how they go about that, we would be surprised if they would broach them in any serious way.

MR LEACH: Yes, I'm sure some companies currently have approached QR or QRNA seeking access rates and I suspect Rio Tinto would have done it for Hale

Creek and other companies that may have done it would be companies with agreements expiring very shortly or companies with additional tonnage coming on not covered by existing contractual arrangements. I believe what QRNA is offering those people is an indicative rate. It has been indicated on the basis that there is no detailed access undertaking in place. It's not possible to give a definitive rate that will certainly apply but I believe they are giving indicative rates that may or may not change but in all likelihood will when the full deals of the undertaking are settled. I think also it has become evident to us, talking to the access group, that they are not sure how the access is going to operate at the present time which makes it even more obvious that they cannot give a definitive rate at this stage for those companies that are seeking one.

MR KLAASSEN: Of course there is the contracts issue, the perception that QR has got the market signed up anyway so why bother.

MRS OWENS: Are you confident that in Queensland you'll end up with a transparent, effective rail access regime at the end of the day?

MR KLAASSEN: Confident is too strong a word. Hopeful, but because the mechanisms which are capable of delivering that are untested, it's too early to be too firm either way. History suggests that we'll be dissatisfied but in the past we haven't had the mechanisms that competition policy now provides, in particular, independent regulatory verification of what the infrastructure owner comes up with. That's a new element that competition policy has brought in, in the form of the Queensland Competition Authority in Queensland and it remains to be seen how they conduct their process and how aligned their views are to ours. To a lesser extent, I think, there is the Commonwealth level with the NCC and the ACCC. In the past, before competition policy, it was very much a begging bowl approach to the government which owned them and it was very much a political exercise. We're hoping that the processes we have now, which are meant to be independent and expert, will give us more ammunition and cause for more confidence but it remains to be seen.

MRS OWENS: In your negotiations on the undertaking you've put a number of things on the table which you've listed here on page 5. To what extent - I think you're saying there is already a draft undertaking out there. I presume that that draft undertaking doesn't pick up any of those things that you have listed there. Is that correct?

MR LEACH: Generally not. I think that's fair to say. It was very general and I think it was our impression that it was meant to be that way and QR would sort out the details after it was approved and as they went along and that concerns us greatly.

MR KLAASSEN: The undertaking as it reads, as a document which is meant to cover of course the entire QR network, not just coal, in places, in our view, reads very badly. It's a scary document. However, once we got into these more detailed talks with the access unit of how it would actually apply to coal, I think it's fair to say that some of our initial fears have been mollified to an extent. For example, a major

concern was that the Central Queensland coalfields could end up paying for the stand-alone capital costs of the entire Queensland Rail network. On our reading of the undertaking that seemed possible; that level of discretion seemed possible. Through our talks on how it would actually be applied to coal though, I think it's fair to say that it's certainly QR's intention not to do that as expressed to us; that coal will pay for its region. It will not pay for the losses incurred on the Brisbane suburban passenger network, for example. That's one of the areas where talking has brought a better understanding.

MR LEACH: I think that's right and these talks have been very fruitful but they have also highlighted some more concerns that while Ben says the issue of cross-subsidisation in that respect is not their intent, it certainly was their intent to discriminate between coalmines on the system based on their perceived ability of those companies to pay and that is an issue we feel very strongly about.

MRS OWENS: Was this an attempt to introduce sort of like a Ramsey pricing type of price discrimination type approach or was it something else?

MR KLAASSEN: No, that's correct. It's expressed in the undertaking by QR as market pricing but it's, yes, price discrimination to reflect perceived capacities to contribute to fixed costs so that a traffic in coal which is capable or perceived to be capable of paying for the entire stand-alone costs of a region would do so, whereas other less commercial traffic would come on line at less than that and potentially absolute marginal cost.

PROF SCRAFTON: Could I just pursue that a little bit? Is there much of that traffic on the core lines? Is there much other traffic? I mean, I suppose - let me put that another way: would it really matter if that was the case, that the other traffic came on at marginal cost? Is there enough to make that an issue on some of these core lines?

MR LEACH: I think the general answer is there's not a lot of other traffic on the line. If QR chose to do that it would be critical from our point of view that that was fully disclosed as to what they are doing. So to answer the question, no, it may not enormously distort the costs for the coal operations but we would like them to justify what they have done.

