

PRODUCTIVITY COMMISSION
INQUIRY INTO RAIL REFORM
NSW SUBMISSION

JULY 1999

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1. PURPOSE

The purposes of this submission are to:

- . provide some further background to the Commission on rail in NSW;
- . identify issues relevant to NSW; and
- . comment on major recommendations made in the Commission's draft report.

The submission has been kept brief to focus on main issues. These fall into 3 groups:

- . outcomes of the reform process since 1991;
- . transitional issues arising in the reforms; and
- . major outstanding issues for the rail sector.

The Department of Transport and the NSW rail organisations would be pleased to provide further detail on specific matters of interest to the Commission.

2. BACKGROUND TO THE PRESENT INQUIRY

2.1 1991 Industry Commission report

In May 1990, the Commonwealth Treasurer provided a reference to the Industry Commission regarding Australia's railway systems. Terms of reference included that the Commission report on institutional, regulatory or other arrangements subject to Government influence which lead to inefficient resource use, and advise on courses of action to reduce or remove such inefficiencies. The reference requested that the Commission give priority to areas where greatest efficiency gains are in prospect and where early action is practicable.

The Commission's report, completed in August 1991, covered passenger and freight Government railways. The Commission's inquiry focused on how institutional and regulatory environments affect railway efficiency. Some road issues were noted as they have the potential to affect rail's performance.

The Commission found that railways faced major problems, notwithstanding significant reform efforts. It estimated potential net benefits of further rail reform of up to \$5billion per annum for the economy as a whole.

The Commission made 27 recommendations that it viewed as creating an environment necessary to encourage and facilitate rail reform. These reflected a number of themes:

- . railways should operate as businesses;
- . commercial practices should extend to fare and rate setting, and to management and workforce practices;
- . Government pursuit of social objectives through railways should be through contracts;
- . competition between road and rail transport should be fair and equitable;
- . there should be less emphasis on regulation;
- . competition and private participation within the rail sector should not be limited; and
- . rail track and infrastructure should be open to third party access.

2.2 Reviews since the Commission's 1991 report

Since the Commission's report there have been a number of reviews and reports into or touching on aspects of the rail sector in NSW. Examples include:

- . the National Competition Policy Report by the Independent Committee of Inquiry (Hilmer report - 1993);
- . review of the State Rail Authority by Mercer Management Consulting (1993)

- . Bureau of Industry Economics research reports on international performance indicators for rail freight (1992,1993,1995);
- . the Industry Commission's report on Urban Transport (1993); and
- . the Productivity Commission's report on the Australian Black Coal Industry (1998)

These generally have been in accord with the broad thrust of the Commission's 1991 recommendations.

Section 3 of this submission outlines the major reforms that go to address the issues raised in these reports. The outcomes, to date, of those reforms are included in Section 4.

In July 1998 the House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform reported on its Inquiry into the role of rail in the national transport network (Tracking Australia). It found that there remain substantial national level problems with the interstate segment of rail including the lack of development of a national rail system and competitive neutrality among the modes.

In May 1998, the Prime Minister announced the establishment of a Rail Projects Taskforce to evaluate how governments can better facilitate viable major rail investment proposals developed by the private sector. The Taskforce reported in April 1999 (Revitalising Rail) on the scope for private investment in rail, barriers to this investment, and other issues relevant to the role of government in facilitating such investment. Among its findings are that:

- . there needs to be a national transport strategy;
- . road and rail funding should be balanced;
- . Governments should develop an appropriate framework for private and public investment;
- . external benefits and costs of transport options should be evaluated from a national perspective in a transparent and consistent manner; and
- . the extent and nature of Commonwealth Government support for private sector proposals to develop major new interstate rail links be assessed against their economic, financial and social merit and conformity with the national transport strategy.

MAIN REFORMS IN NSW SINCE 1991

Many of the Commission's 1991 recommendations have been adopted in the structure and operation of the rail sector in NSW. This section briefly traces through the major reform elements. Some further details are included in the discussion in sections 4 and 5.

3.1 National Rail Corporation

The National Rail Corporation was formed under the *National Rail Corporation Agreement 1991* between the Commonwealth and the mainland States. The Commonwealth, NSW and Victorian Governments became shareholders in a "corporations law" company which was to take over all interstate rail freight carried by the various rail authorities.

The *National Rail Corporation Agreement* is backed by Commonwealth and State legislation – in NSW, *The National Rail Corporation Agreement Act 1991*. The *Agreement* provides for the establishment of the company, including through:

- . the provision, including by transfer, of certain assets of the shareholders' rail authorities (the State Rail Authority, Australian National Railways and the Public Transport Commission/V-Line) nominated by the company; and
- . certain relationships between the company and the rail authorities in commercial dealings during the company's establishment phase.

National Rail Corporation commenced business in 1993. Its operations in NSW and other States was and continues to be on a vertically separated basis. That is, National Rail Corporation does not own or control the track on which it operates, notwithstanding provisions in the *Agreement* which enable it to acquire the track.

National Rail Corporation can be seen as the first significant example of two major reform elements in Australian rail:

- . a vertically separate train operator; and
- . an organisation not constrained by State and Territory boundaries – a national organisation.

3.2 Rail Safety Act 1993

The *Rail Safety Act 1993* introduced new responsibilities for rail safety in the State.

The Director General of the Department of Transport became responsible for administering an “accreditation” system. In this system, railways - that is owners and operators of track and rolling stock - propose for accreditation their safety systems.

Prior to 1993, safety was the responsibility of the State Rail Authority. The implications of the 1993 changes included separation of safety regulatory responsibilities from the commercial operations of the railways. Among other things, this facilitates competition within the rail sector.

Following NSW, other States have passed similar legislation separating responsibilities for safety regulation from commercial participants in the transport industry.

3.3 Intergovernmental Agreement on rail safety 1995

The Commonwealth and States signed an *Intergovernmental Agreement on Rail Safety* in 1995. Key purposes of this agreement are to ensure that accreditation is used as the regulatory framework for rail safety, and to establish a process of “mutual recognition” of rail safety accreditations among jurisdictions. Mutual recognition involves the automatic acceptance in all jurisdictions of certain core elements of a railway’s accreditation by other jurisdictions.

Mutual recognition, along with moves towards harmonisation and uniformity in Australian rail standards and procedures, strengthened the focus on national rail issues.

3.4 Structural reforms, 1996

In 1996, the NSW Government implemented a reform package that fundamentally restructured the rail industry in NSW. The mechanism was the *Transport Administration (Rail Corporatisation and Restructuring) Act 1996*.

Key changes were:

- . vertical separation of the track and associated “essential facilities” to the ownership and control of a State owned corporation - Rail Access Corporation;
- . ability of the Minister for Transport, with the approval of the Premier, to implement a regime for access to Rail Access Corporation’s track;
- . separation of State Rail’s freight haulage and associated functions and services, including nominated terminals, to a State owned corporation – Freight Rail Corporation (FreightCorp); and

- . separation of track and workshop maintenance functions from the State Rail Authority into a new statutory authority – the Railway Services Authority.

Passenger services including trains and stations, and residual functions including management of real estate, remain with the State Rail Authority.

The two central themes of the 1996 reforms were open access to rail tracks via structural separation and further commercialisation of rail businesses.

3.5 Open access

The report by the Independent Committee of Inquiry on National Competition Policy (1993) – the Hilmer report - recommended that Governments examine the potential for the structural separation of public authorities into “natural monopoly” and “potentially contestable” activities. The report recommended that there be a right of access to certain strategic natural monopoly assets – “essential facilities”. The report identified rail track as an example of a natural monopoly.

The *Competition Principles Agreement* (1995) between the Commonwealth and the States largely adopted the principles proposed in the Hilmer report. This agreement refers to structural reform of public monopolies, and access to services provided by significant infrastructure facilities:

- . clause 4(3) indicates that there should be a review of the merits of separating the naturally monopoly elements from the potentially competitive elements of a public monopoly before competition is introduced to a market traditionally supplied by the monopoly; and
- . clause 6 provides for Commonwealth or State regimes for third party access to services provided by certain significant infrastructure facilities.

The NSW reforms, in particular the formation of the Rail Access Corporation and the application of an open access regime, are fully supportive of these directions.