PROF SCRAFTON: You're prepared to see. Because it would seem to me, as an absolute outsider and just learning from you about how these lines work and that, that more important would be that this marginal pricing was not used to attract traffics which then disrupted your delivery, you know, your paths or whatever. That would be a far more critical cost than the actual addition that you might carry because these people have come in and bought it at market.

MR KLAASSEN: Yes, that's true and that's why, having confidence that the region is fenced off from the rest of the network is the main cross-subsidy issue; that is, subsidy between coal and different types of traffic but it still does not go to this issue

of potential discrimination between different coalmines and that's something which we're still exploring with QR. There's obviously an intention to exercise a degree of discrimination but we're still trying to pin down exactly what they mean by that, the extent of discrimination and frankly, as Noel has indicated, I think we're both learning something from the discussion and those talks are continuing.

PROF SCRAFTON: Of course, it would also be a test for the approving authority, for the rail authority, if the undertaking was put forward with some of - well, the way you described it earlier to us in very general terms. The competition authority that was responsible for approving it would surely find it very difficult to accept it in that form. It's almost meaningless, the way that you first described it.

MR LEACH: It's not so much meaningless, but it gives such a wide discretion, is probably the better word for QR to apply different policies to different situations which will result in some sort of discriminatory pricing.

MRS OWENS: I just want to clarify this, partly for the transcript, but there are basically three areas, three different levels at which price discrimination could occur. One is competition between coal companies and coal lines. One is between coal and other traffic on the same line.

PROF SCRAFTON: Or in the same region.

MRS OWENS: Or in the same region, and the other is between coal and other traffic on other lines in other regions. You may have different approaches to price discrimination depending on which of those three you're talking about, presumably.

MR LEACH: Yes.

MRS OWENS: So you are happy to see some degree of price discrimination in the last instance when you're looking at different regions, coal here versus other traffic in other regions. You want to ensure that you're not cross-subsidising that other traffic. Is that correct?

MR LEACH: That is correct.

MRS OWENS: When it comes to the coal and other traffic on the line or within the region, you don't want to see price discrimination if it leads to other traffic disrupting the coal traffic, if the other traffic can come in at sort of a marginal cost of zero.

MR LEACH: Yes.

MRS OWENS: With coal, when you're talking about competition between coal companies within a region you are talking about no price discrimination.

MR LEACH: Yes.

MRS OWENS: Presumably because if you're looking at Ramsey pricing you're assuming that that pricing elasticity of demand, which is what you'd be basing the price discrimination on, is going to be the same regardless. You shouldn't be looking at the actual profitability of the company, but the pricing elasticity. If you're going to have an efficient pricing regime it should be based on pricing elasticity and demand. If you're talking about coal I would presume the pricing elasticity of demand is pretty well uniform. But maybe there's different sorts of coal products.

MR KLAASSEN: There are different sorts of coal products and presumably the elasticities are different. But I've seen widely different estimates of price elasticities for different broad types of coal done by apparently equally authoritative analysts and of course coal is a dynamic product, a dynamic market. Qualities are changing all the time. Markets are shifting and there are blurred areas between different types of coal. So I believe that to think you can rigorously apply some sort of relative capacity to pay based on the elasticity of demand between different coalmines, I think it's nonsensical to presume you can do that in a rigorous way. The other aspect, the other side of the coin, is that these mines are in competition with each other and every mine is in competition with the next potential mine and we believe that relationship needs to be respected.

MRS OWENS: I think one of the most convincing arguments against doing it in certain circumstances is just the one you mentioned - really is about getting appropriate information and the information costs, and if you can't get accurate information, that makes it even more difficult to achieve a satisfactory outcome. I don't think that what governments do in terms of, "Well, we'll pick off the ones that can afford to pay more," is necessarily an appropriate interpretation of what Bauvrol was arguing.

MR KLAASSEN: Yes, exactly.

MRS OWENS: I think that was very useful for me just to clarify that.

PROF SCRAFTON: I just thought of a question of fact that I'd like clarified from you. From the comments that you made earlier I assume that the coal rate reductions that have taken place in New South Wales are greater than the ones you see in Queensland. Is that a fair assumption or just the way that I read - I just had the feeling that the way I heard it, the reforms in New South Wales have resulted in more satisfactory negotiations about the coal rate in New South Wales.

MR KLAASSEN: My understanding is that since the access regime was taken up in a serious way in New South Wales that the average reductions have been in the order of 20 to 25 per cent. I've seen reference to those sorts of numbers, and that more reductions are in prospect even without haulage competition, mainly through the mechanism that with access and separation of infrastructure from haulage, an allowable revenue requirement attaches to access and as tonnes increase, which they have, unit rates have fallen to avoid exceeding that allowable revenue profile. Now, that very simple mechanism doesn't apply in Queensland and I understand that's

driving a lot of the change in New South Wales, and that's quite apart from the policy schedule of reducing de facto taxes in New South Wales.

We've had a form of that in Queensland as well; that is, identifying the so-called de facto royalty and phasing it out. A different mechanism, not as good a mechanism as New South Wales, but there has been a mechanism like that. But my perception is that the thing we don't have in Queensland is that separation, that transparency, that need to defend rates, and therefore the need to comply with a revenue cap, however it's derived.

MR LEACH: I think the other thing we have seen in New South Wales is, apart from the straight effect on rail freight rates, is the effect on the general terms of their contracts, those termed to be a lot more flexible than they were in the past and certainly more so than we have in Queensland, in that I believe there are no long-term contracts essentially being offered. 2 or 3 years seems to be very general. Also I think escape mechanisms in contracts - essentially if lower prices can be found elsewhere they are fully prepared to meet that competition in that market head on and not tie it up or lop it out with refit of contracts.

PROF SCRAFTON: So you really do see competition at work reflecting in - narrated in the contract.

MR KLAASSEN: Can I caution you on one thing, and I'll say this because it came up in the House of Representatives inquiry. That is, statements attributed to QR about reductions in coal freight rates, unit coal freight rates over time, need to be treated with caution, at least in the instance that - I'm referring to previously, there was a confusion of commercial rates and reductions in de facto royalties. It was very unclear what was actually being talked about. So to the extent that you receive those statements of coal freight per tonne reductions I think they deserve to be very closely scrutinised as to what is actually - - -

PROF SCRAFTON: What was actually - yes.

MR KLAASSEN: And who was driving them.

MRS OWENS: Can I ask a sort of leading question and that is, would you prefer to be working under the New South Wales regime?

MR KLAASSEN: I'd be reluctant to say yes because although it has some desirable features that we don't have, we haven't been in the middle of it. Certainly my perception of the comments of a couple of companies who do cross the border, that for all its warts and frustrations they see the New South Wales system as being more progressive and proceeding at a quicker pace towards something that's legitimately competitive.

MRS OWENS: There have been a number of arguments put, particularly when we're in Western Australia, about the sort of disadvantages of what's happening in

New South Wales with separation and the arguments go - and I'm sure you've heard them - that you lose the economies of scope and the ability to integrate above and below track activities and investments and so on. Do you think those are significant problems? If you're comparing regimes are there other things that outweigh those particular benefits? I mean, implicit in what you've written, I think you're basically saying yes.

MR KLAASSEN: Our perception is that the loss of scale economies would be outweighed by the pro-competitive effects. That's our belief based on principle logic and limited information. Our big complaint with the decision - and admittedly it was the previous Queensland government, the decision to retain QR in an integrated state, was that we didn't see the evidence that they had looked into it in appropriate detail. If they did, they did not make that public. It was very much a closed process. We had some input but it was at short notice and very cursory, and it contrasted to a process that the same government had followed in respect of electricity, which was a very good process. It was an open, independent inquiry by competent people which took public submissions, analysed the issue rigorously and came to what we saw as good decisions on the structure of the Queensland electricity industry and set the industry up for the operation of the Queensland electricity market. Now, there was a big contrast between the way the two issues were dealt with.

PROF SCRAFTON: It has been put to us that one possible reason for that is that the government could find itself financially disadvantaged if it doesn't do it in the case of electricity because of the competition policy and its implementation and the fact that there is an inter-governmental agreement which is binding, whereas no such agreement exists for rail. That problem has arisen in a number of very different contexts in this inquiry, that the performance of rail reform can be very sharply contrasted with that in - particularly electricity and gas are the two examples, depending where people came from and what their interests were. Could I just mention one thing though, ask you one general question? The lead of the question was to me did the Queensland government explain why they came down in favour of vertical integration and you've just answered that, that they made the decision and there were no - - -

MR KLAASSEN: There was reference to the economies of scale argument. I think that's about as far as it went.