3.6 Rail Access Corporation

The essential transport purpose of Rail Access Corporation is to provide open access to rail tracks. Vertical separation, formal separation of rail access from “above rail” activities, has two major advantages for open access:

- . it eliminates problems of attempting to ensure that all access seekers are treated fairly and on a “level playing field”. These problems arise when the owner of the infrastructure is also a major user of the facilities ie. when the owner competes with other access seekers for either use of infrastructure

- capacity, or in end markets. Even perceptions of such problems may reduce competitive pressures; and
- it increases transparency in infrastructure costs, equipping policy makers with information on which to make better assessments of rail policy, and more importantly, transport related policy.

Rail Access Corporation embodies vertical separation in NSW. NSW is not the only place where vertical separation and open access has been implemented for rail. Other notable examples include the United Kingdom, Europe, and interstate rail freight in Australia.

3.7 Access regime

In Australia, the *Trade Practices Act (1974)* creates an access regime to essential facilities of national significance – the national access regime.

This national regime is generic, ie: not rail specific. It operates through a process in which the National Competition Council (NCC) “declares” the services provided by the essential facilities to be accessible as of right in favour of third parties - third parties being persons other than the owners of the facilities. Access may then be negotiated between the facility owner and the third party, with the Australian Competition and Consumers Commission being able to arbitrate terms and conditions if the parties cannot reach agreement.

The *NSW Rail Access Regime* is modelled on the parts of the national access arrangements necessary for a State based regime to be “effective”. However, most importantly, it establishes access as right for access seekers, rather than a right that is created only after a “declaration” process. Other key features are:

- it binds Rail Access Corporation to permit access to the network on certain terms and prohibits the corporation from competing above rail;
- provides a “negotiate and arbitrate” framework for access, as distinct from prescribed terms and conditions such as for prices;
- establishes the Independent Pricing and Regulatory Tribunal as arbitrator in NSW rail access matters, but does not establish a specific regulator for the rail sector;
- includes temporary provisions for access prices for coal haulage; and
- establishes “passenger priority” provisions for use of the network.

In 1997, NSW commenced the certification process and submitted its *Regime* to the NCC. After extensive consultation, the NCC indicated that the *Regime* could be recommended for certification, provided some amendments and supporting actions were undertaken.

As a result, there have been amendments to the *Transport Administration Act 1988* and to the *Regime*. The *Regime* has been resubmitted to the NCC for finalisation of the certification process. NSW was the first jurisdiction to submit a rail access regime to the NCC.

3.8 Commercialisation

Prior to the 1996 reforms, the State Rail Authority operated under a commercial charter. However, issues had been raised about its commercial performance, including in relation to transparency and the possibility of cross subsidisation among business areas. The 1996 reforms work towards addressing these matters, as is discussed in section 4. All four rail entities are subject to normal business laws including the *Trade Practices Act (1974)*.

Corporatisation of Rail Access and FreightCorp provided the new entities with specific and focused charters. Ministerial “ownership” is separated from the regulatory and portfolio responsibilities for these entities. The Treasurer and one other Minister, not being the portfolio Minister, are shareholders. In the case of Rail Access Corporation, the Premier is the other shareholder. In the case of FreightCorp, the Minister for Sport and Recreation is the other shareholder.

The new corporations have separate Boards. Principal objectives include business performance and efficiency, conduct of operations in accord with ecologically sustainable development principles, and a requirement to exhibit a sense of responsibility to the community and towards regional development.

Arrangements for these organisations are largely the same as for other non-rail entities covered by the *State Owned Corporations Act (1989)*.

On 1 July 1998, the Railway Services Authority was corporatised as Rail Services Australia. It follows this corporate governance model, with the shareholders being the Premier and the Treasurer.

3.9 Intergovernmental Agreements 1997

Commonwealth and State Transport Ministers entered two Intergovernmental Agreements for rail in 1997.

The first was at the National Rail Summit in September. The *National Rail Summit Agreement* noted an urgent need to reform interstate rail. An interstate network was identified. It was agreed that this network would be operated as a single network, including for investment and access. By 1 July 1998, there would be single management of track from Albury and Broken Hill to Kalgoorlie. Ministers also

agreed to plan for the extension of this network to Perth, and to plan for the provision of a dedicated freight track(s) through Sydney.

The *National Rail Summit Agreement* also called for the Governments to immediately commence an investigation of all relevant matters including:

- . competitive neutrality issues affecting road, rail and sea transport; and
- . organisational arrangements for the network and for harmonisation of technical standards.

At the Rail Summit and the subsequent meeting of the Australian Transport Council, Ministers asked officials to advance a number of more detailed tasks relating to the interstate network. These are being progressed through an inter-jurisdictional group of officials - Rail Group. The tasks include:

- . work on safety, technical and operational requirements for addressing uniformity;
- . the need for a decision making process eg. a national rail body along the lines of the National Road Transport Commission;
- . report on rail safety uniformity;
- . more open accident and incident reporting;
- . the need for a rail research body;
- . monitor progress on upgrading the network; and
- . a rail model for use in development and investment in the network.

Concepts of a national rail network had been discussed prior to the National Rail Summit. For example, the *National Rail Agreement* allowed National Rail Corporation to nominate for acquisition track that was predominantly used for interstate rail freight.

In 1995, National Rail Corporation indicated its in-principle intention to nominate relevant track. If accepted, this would have resulted in a vertically integrated national rail freight operator.

Also in 1995, officials examined the “Track Australia” concept. This envisaged a vertically-separated national track authority, which would manage, control and own the track that National Rail Corporation intended to nominate. This would apply the Rail Access Corporation concept to the interstate network.

The Australian Transport Council in November 1997 made a further agreement, for the creation of the *Australian Rail Track Corporation* (ARTC). The ARTC is a Commonwealth owned corporation. Major points of the *ARTC Agreement* include:

- . duration of five years;
- . open access to a defined interstate network;
- . ARTC is to be the sole point of interstate access to the interstate network;
- . ARTC is not to undertake rail operations;

- . ARTC is to administer an investment program for the network; and
- . changes to the management and control of some parts of that network, with ARTC owning track in the Commonwealth jurisdiction, leasing track in Victoria and having access rights in Queensland, NSW and Western Australia.

As part of the two agreements, the Commonwealth agreed to invest \$250 million over 4 years in interstate track.

3.10 National Transport Secretariat

In December 1998, the Australian Transport Council agreed in-principle to the establishment of a land transport commission. The idea behind such a commission was the need for Governments to deal with the decision making issues identified at the *National Rail Summit* and to develop an integrated approach to road and rail freight reform throughout Australia. Integration in this context relates to both cross-modal and cross-jurisdictional issues, sometimes referred to as a national transport strategy or plan.

This need for policy and cross modal integration, or a national transport plan, has been recognised in reports such as *Tracking Australia*, and *Revitalising Rail*.

The establishment of a land transport commission or similar advisory mechanism would represent a significant shift in the traditional approach taken by policy makers to road and rail issues. Previously, road and rail policy initiatives have been progressed through separate arrangements in Australia with a national reform program and process covering all jurisdictions only agreed for roads (via the National Road Transport Commission).

While the road arrangements have achieved significant outcomes, they do not extend to consideration of cross-modal issues, such as the effect of heavy vehicle mass limits on competing rail transport. Moreover, there was no agreed process for resolution of cross-jurisdictional national rail issues.

The Australian Transport Council considered options for such a cross-modal agency and for advancing inter-jurisdictional rail reform at its meeting in April 1999. It agreed to:

- . a National Transport Secretariat to directly advise it on major issues of national importance, which will include cross modal issues;
- . develop an intergovernmental agreement as an interim measure to facilitate implementation of uniform operational requirements and standards, including the establishment of a unit attached to the Commonwealth Department of Transport and Regional Services to facilitate implementation arrangements; and
- . an independent review of rail safety arrangements on the interstate system, including of the current intergovernmental agreement on rail safety.

3.11 Summary – current structure of rail

At the time of the Commission's 1991 report, virtually all rail operations in NSW were conducted by the vertically integrated State Rail Authority.

There have been major structural changes to this. Now, in 1999 in NSW:

- . regulatory responsibilities have been removed from commercial operations;
- . there is vertical separation between track and train operations;
- . there is open access to track;
- . open access arrangements are under a “negotiate and arbitrate” framework with an independent arbitrator and without a rail regulator;
- . freight and passenger operations are conducted by different organisations; and
- . there is explicit recognition of national level issues including in relation to interstate train operations and interstate access.

4. RAIL TASKS AND PERFORMANCE

4.1 NSW Rail Tasks

The Commission's 1991 report indicated that rail serves four main types of transport task:

- . urban passenger services;
- . non-urban passenger services;
- . bulk commodity freight; and
- . non-bulk freight.

In the urban passenger segment, State Rail's CityRail is the only service provider. CityRail's urban and interurban passenger services operate within the electrified network bounded approximately by Macarthur (south west), Dapto (south), Lithgow (west) and Broadmeadow-Newcastle (north). Since the Industry Commission's 1991 report CityRail passenger numbers declined from a peak of 251.6 million in 1990-91 to 229.8 million in 1992-93. Between 1992-93 and 1997-98 passenger numbers increased by 16 percent, with annual growth tapering off to 0.7 percent in 1997-98 itself. CityRail currently holds around 17 per cent of the Sydney journey to work market, and 52 percent of the Sydney CBD journey to work market.

The figures for the non-urban passenger segment come from State Rail's Countrylink division. Countrylink operates regional as well as interstate passenger services. In the late 1980s and early 1990s, passenger numbers declined to a low of 2.1 million in 1993-94, with passenger kilometres falling to 0.83 billion. Since then there has been a steady increase to 2.5 million passengers and 1.01 billion passenger kilometres, although both figures are below historic records. Rail currently holds only a minor share (less than 5 percent) of the country and interstate long distance passenger market in NSW.

Bulk commodity rail traffic has increased very substantially since 1991, particularly in coal traffic. FreightCorp dominates these markets in NSW.

Growth in FreightCorp's coal and minerals traffic has been strong in recent years, with coal hauls totalling 69.1 million tonnes in 1997-98, compared with 51 million tonnes prior to the structural reforms in 1995-96. Around 90 percent of coal hauls are through the Hunter Valley to Newcastle for export. Rail holds around 90 percent of the coal haulage market.

Grain traffic generally is intrastate and has been dominated by FreightCorp. It is much more seasonal in nature than coal, depending on variations in annual climate conditions in the grain zone. Export wheat is the main task, accounting for around 74 per cent of the total grain task in 1997-98.

Non-bulk freight comprises intra-State and inter-State freight hauls of containers and products such as steel. While these segments are dominated by FreightCorp and

National Rail Corporation respectively, both corporations are seeking to work in both intra and inter state segments ie. in each others traditional markets. Also new operators have emerged in both segments.

4.2 Network usage

The NSW rail network is “standard gauge” (1435 mm). This is the gauge used in other States for interstate rail traffic. Together with the significance of NSW, and especially the Sydney area as a transport centre, this gives rise to a close relationship between NSW and national rail issues.

Unlike in other States, all NSW tasks are carried on the standard gauge, and few parts of the network are dedicated to a single transport task. However, in certain parts of the network there is a clear predominant use of the tracks for a certain transport task.

Market based segment figures may be mapped onto the NSW network. This would show the NSW network as comprising a number of use based sub-networks:

- . in the Sydney electrified area, the predominant task is urban passengers. There is a limited separate freight network within this area;
- . the predominant task for the Hunter Valley area (extending from Newcastle ports to Muswellbrook) is coal;
- . the predominant tasks for lines connecting with other States outside the Sydney area (through Albury, Broken Hill and Kyogle) include interstate non-bulk freight in many places; and
- . the predominant tasks for most other lines are largely bulk freight, including grains

Aggregate network utilisation is generally measured in terms of total gross tonne kilometres (gtk) per route kilometre. The NSW average in 1997-98 was 5.26, an increase from 5.24 in 1996-97.

There are major variations in network utilisation throughout NSW. In terms of gtk/route km the most heavily utilised segments are in the Hunter Valley. In terms of train numbers, the most heavily utilised segments are in the electrified area which is the most densely trafficked area in Australia with nearly 2,600 scheduled train services each day.

4.3 Productivity measures and performance indicators

Selected partial productivity measures and performance indicators, as reported by the rail organisations for 1997-98, are shown in Table 1.

In recent years, performance and productivity measures have generally shown solid improvements. For example:

- . State Rail's on-time running, which deteriorated in 1996-97 (unrelated to the structural reforms), improved substantially to near previous peaks in 1997-98. This includes moving 923,000 people to the Easter Show (mode share of 69 per cent);
- . FreightCorp's employee productivity increased by 18 percent in 1997-98;
- . National Rail Corporation has virtually eliminated the very substantial losses previously suffered by interstate rail freight, and an independent study concluded that in most cost categories the company was operating near world best practice in 1997-98;
- . Railway Services Authority has won significant contracts including some outside its traditional markets; and
- . the NSW track condition index managed by Rail Access Corporation for 1997-98 is the best on record in NSW, and the percentage of interstate track in NSW under temporary speed restrictions at 0.8% was the lowest in Australia.

Table 1: Partial productivity measures and performance indicators

Organisation/measure	1997-98
State Rail Authority	
. on-time running (suburban)	94.3%
. on time running (Countrylink)	85.0%
. cost per passenger journey (\$)	6.00
FreightCorp	
. ntk per employee (000)	3907
. ntk per wagon (000)	2335
. wagon availability	96%
. ntk per locomotive (000)	41614
. locomotive availability	90%
. locomotive reliability	95.5%
National Rail Corporation (a)	
. ntk per employee (000)	11700
. ntk per wagon (000)	3900
. wagon availability	98%
. ntk per locomotive (000)	20100
. on time availability of intermodal freight	91%
Rail Services Australia	
. revenue per employee (\$000)	115.0
. disruptions due to infrastructure failure (%)	18%
Rail Access Corporation	
. gtk per route kilometre	5.26 million
. temporary speed restrictions	1.4%
. on-time paths	94.3%
. incidents due to infrastructure/network control	81

(a) Extending beyond NSW.

Source: NSW Department of Transport 1999

Financial and price indicators are noted below.

4.3 Financial performance

Financial performance is summarised in Table 2. Some care is needed in comparisons with years prior to 1996-97 due to the structural reforms of 1 July 1996. These reforms increased the number of entities and the transparency of financial flows within the rail sector.

Table 2: NSW rail financial performance

Organisation	Function	1997-98 (\$million)
State Rail Authority . passenger revenue . social programs (a) . operating surplus	Passengers	434.1 495.5 (45.4)
FreightCorp . market revenue . revenue from Govt (a) . operating profit post tax	Intrastate freight	683.6 90.0 13.6
National Rail Corporation (b) . operating revenue . revenue from Govt . operating profit post tax	Interstate freight	485.2 0 (8.9)
Rail Services Australia . revenue excluding Govt . revenue from Govt . operating profit	Input services	669.2 32.8 (1.57)
Rail Access Corporation . market revenues (c) . revenue from Govt (d) . operating profit after tax	Track and access	602.9 177.0 118.3

(a) Social programs (CSO) payments are revenue from Government

(b) Extending beyond NSW.

(c) Excluding Government funding and operator funded capital projects.

(d) Excluding capital funding.

Source: NSW Department of Transport 1999

One key issue for the rail sector is the level of prices charged for rail transport. Prices charged to rail customers relate to a number of factors including social program payments, competitive pressures and productivity levels.

Reflecting productivity improvements, internal rail sector costs have fallen significantly, a trend which has been pronounced since the 1996 structural reforms. For example, Rail Services Australia and Rail Access Corporation have reduced annual rail maintenance costs from \$640 million to \$528 million. Rail Access Corporation expects further reductions and estimates accumulated savings of \$296 million for the period 1 July 1996 to 1 July 1999, including infrastructure maintenance cost reductions of \$219 million (23 percent in real terms). It forecasts some \$164 million of this will flow to operators via reduced access charges.

Reductions in access costs and in above rail costs have provided freight operators with an opportunity to reduce freight rates. Increased competitive pressures have provided a stimulus for such reductions. In this regard, it is worth noting that there are several new operators on the NSW network and that both National Rail Corporation and FreightCorp have taken advantage of open access and moved beyond their original respective boundaries of interstate and NSW intrastate freight.

FreightCorp's average freight rates fell by 7 percent in 1996-97 and by 9 per cent in 1997-98. The reductions in 1997-98, coupled with increased volumes, represent a gain by its freight customers of \$60 million. Reductions in freight rates were particularly great for coal where average prices for Hunter hauls have reduced by 25 percent over two years.