MR LEACH: I think that was generally the accepted reason within QR for going that route.

MR KLAASSEN: That the costs of breaking up - the loss of scale economies - would outweigh the potential benefits, and that under the new structure with appropriate ring fencing arrangements they could still make access fair and workable.

PROF SCRAFTON: But you create - in the same paragraph on page 2 there in

your letter you create your own silver lining. You point out that the conflicts of interests that would inevitably arise will cause - I think your words are "forcing a rethink" and it's really a matter of how quickly the problems emerge and how responsive the various parties are - the government and the railways together respond to that.

MR KLAASSEN: Yes.

PROF SCRAFTON: The way that you worded it in your letter made me feel that if the government were to read that, you know, why didn't they come to the same conclusion? But I guess you spend your life trying to tell them about it - thanks.

MRS OWENS: Do you think at the end of the day after the access regime has been worked out in Queensland and you get to the end of these long-term contracts, early in 2000, 2001, 2002, some time around then, you will end up with other players in the market hauling your coal?

MR KLAASSEN: I certainly believe if the regime is a decent one that there will be genuine attempts to enter the market, and I think that's the important thing. Whether it actually translates to a competitor remains to be seen, but it's the potential, and the need for QR to respond to a legitimate viable alternative that is going to drive the outcomes. The companies want low freight rates. They don't mind who they get them from.

PROF SCRAFTON: At least you would generate a truly contestable market, whether it converted to - - -

MR KLAASSEN: Yes, genuine contestability is the key. Competition might be a result.

MRS OWENS: We've heard from Rio Tinto and others that, even if you get the best access regime you can hope for, there's still the potential problem that in very subtle ways the incumbent can keep the competitors out, in other ways. It may not apply so much on your tracks and for your business, but in terms of just scheduling and so on, you cannot control for all these contingencies.

MR KLAASSEN: Yes.

MR LEACH: That's a very important issue and it's one we discussed with the QRNA a few weeks ago in our ongoing talks. That was specifically the scheduling issue. Just the geographic location of the scheduling person for coalfield - he'll be sitting in the haulage arm's office, and actually his salary will be paid and his future increases will be governed by the head of the haulage group. So there's a conflicting interest there for him, obviously. We're not saying he's deliberately going to be biased, but he has some pressures on him, I think unreasonable pressures.

PROF SCRAFTON: Was there a reason for that? It seems extraordinary that there

are other examples. Even in the New South Wales model the freight control rests with the Sydney metropolitan passenger trains. They argue it's because it's the biggest user and so on, but it does seem a fairly critical part of trying to ensure fairness in scheduling and providing paths and maintaining paths and ensuring reliability to have it sitting in, in your case, the haulage commission.

MR KLAASSEN: I think the rationale was that, a little bit like the overall structure issue, "If it ain't broke, don't fix it. We don't perceive it to be broken," or, "We don't perceive it to be deficient, and in respect of that scheduling operation we may as well keep it where it is until an apparent problem arises," which we think is the wrong way to approach the issue. But I think - I hope I'm not doing QR an injustice - that that was the rationale behind it.

PROF SCRAFTON: The evidence elsewhere in Australia is where that control function has gone to the track access organisation or the component of an integrated organisation responsible for track access, is that, aside for the direct performance on a day-to-day basis, it raises the image or the reputation of the organisation enormously. We heard about it in Victoria too. I think it was called VicTrack, and its reputation was very quickly established amongst all users for fairness. It's not just the actual performance but the perception of the users that raises the credibility of not just the access unit or the access provider, but also the whole organisation, if it is in an integrated organisation or of it's housed close to one, as in the case of the two southern states. I think there is something to be learned from that.

MR LEACH: I think the other issue there - and it's something again we've discussed with them - is what is the actual access product they are selling. Are they selling someone a right to move X amount of coal per year in roughly equal weekly instalments or are they selling a specific time slot? The impact that the schedules have, depending which way that goes, can be very significant. I think we've generally agreed in principle with QR, and it's certainly our approach, that they adopt the first of those options. To utilise the efficiencies of the system, they really do need some flexibility to move coal around, say in a weekly slot rather than be fixed into a very rigid position.