In the case of passenger services, adjusting for the cost of service improvements, services are being delivered at an appreciably lower cost (ie. in the 3 years to 1998/99 costs have been reduced by nine percent).

4.4 Community Service Obligations

Most reviews of rail comment on social programs, or Community Service Obligation (CSOs) payments.

In NSW, the Transport portfolio is responsible for purchasing CSOs. The *Transport Administration Act 1988* allows for the Director General of the Department of Transport to enter into relevant contracts.

There are explicit CSO contracts with the relevant rail entities for provision of "non-commercial" rail services relating to freight, passengers and track. These are services that would not be provided by the rail entities without Government funding. Only the NSW Government rail entities hold CSO contracts. The contracts are annual, with the exception of Rail Access Corporation's contract which lasts for 7 years (see 4.5.3 for details). The Department of Transport uses the contract framework to maximise service outcomes for value and to monitor and evaluate service performance.

4.5.1 Freight CSO

FreightCorp receives a payment for the transport of some grain, minerals and general freight across regional NSW. This is allocated by product.

In essence, the Government is buying the movement of these freight products by rail. Current CSO payments for these products are \$89.2 million. In addition, a minor amount (\$0.8 million) is provided for the purchase of locally manufactured locomotives.

4.5.2 Passenger CSOs

The Department of Transport has separate CSO contracts with State Rail in relation to CityRail and Countrylink services.

In both contracts, total payment equals the expected estimated gap between operating expenditure and total revenue on a cash basis. Total SRA CSO funding is \$495.5 million.

CityRail CSO payments are estimated in three categories:

- . Pricing CSOs recognise low general fares, which are aimed at encouraging increased use of public transport. This \$68.1 million CSO payment represents the difference between estimated revenues from actual prices charged and estimated revenues from prices were they to be set on a “commercial” basis.
- . Concession CSOs fund targeted concessions such as those provided for pensioners, war veterans and school children. Total cost is \$133.5 million. The payment is based on estimated revenue foregone by CityRail due to the offering of concessions.
- . Service CSOs payments are made for the provision of services which would not be provided, even with revenues from “commercial” fares. Total cost is \$219.8 million.

The CityRail CSO includes coverage of all operating costs, including those relating to the use of track in the electrified area. In essence the Government is buying:

- . the continued availability of urban passenger services;
- . increased utilisation of those services by the general public; and
- . discount fares for certain groups.

The Countrylink CSO payment comprises a \$67.8 million concession element to allow discount fares for certain groups, and a service element is \$6.3 million.

4.5.3 Track CSO

CSO payments are made to Rail Access Corporation to support rail lines outside the Sydney electrified network. These CSOs are allocated on a line section basis, with specific funding allocated to identified line sections. The lines then are available for use by rail operators under access agreements.

This CSO is provided under a 7 year contract. This enables Rail Access Corporation to offer long term access prices to access seekers. Total funding in 1997-98 was \$177.2 million.

4.6 Performance – summary

The NSW rail network comprises a number of sub-systems. Since 1991, and particularly since the structural reforms of 1996, there have been major improvements in all main rail activities.

In the case of freight, improvements are flowing through in price reductions and increased reliability of services. There are signs of innovation emerging in freight, including in rolling stock design and operation and in positioning rail line haul in logistics management.

In the case of passenger services, adjusting for the cost of service improvements, services are being delivered at an appreciably lower cost (ie. in the 3 years to 1998/99 costs have been reduced by nine percent).

The 1996 reforms have provided much greater transparency in rail and increased competitive pressures throughout the sector. Already it appears that significant benefits are flowing through the rail sector to its major customers and to Government.

5. TRANSITIONAL ISSUES

The reforms in rail in NSW since 1991 have improved transparency and increased competitive pressures on the sector. This has provided strong incentives for rail organisations to raise performance. However, it also has generated or thrown light on a number of important issues.

One group of issues are transitional matters which are being addressed in a relatively short time frame. Examples of these are raised in this section. There also are more fundamental issues concerning the future role of rail as a transport mode, examples of which are raised in section 6.

5.1 National Rail Corporation

The *National Rail Corporation Agreement* envisaged the creation of an interstate rail freight carrier. The purpose was to turn around the loss making interstate rail business conducted by 5 separate State rail authorities. Estimated losses of this business prior to the formation of National Rail Corporation were \$321 million on a revenue base of around \$460 million.

The formation of the company was to be achieved in two phases – a transition period and an establishment period. During the 3 year transition period (to 1 February 1996), National Rail Corporation was to progressively take over the interstate rail functions performed by the State rail authorities, and the shareholders would contribute cash and assets to assist in the restructuring of the business.

By the end of the 5 year establishment period (1 February 1998), the company was to have been equipped with all relevant assets, including from the shareholders' rail authorities, and operate as a stand-alone entity. The *National Rail Agreement* provided some detailed processes for each of the main tasks of take-up of functions, introduction of commercial service contracts between the rail authorities and the company, "compensation" or "wedge" payments by shareholders, and the transfer of assets in exchange for shares.

In the event, implementation of the *National Rail Agreement* has taken significantly longer than originally anticipated. Factors include:

- . the moves towards vertical separation of track from train operations, which was not anticipated at the time of formation of National Rail. Indeed the *Agreement* included a process through which the company could seek to acquire the interstate track;
- . some technical difficulties with the identification and transfer of assets, for example the need to establish development consent for an appropriate terminal site in the Sydney area (originally Enfield, now Chullora); and

- . prolonged consideration by shareholders of their obligations to provide the company with compensation payments and rail authority assets, for example certain locomotives, terminals and track.

Matters considered by shareholders in the discharge of the *Agreement* included the changing rail environment, such as the emergence of above-rail competition for interstate rail freight, the formation of the Australian Rail Track Corporation and moves to sell Australian National Railways and V/Line freight.

The announcement by some shareholders of their intention to sell shares in National Rail was made well in advance of the resolution of the issues relating to the establishment of the company. This was notwithstanding the fact that some resolution would be required before a sale could take place.

These issues have now largely been resolved. In the interim, the company has faced much stronger than expected competition on-rail and from road transport. Partly offsetting this, the company sought, and was granted, the ability to operate intrastate rail services in NSW and Victoria. It has had some success in this field, and has further extended its operations to provide locomotive power to some long distance passenger trains.

In summary, implementation of the *National Rail Agreement* has taken considerably longer than expected. The main reasons for this appear to be the substantial broadening of the rail reform agenda since the company commenced operations.

5.2 Rail Safety

The *Rail Safety Act* was passed prior to the moves towards more uniform national arrangements for rail safety that are embodied in the *Intergovernmental Agreement on Rail Safety*. The *Rail Safety Act* also predates the 1996 NSW structural reforms. Of course, in undertaking the reform process NSW has been most concerned to ensure that all changes enhance safety outcomes.

The *Rail Safety Act* is due for review by September 1999. Issues arising from the reform process will be relevant to this review including:

- . adaptation of the safety management framework to a vertically separated railway in NSW and on the interstate track in other states, and in particular the management of interfaces;
- . the place of the NSW framework in the national rail industry, including issues such as mutual recognition and rationalisation of interstate accreditation costs; and
- . implementation of arrangements to ensure that safety considerations do not constitute an anti-competitive barrier to entry to the rail sector or use of access rights.

The later two points were the focus of some attention in the process of NSW seeking certification of the NSW Rail Access Regime. To address the issues raised by the National Competition Council, NSW undertook certain actions including providing a reference to the Independent Pricing and Regulatory Tribunal to review rail safety accreditation costs. The Tribunal finalised its report in March 1999 and the Department of Transport is implementing the key recommendations.

As noted above, the Australian Transport Council has asked for an independent review of the arrangements for interstate rail safety – a review of the *Intergovernmental Agreement on Rail Safety*. This review will need to deal with the issues of consistency of safety regulation among jurisdictions, and mutual recognition of accreditation.

These reviews are timely given the major changes in the rail environment and the expectation of increased private sector involvement in rail operations.

5.3 Implementation of the 1 July 1996 Structural Reforms

The Government established a Transport Reform Steering Committee, comprising senior officials and Chief Executives of the NSW rail entities to oversee the transition to the post 1 July 1996 rail structures. The Steering Committee dealt with a number of implementation issues including asset allocation, finances and access pricing.

5.3.1 Asset allocation

A key issue in the new structure was the allocation of assets. The process used was for the 3 new entities, Rail Access Corporation, FreightCorp and Railway Services Authority, to nominate and agree among themselves and with State Rail on the assets and staff needed for their new businesses. The Minister for Transport would then vest the assets and staff to the new entities consistent with a new process established by *Transport Administration (Rail Corporatisation and Restructuring) Act 1996*. State Rail would hold the residual, and dispose of unnecessary assets. Asset allocation included:

- . for Rail Access Corporation, rail infrastructure facilities – track, signals etc - in line with an agreed network diagram;
- . underlying corridor land was not transferred to Rail Access Corporation, rather the *Transport Administration (Rail Corporatisation and Restructuring) Act 1996* provided the Corporation with rights in relation to relevant land;
- . for FreightCorp, most freight assets including locomotives, wagons and some terminals; and
- . for Railway Services Authority, nominated assets including workshops and certain land sites.

Most asset matters were resolved prior to, and transfers effected on, 1 July 1996. However, a few issues took somewhat longer to finally resolve:

- . terminals; it was argued by some that Rail Access Corporation should control some terminals in the Sydney area as “common user” facilities. This was not accepted and terminals which remain with State Rail are being progressively transferred to rail operators and other parties. It should be noted, however, that Rail Access Corporation controls entry and exit to terminals onto the mainline system;
- . land; there were some questions as to whether certain parcels of land within or adjacent to rail corridors should belong to State Rail, Rail Access Corporation or the Railway Services Authority. The resolution of this is that corridor land generally is held for the benefit of Rail Access Corporation as it forms part of the rail network, even though parts of it may be occupied by other parties; and
- . intellectual property; the intentions of the reforms in relation to the division of ownership of plans and methodologies was not as clear as was the division of physical assets. The issues here have been resolved by mutual agreement among the entities as to the division and use of intellectual property.

There has been some further refinement of asset allocation including in relation to the core rail telecommunications network which has been transferred to Rail Access Corporation.

5.3.2 *Finances*

Underpinning the financial position of any entity are costs and revenues. One effect of the 1 July 1996 structural reform was that some of the costs of each entity became revenues to another entity. For example, access prices are a cost to FreightCorp but a revenue for Rail Access Corporation.

The structural reforms took place at the same time as Government sought to improve overall efficiency by rigorously addressing net support for the rail sector. The focus on net support, as distinct from outlays only, reflected the fact that the new structure involved the establishment of commercial businesses and elimination of cross subsidies. It was expected that there would be some payments from rail entities to the Government, which would in part offset Budget outlays.

It also was envisaged that recurrent funding be provided only to rail operators. Funds would flow via operator access payments to Rail Access Corporation. These payments were to be negotiated among the parties, rather than be mandated by Government, consistent with the “negotiate and arbitrate” provisions of the *Rail Access Regime*. The *Regime* sets boundaries intended to ensure that access pricing does not involve cross-subsidisation. Rail Access Corporation then would provide funds to the Railway Services Authority for maintenance works.

This scheme implies that agreement of access prices would need to be made consistent with the allocation of Government funds, and this occurred under the guidance of the Transport Reform Steering Committee in 1996-97. Matters arising in this process included:

- . the identification of an issue relating to the annual basis of Government recurrent funding, and operator and Rail Access Corporation requirements to enter into long term access contracts with some certainty and stability of access prices. This has been largely resolved by the seven year line CSO contract;
- . strong pressure was placed on the Railway Services Authority to improve efficiency as it had no direct source of Government funding for its maintenance functions. The Authority was at the “end of the chain” for virtually all of its funds; and
- . the impact of the elimination of cross subsidies via commercial access arrangements on reported performance. The elimination of cross subsidies contributed to the reported financial improvement of the freight business and returns to Government and to the need for additional direct funding for passenger rail.

5.3.3 Contestability Program

As part of the structural reforms, the Government agreed that Rail Access Corporation contracts for track maintenance would be made contestable through a staged program. In implementing this policy, Rail Access Corporation created 13 contract bundles based on geographic areas. These were to be progressively tendered over four years, through a competitive tender process.

In the first two years of the contestability program, significant savings were achieved in infrastructure maintenance. This included both areas in which contracts were contested and areas in which contracts were not then contested.

The contestability program was suspended in February 1998, to allow for the corporatisation of Rail Services Australia (RSA). Contestability will now recommence in key regions with a review by March 2001 covering options for further contracting out and an assessment of the performance of RSA.

5.3.4 Summary of structural reform implementation

Implementation of the structural reforms in NSW has largely been a smooth process. The co-opting of all the entities into the process is likely to have been a major contributing factor to its success. In addition, the establishment of the Transport Reform Steering Committee proved to be a useful device to identify and resolve difficulties that emerged in the transition to the new structure.

5.4 Open access issues

A series of transitional issues arose out of the vertical separation and access policy that was an integral part of the 1 July 1996 structural reforms. These are briefly discussed below. Coal issues are dealt with in section 5.5.

5.4.1 Establishing relationships between vertically separated organisations

The establishment of Rail Access Corporation and the implementation of open access has resulted in a new industry structure and institutional arrangements. Significant arrangements that previously had long been internal or in-house within a single rail organisation (the State Rail Authority) now need to be conducted at arms-length between separate entities and in accord with business laws.

Transitional issues emerge in any restructuring of business activities, including in the restructuring of Government businesses, and some of those for the 1996 rail restructuring have been discussed above. In rail, further important issues arise regarding the relationships required for a vertically separated railway to function most efficiently.

Open access and vertical separation have the potential to deliver significant benefits to the community through allowing for the development of strong competitive pressures on rail operators. Also important is the creation of full transparency and the generation of commercial or market based pressures in all parts of the rail transport chain, neither of which may be achievable in a vertically integrated structure. The benefits include reduced end market transport costs, for example lower freight rates or reduced Government contributions, and improved services and innovation. These already are being seen in NSW.

However, vertical separation may risk an increase in rail system costs if infrastructure management becomes remote and unresponsive to rail operator requirements. The engineering relationship between infrastructure and operations means that there are trade offs between maintenance and investment in infrastructure and in rolling stock. In vertically integrated railways coordination of such trade-offs are readily achieved including by administrative means.

It is possible to deal with the trade-offs through commercial contractual processes. In a vertically separated railway such an approach is necessary. Optimisation of the trade offs under vertical separation requires a flexible commercial approach on the part of both the infrastructure owner and the rail operators. Administrative decision making processes are replaced with commercial processes.

To some extent a flexible commercial approach to the infrastructure-rolling stock trade off would have been necessary in NSW even without the July 1996 reforms. For example, on the declaration of access to the network under the Competition Principles Agreement, a NSW entity would need to have negotiated an access price with the access seeker whether or not the structural separation took place.

Similarly, a NSW entity would have needed to be responsible for the commercial provision of access to the National Rail Corporation, consistent with the *National Rail Agreement* irrespective of the 1996 reforms.

In the investment trade-off, it is likely that some learning process is required to achieve best results. The *NSW Rail Access Regime* now specifically provides for the negotiation of new investment on the network. There are signs that this process is taking effect. For example, National Rail Corporation is now negotiating with Rail Access Corporation for the commercial construction of passing loops on the NSW network.

Associated with these matters are issues about the planning and development of major Government funded rail projects, such as that proposed in the Sydney area for the Parramatta rail link. In the new rail environment, the development of such projects requires strong input from a number of organisations.

5.4.2 *Open Access*

Under the 1996 structural reforms, open access to the NSW rail network became the responsibility of Rail Access Corporation operating under the *NSW Rail Access Regime*.

The *Regime* is of a “negotiate and arbitrate” nature, apart from some of the transitional provisions for coal. The Independent Pricing and Regulatory Tribunal (IPART) is the arbiter of disagreements among the parties. Most parties have negotiated and agreed with Rail Access Corporation on terms and conditions of access to the network. There are three new freight operators already on the network, and both National Rail and FreightCorp have taken advantage of open access to commence new services.

In some cases, formal competition policy processes were invoked in reaching agreement. Soon after the 1996 reforms, National Rail Corporation and Rail Access Corporation sought to initiate arbitration as they were unable to agree on terms and conditions of access. After preliminary hearings, this matter was settled by the parties.