PROF SCRAFTON: Rather like the general freight operator might want every night at 5 o'clock or whatever it is - - -

MR KLAASSEN: Yes. One of the other encouraging things about our talks is that it certainly appears that the network access group does have the overall efficiency of the system in its sights as a key consideration. But, of course, the industry wants an efficient as well as a competitive, contestable arrangement.

MRS OWENS: We've kept you longer than we - we started a bit late. I'm not sure what time your flight is to go back, but I haven't got any other questions. Do you want to make any other comments? I know, Ben, at the beginning you said we might come back and talk about certification. We've covered a lot of the sort of related issues. I don't know if you wanted to say anything else about certification.

MR KLAASSEN: Nothing in particular about certification. It's a process that will run. We've got a view on the path that it will follow. It remains to be seen. It's important and certification should be acquired at the appropriate time. We don't see there's any particular rush to it. We hope that there's no perception of urgency there which might impinge on, for example, our talks at the working level with QR.

In terms of coming back to other things, there's a point which I think you were leading to earlier, which is how the progress of rail access reform generally has suffered from rail not being the subject of one of those national policy agreements and therefore not something that's perceived to have competition payments attached to it, which has meant that there hasn't been the same level of enthusiasm. That's true. Having said that, I'd be reluctant to see our small but very, very important Queensland coal rail access issue somehow pulled back and subsumed within some new COAG-driven national reform agenda. We've waited a long time but we're on track and we want to push that as far as we can, having reached this point.

PROF SCRAFTON: So you're comfortable fighting with the existing regime rather than having some sort of a new order imposed? I don't think there's any suggestion of that for the present.

MR KLAASSEN: Okay.

PROF SCRAFTON: I was not implying that in any way; I was simply drawing to the fact that it is something of an anomaly which people have put forward to explain the different level of response. It was probably your counterparts in New South Wales who pointed out that something happened in the electricity business there in about 3 years and up to now they've been working for 2 years in the railway business. You know, the contrasts are - - -

MR KLAASSEN: Yes.

PROF SCRAFTON: And maybe it isn't that simple. We wouldn't want to over-exaggerate that. Nevertheless, the time difference is enormous.

MR KLAASSEN: Yes, I agree with you. It's been a key motivator.

MR LEACH: I think we should say, though - I think there should be a sense of urgency in putting an access regime in place in Queensland, but not at the expense of getting it wrong. Certainly, I think the results of our current discussions on the undertaking are crucial to that and I think will largely determine the timing.

MR KLAASSEN: Yes.

MRS OWENS: What is the timing with your discussions?

MR KLAASSEN: QR hopes to complete its discussions with us, and others

presumably, come up with a final product and have it approved by its senior management and board and submitted to the Queensland Competition Authority by the end of this year. Whether that's - - -

MRS OWENS: I think that's quite encouraging in a way. At some stage during our processes this will have moved on and we'll be able to observe where it's got to, and by the time we see you again - and I hope we do - you may have reached some resolution on the undertaking and it may have gone through the system.

PROF SCRAFTON: And matters moved ahead, say, with the certification of the regimes either in Queensland or elsewhere, so at least there is progress to report.

MR KLAASSEN: The ideal scenario would be over the next couple of weeks we and QR agree on, maybe if not everything, almost everything; the undertaking is amended appropriately and perhaps there is a back-up explanatory document supporting our talks; that all goes to the Queensland Competition Authority, with our endorsement as well as QR's; it gets approved; and then on the basis of that effective independently-assessed and consultative document the NCC feels able to give the regime a tick. Then the next step from that would be generating what other information might be necessary - for example - technical information, operational protocols etcetera - which might be necessary for the companies to be in a position to go to potential third party operators and say, "Okay, bid for our business."

That would be great. The key sticking point is that end one. If they don't have any uncontracted tonnes to go to an alternative to say, "What will it cost us for you to haul that?" then, at least for a while, the rest is for nought.

MRS OWENS: Okay. Nothing else you want to say?

MR KLAASSEN: Nothing else, no.

MRS OWENS: Thank you both for coming. This actually brings to a conclusion not only our Melbourne hearings but the series of hearings that we've been holding over the last 4 weeks. A draft report will be released in April 1999, but I'd like to thank you and I'd like to thank everyone else that has participated in these hearings.

MR KLAASSEN: Thank you.

AT 2.30 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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