Specialised Container Transport and the NSW Minerals Council pursued a different route in dealing with their differences with Rail Access Corporation on access issues. Both parties sought declarations over parts of the NSW rail network through the National Competition Council (NCC) and the national access regime process, rather than through the arbitration processes established by NSW. In essence, they argued that the *NSW Rail Access Regime* was not “effective” within the meaning of the relevant legislation, and that a declaration should be granted (see 5.4.3 below) to bring access under the national access regime.

As the national access regime is also of a “negotiate and arbitrate type”, but without guidance as to pricing, one effect of granting such a declaration would have been for the Australian Competition and Consumers Commission, rather than IPART, to arbitrate on disputes.

The NCC recommended in favour of a declaration in both cases, however, these recommendations were not accepted by the NSW Premier. Specialised Container Transport later agreed with the Rail Access Corporation on access terms. The NSW Minerals Council has appealed to the Australian Competition Tribunal and the appeal has not yet been heard.

5.4.3 Access Regime

The NCC declaration process is not available to third parties if there is in place an “effective” State based access regime in relation to the relevant facilities. An “effective” regime is one which has been certified as effective by the relevant Minister, being the Commonwealth Minister for Financial Services and Regulation. To be certified as effective, an access regime needs to meet certain criteria which are set out in the *Competition Principles Agreement*. The process of certification involves jurisdictions submitting access regimes for the consideration of the NCC. The NCC provides a recommendation to the relevant Minister as to whether the regime should be certified as effective and thus displace the national generic regime.

In June 1997, NSW applied for certification of its *Rail Access Regime*. After extensive consultation with the Government, the NCC issued a draft report indicating that the Regime could be recommended for certification, provided some amendments and supporting actions were undertaken.

The main amendments and supporting actions recommended by the NCC included:

- . expansion of the class of persons who can hold access rights. Previously only rail operators could hold such rights. This has been expanded to include access seekers who wish to use the services of rail operators, and to include the ARTC;
- . specific provisions for access seekers to negotiate new investment on the network;
- . development of a capacity transfer policy;
- . clarification that an access agreement may be executed prior to the access seeker gaining relevant approvals under the *Rail Safety Act*. Of course, such approvals are necessary before the commencement of actual rail operations;
- . publication of information including in relation to determinations of the arbitrator;
- . provision of information packages by Rail Access Corporation to access seekers;
- . review by the Independent Pricing and Regulatory Tribunal of rail safety accreditation costs; and
- . adoption in the *Regime* of a review by the Independent Pricing and Regulatory Tribunal of certain economic aspects of the Regime (discussed below).

These amendments and supporting actions are either in place or have commenced. A new *Regime* has been gazetted, and the certification processes have commenced.

NSW was the first jurisdiction to submit a rail access regime to the NCC.

5.4.4 IPART Review of Aspects of the Rail Access Regime

In the NCC consultations on the *Regime*, issues were raised about the general pricing provisions. The “negotiate or arbitrate” principles mean that prices are agreed within a floor to ceiling range, and are not fixed or set.

Initially it was claimed that the range in which prices could be negotiated or arbitrated was so wide as to cause uncertainty and inhibit new access. A further point of contention raised was the claim that the floor and ceiling were inappropriately set. In particular, it was claimed that the ceiling was too high. These issues have been addressed by a reference from the Premier to IPART.

IPART produced a draft report in February 1999, and a final report in April 1999. The report includes recommendations addressing definitions of a number of economic terms in the *Regime*, asset valuation and the maximum rate of return. Key recommendations include that for pricing purposes:

- . access prices should be based on forward looking (forecast) efficient costs;
- . existing corridor vested in Rail Access Corporation should be valued at zero;

- . assets owned by Rail Access Corporation should be valued using a depreciated optimised replacement cost methodology in the calculation of ceiling prices;
- . the maximum rate of return (in real, pre tax terms) should not exceed 8.0 percent; and
- . the Regime should specify a process and frequency for revising the maximum rate of return.

Schedule 3, clauses (iii) and (iv) of the *Regime* automatically adopts the Tribunal's key recommendations on pricing definitions.

5.4.5 Summary of general open access issues

Open access policy administered by the Rail Access Corporation is settling under the *Rail Access Regime's* negotiate and arbitrate framework. There has been an expansion of access under the policy. The *Regime* itself has been modified to further facilitate access. The Independent Pricing and Regulatory Tribunal has provided guidance on key pricing issues which will be adopted.

5.5 Coal access issues

Coal is the largest commercial tonnage task for the NSW rail network. NSW has two coal ports, Newcastle and Port Kembla, both of which are served by rail.

Newcastle is the world's largest coal export port, and rail plays a critical role in the efficiency of the regional coal chain and in the development of the Hunter Valley coal areas.

Against this background, the principles for access to the NSW rail network for coal haulage are especially significant. Of these principles, pricing under the *NSW Rail Access Regime* has attracted most comment. The two main issues being the "adjustment component" up to July 2000, and the ceiling price on which this is calculated and which may be negotiated thereafter.

The *Regime* provides for special transitional principles for the pricing of access for coal haulage. The background to the transitional principles is that the national competition policy intended to create a "moratorium" in respect of competition for coal haulage and therefore in relation to track access until November 2000. The intention of Governments in agreeing to the "moratorium" appears to have been to protect State net revenues generated by coal haulage.

Rather than shielding FreightCorp from competitive pressures by denying potential competitors the possibility of access, NSW provided for immediate open access to all track including for coal haulage. It is understood that some coal interests have sought competitive bids from various rail operators for their rail freight

requirements, and National Rail Corporation has won a coal haulage contract in the Hunter Valley.

Access prices for any operator include a phasing-out of what the coal industry considered “monopoly rent” in hauls from the Hunter Valley areas by reductions in an “adjustment component”. The methodology for calculating the adjustment component has its origins in previous discussions between NSW and coal interests on increasing private sector participation in rail operations. These discussions included consideration of “monopoly rent” defined as rail revenues in excess of what might be considered ceiling costs – total operating costs and an appropriate return on capital.

The 1 July 1996 structural reforms have unbundled these costs into access and above rail operation parts. The coal pricing principles place the “adjustment component” with Rail Access Corporation. The adjustment component is being phased out over 4 years to 1 July 2000. Pricing will be on a full negotiate and arbitrate basis from 1 July 2000. In the interim, Rail Access Corporation remits all adjustment revenues to the Government, and this eliminates the possible use of revenues for cross subsidisation.

As such only some, but not all, of net coal rail revenues are protected. Strong competitive pressures have been brought to bear on FreightCorp in the Hunter. This is evidenced by a substantial reduction in average Hunter Valley coal freight rates.

Amendments to the open access framework made since 1996 operate to accelerate the pace of rail reform to the advantage of the coal industry. Relevant matters include the ability of certain non-rail operators to seek access, enabling the base (non-adjustment) component of the coal access price to be negotiable, and the information provision requirements of the *Regime*. Also relevant are the pricing definitions recommended by IPART as these will affect the ceiling price for rail access, including for coal.

5.6 Community Service Obligations

Prior to and immediately after the 1996 structural reforms, Government policy was to provide all relevant Community Service Obligations (CSO) payments to Government rail operators.

In 1997, this policy was changed to provide for some CSO payments to be made to Rail Access Corporation. These are for the lines requiring support outside the Sydney electrified area. Within the Sydney area, the State Rail Authority is provided with CSO payments from which it pays access charges.

The decision to change this policy reflected the Government's desire to support the network over a significant period and thereby maximise the prospects for Rail Access Corporation to increase network utilisation by offering reduced access prices.

The rail industry has generally welcomed this initiative.

5.7 InterGovernmental Agreements 1997

The two Intergovernmental Agreements of 1997 were intended to designate and promote greater uniformity on the interstate rail network. Implementation is following two streams.

In the first stream, the Rail Group is sponsoring the development of uniform procedures and processes for the interstate network, and for monitoring improvements to the network. Most of this work is well underway.

A significant aspect of this work was the commissioning of a report on rail uniformity. The result, the "Maunsell report", provides a blueprint for a possible future uniform national network including:

- . signalling, communications and safe working systems;
- . operating protocols;
- . track speeds and axle loads;
- . maximum train lengths; and
- . loading gauge (the height and width dimensions of trains).

The Australian Transport Council has agreed that an intergovernmental agreement should form the initial mechanism to lock in those national rail reforms relating to uniformity of standards and operations.

In the second stream, ARTC is working to become the single point of interstate access to the interstate network. ARTC has concluded agreements with the Commonwealth and with VicTrack in relation to track management and control between Kalgoorlie and Albury/Broken Hill.

Rail Access Corporation and ARTC are progressing negotiations on the handling of access arrangements through NSW.

In late 1998, the Commonwealth wrote to NSW advising that it wished to discuss the first round of projects to be undertaken under its \$250 million interstate rail investment program. Construction of the first project, at Flemington junction in Sydney, commenced in late 1998.

Generally, implementation of these arrangements has taken longer than was originally expected. However, most appear to be now well underway.

5.8 Development of management and employee skills

Development of skills in the new rail environment is likely to become a significant transitional issue for the rail entities.

The separation of the rail entities has focused each of the NSW rail organisations on a specific and more limited core business. This process has necessitated that the organisations carefully evaluate management and skill requirements for their particular role in transport markets.

Each of the NSW rail entities has an enterprise agreement and are using these and related processes to achieve workplace and managerial reform. Initiatives implemented include job and work redesign and strategies to enhance the skill base and promote skill development.

5.9 Summary of transitional issues

A variety of issues has arisen during the course of the rail reforms in NSW, particularly the 1996 changes. The consultative and co-operative framework used by NSW, including the Transport Reform Steering Committee, and discussions with the NCC, has assisted implementation.

In several respects, reforms at the national level have taken longer to effect. There have been some delays in the implementation of new national arrangements. This affects rail in NSW for a number of reasons including the interconnectedness of the NSW network with the national rail system.

Nonetheless, most of these issues, which are rail specific, have either been addressed or are subject to process which will result in their resolution.

6. STRATEGIC ISSUES

There are a number of strategic issues facing rail in NSW for which there is no clear formal process for resolution. These include:

- . relationships between national and regional rail systems;
- . consistency in policy directions among jurisdictions; and
- . competitive neutrality among the land transport modes.

Among other things, these issues are likely to have significant implications for private investment in rail.

6.1 Relationships between national and regional systems

In recent years, there has been substantial debate about the need for a national rail network. A number of models for such a network have been proposed including:

- . the vertical integration envisaged in the *National Rail Agreement*;
- . Track Australia;
- . a National Rail Infrastructure Authority;
- . arrangements similar to those for the National Highway Network; and
- . those in which State track authorities act as agents in a national scheme.

Governments in 1997 agreed for the Commonwealth to establish the Australian Rail Track Corporation (ARTC) track as the preferred model for five years. This corporate organisation is to exclusively provide interstate access based on a mix of ownership, leasing and access rights over standard gauge tracks between Perth and Brisbane.

The essential argument for a national network is that it will develop or embody uniform (harmonised) operating arrangements such as signalling, safe working systems and operating protocols, and that such uniformity is necessary for the rail sector to substantially increase its share of land transport markets. Implicit in the argument for a national network is a view that the target market is national ie. interstate freight.

The 1997 *National Rail Summit Agreement* set some infrastructure performance specifications for a designated national network, including certain tracks in NSW. Both this Agreement and the *ARTC Agreement* refer to the desirability of national uniformity. The 1998 Maunsell report identifies the relevant operational attributes of a national network.

This is of special relevance to NSW as all State track is standard gauge. That is, the same infrastructure in NSW is both part of the designated national network and part of the NSW network. In many areas of NSW, interstate freight is currently not the

predominant traffic in terms of task or of financial contributions. It is the main traffic in some parts of the NSW network, but only a marginal user of others. For example, in Sydney interstate freight trains share tracks with passenger trains, but are only a small fraction of the total rail task. However, interstate freight movements are constrained by lack of track capacity in Sydney, with effects throughout the interstate network. In recognition of the importance of improving capacity through Sydney to rail freight movements throughout Australia, parties to the 1997 *National Rail Summit* agreed to develop a plan for the provision of dedicated freight track(s) through metropolitan Sydney.

The relationship between the regional and national networks is at the heart of the issues regarding harmonisation and uniformity, including the matters identified in the Maunsell report. The key issues in progressing this agenda include:

- . the extent to which harmonisation of interstate operating conditions is compatible with continuing harmonisation of local operating conditions;
- . the extent to which lack of harmonisation is due to inappropriately different regulations among jurisdictions, whether there is a cost to rail of changing such regulations, and if there is, where that cost is borne;
- . the strength of incentives within rail, or the availability of funding, to address non-regulatory causes of non-uniformity; and
- . what would be an adequate and efficient decision making process for the pursuit of harmonisation and uniformity across Australia's rail systems.

As noted above, the Australian Transport Council has agreed to draft an intergovernmental agreement as a process to start to resolve these issues. However, irrespective of the administrative process chosen, the operational substance and characteristics of underlying infrastructure are likely to have a very significant effect on how far uniformity can advance in the absence of substantial Commonwealth Government uniformity funding.

6.2 Consistency in policy directions

There have been considerable efforts at rail reform in all Australian jurisdictions. However, not all jurisdictions are pursuing reforms in the same direction and there have been significant delays in implementing policy agreements, including those at a national level.

The implementation of the *National Rail Agreement* is an example where final agreement as to Governments' obligations to equip the corporation with assets was not reached until more than two and a half years after the date specified in the Agreement.

The *National Rail Corporation Agreement* also envisaged the possibility of a vertically integrated rail freight operator developing the national rail network. The

discussions on national network models culminated in the November 1997 *ARTC Agreement*, which implicitly rejects vertically integrated control of the network used by National Rail Corporation, for at least 5 years. However, the position on at least one part of this network – Alice Springs to Tarcoola – is not entirely clear, with one proposal being that this segment would be leased to the successful proponent of the Darwin-Alice Springs rail line.

Also, a number of national proposals for private and publicly supported private new rail systems have been advanced and are under review. Consideration of these proposals at Government level appears to have been largely ad-hoc, and without the benefit of a coordinated national plan or strategy for rail or land transport.

However, recognition by Governments of the need to consider the tracks linking the States as a national network and their desire to attract private investment into that network would suggest some need to consider inter-linkages and effects of major new rail schemes on existing networks.

This point appears to be the basis for the call for a national transport strategy, for example, as made in the *Revitalising Rail* report. This report noted (at p.6) that the need for a national transport plan continues even with increased private sector involvement in transport. Indeed, the lack of such a plan is a major impediment to strong private sector participation in rail:

“The support for a national transport plan covering all modes is considerable and the Taskforce supports moves in this direction. The private sector’s concerns centre around the need for certainty and consistency in government policy directions. Addressing the issues involved is no easy matter, especially as it represents something of a paradigm shift in the way governments deal with transport issues”.

NSW has published its plan for transport for the next 12 years – *Action for Transport 2010*. Initiatives in this plan are significant in the context of national transport systems, for example improvements to NSW road and rail freight routes including a priority freight line from Macarthur to Chullora, and the grade separation at Flemington junction. This will assist the private sector in determining whether and where to invest in rail. A similar approach at the national level would be of great assistance to the sector and transport generally.

6.3 Competitive position of rail and road

While there are arguments about the extent of regulation in each mode, the key in the relative competitive position of road and rail relates to infrastructure charging and development arrangements.

The rail sector faces different infrastructure charging and cost recovery arrangements from those in the road sector. The variations are documented in the Tracking Australia report.

These differences make difficult an assessment of whether or not the modes compete on an equal footing. The market segment in which this is of greatest contention is long distance non-bulk freight which may be carried by either truck or train – “intermodal freight.”

There have been long and inconclusive arguments about this matter. The road freight sector points to large “rail deficits” and the fact that taxes and registration charges paid by all road users exceed estimated annual expenditures on roads. The rail sector points to what it views as cross-subsidisation within roads of heavy vehicles that travel long distances – those vehicles that compete with rail freight, and “double charging” of rail users in which access fees are paid in addition to (notional) road user charges. A variety of technical arguments are presented to support the respective views.

The question, however, is not merely academic. It may have major implications for the optimal development of freight transport networks. It may also have implications for all of the rail sector due to high fixed infrastructure costs and the ability for self-funding being limited by road competition.

Less than optimal development of transport systems due to poor infrastructure charging signals has implications for the likelihood of private sector investment in transport and calls on Government funding, and would also have adverse community and environmental consequences.

The Revitalising Rail report indicates strong concerns on the part of the private sector as to the effects of a lack of a competitively neutral environment for road and rail, and investment opportunities.

Pressure to address this issue is increasing due to:

- . the Commonwealth’s announced taxation reforms; and
- . the increased opportunity for corporate and private participation in rail freight operations through open access policies which are eroding traditional barriers between what were the road and rail industries. Road firms are undertaking rail operations in the open access rail environment, and rail

organisations are exploring opportunities to provide complete transport services, including road options.

This latter point provides a challenge to the policy maker's usual framework of separate and mode based transport industries. With the introduction of open access to rail and vertical separation, there have been strong calls for the reform agenda to widen from internal rail issues to those which affect the performance of rail in the transport system. The relevance of market based analysis, such as for urban transit and freight, arguably is increasing, and this can be seen in topics of research sought by rail organisations and transport firms.

In line with this, NSW's Action for Transport 2010 is a cross-modal transport plan. NSW also is developing a freight strategy within its transport plan. This strategy aims to take a long term view of community requirements for freight in NSW, including consideration of road, rail and mode interface issues.

However, road/rail competitive neutrality is a fundamental land transport issue that needs to be addressed nationally especially as a critical area of cross modal competition is in interstate line haul.

These are key reasons behind support for the establishment of a national advisory body to assist governments to address national cross modal and strategic issues. These issues, which are not simply internal to rail or to NSW, are the next critical matters on the rail reform agenda.

7. COMMENTS ON THE COMMISSION'S DRAFT REPORT

7.1 Findings of the draft report

Draft recommendations

1. Governments should consider the scope for and assess the potential benefits of further private sector involvement in rail reform eg contracting out, BOOT arrangements, franchising and privatisation.
2. Pricing and allocation of train schedules should reflect the value that users place on the track
3. A single annual fee for safety accreditation should be payable in the jurisdiction of principal activity.
4. Changes to safety accreditation and mutual recognition processes should apply the principles of best practice regulation including regulatory impact statements.
5. Best practice regulation should be adopted for codes of practice.
6. The Commonwealth should take a leadership role in removing regulatory impediments to interstate rail operations.
7. Governments should apply a more commercial approach to railways and the provision of road infrastructure.
8. The Commonwealth should clarify and state explicitly the objectives of the diesel fuel excise. The objectives would determine any adjustments required to the fuel excise and heavy vehicle charges.
9. The Commonwealth should establish an inquiry into the provision, funding and pricing of roads in Australia.

7.2 General comments

NSW believes that the Commission's analysis, or exploration of the implications of that analysis, may benefit from further extension. (Numbers relate to the relevant chapters in the Commission's draft Report).

(3) Rail reform in Australia

Governments' policies have not always been stable during the reform process. Not only have policies of various jurisdictions been developed along different lines, and implemented at different times and in different ways, but in some cases there have

been significant delays and reversals in policy. Most notable among these has been the process for the establishment of a national track authority.

Tangential to this is consideration of the success and stability of radical reform programs in other countries such as the UK. Notably, the full effect of the UK reforms, begun in the early 1990s, is only now becoming evident. It would be useful for the Commission to report the most recent developments in that jurisdiction, including the formation of a Strategic Rail Authority and the statement that the Government may become operator of last resort.

(4) Performance of Rail

The issue here relates to the timing of the report. Most of the substantial structural changes in Australian railways occurred after mid 1996, and it is unlikely that the full effects of these will be evident for some considerable period of time. The period analysed in terms of industry performance is up to 1996-97. This does not allow an adequate assessment of the outcomes of 1996 reforms because it is only a single year observation, which may be biased by one-off factors such as seasonal conditions as well as transitional arrangements.

That one off factors can have a major effect on reported performance is shown in the draft report in charts relevant to the formation of National Rail Corporation eg. the substantial fall in reported productivity of SRA and the Public Transport Commission of Victoria in 1994-95 (draft report Figure 4.1).

NSW data for 1997-98 shows significant changes from 1996-97 including:

- . growth in coal task and decline in coal freight rates;
- . improved operator and maintenance productivity measures;
- . improved on time running and pathing and speed restrictions; and
- . reduced overall network utilisation.

(5) Structural Reform

The Commission recommends horizontal separation of rail networks (p103). The concept of breaking networks horizontally in terms of primary market or dominant user may be sound. However, there are practical difficulties in achieving this where there are multiple actual or potential users of track.

In some cases there is a clear dominant user of the track sections, even though there may be other users. For example, track within the electrified area in Sydney, excluding the existing freight track (Chullora to Port Botany and Rozelle) is primarily used by urban passenger trains. However, in other cases the matter of dominant use is not so clear. For example, there are differences between dominance assessed in terms of train paths, gtps and financial contributions to track.

In practice horizontal separation may be difficult as transport is only an intermediate input. Its end markets refer to origins and destinations, and such sites which may be

shared among markets. Also market transport requirements are frequently superimposed on each other. The boundaries of rail markets in NSW are blurred, even in the most apparently clear cases. For example, the Hunter Valley rail system has variously been defined as running from the Port of Newcastle to the central Hunter, to include some parts of the main north coast line, to Gunnedah and Ulan (and beyond), to include some parts of the Sydney–Newcastle lines, or to be restricted to only those segments in the Hunter areas where there are 4 tracks (two of which are “dedicated” to coal).

As a further example, the draft report takes the view that urban railways should be horizontally separated, and while this may be practicable in say, Melbourne, it would be significantly more challenging in Sydney. At present it is not physically practicable to have horizontal separation in Sydney.

The Commission’s argument for horizontal separation and vertical integration for some network segments is weakened where there are multiple significant users of a track section. Although those users do not compete for the same transport task, they do compete for the use of limited track capacity. Apart from this, consideration of vertical integration and horizontal separation needs to consider issues such as connectivity (the existing Sydney freight track providing a good example), and national standardisation.

(6) Public and private participation

Draft recommendation 6.1: Governments should consider the scope for, and assess the potential benefits and costs of, further private sector involvement (through contracting out, BOOT-type arrangements, franchising or privatisation) as an integral part of their approach to rail reform.

The NSW Government has been reviewing ways to further private sector involvement in the provision of rail, with a view to increasing competition, lowering costs and improving service reliability. Indeed the NSW Government is currently involved in Australia’s largest BOOT railway project, the New Southern Rail Project.

Involving the private sector in the financing of rail infrastructure adopting a BOOT approach has not been easy. The Federal Government, through the *Income Tax Assessment Act* (ITAA) significantly influences the development of such arrangements. The discretionary powers under section 51AD of the ITAA introduce a level of uncertainty for State Governments that seriously disadvantages BOOT type projects. Given the level of State Government financial support for the rail industry, the private sector would generally fail the ATO’s ‘control’ test when applied to BOOT projects. In fact, ATO clearance of the BOOT component of the New Southern Railway project came only after lengthy negotiations over the amount of ‘control’ exerted by the State Government in the contract arrangements with the private sector developer.

A more commercial approach through industry privatisation may be difficult to achieve with vertical separation and open access. Vertical separation implies different business ownership arrangements for infrastructure and for above rail operations. Detailed regulatory control is no substitute for different owners, and the NSW experience to date indicates that there are benefits in vertical separation including in the promotion of transparency and the ability to generate competitive forces.

It could be argued in practice that Governments need to retain ownership of rail infrastructure for such separation to continue. However, the Commission appears to have concerns regarding the adequacy of investment under corporatisation and government ownership arrangements, because of the competing demand for government funds. There may be a tension between vertical separation and the full ability to gain private investment in track, which does not appear to be recognised in the draft report.

Put another way, large scale direct private investment in infrastructure is unlikely without private ownership or control of assets. The more substantial the private investment, the more substantial the stake in terms of control over assets. For example, in the case of the New Southern Railway, the stations are to be leased to (temporarily owned by) the private sector for a significant period.

(7) Access

Draft recommendation 7.1: The pricing and allocation of train schedules should reflect the value that users place on the track.

The NSW Government, through its Rail Access Regime, is pricing and allocating train paths in a manner which reflects the value users place on the track by way of a 'floor/ceiling' approach to price regulation. The Government is supportive of the Rail Access Corporation's established pricing regime which is transparent, consultative and has increased the availability of rail services as a result of competitive pressures. The current regime has seen the emergence of three new private operators in the intrastate freight market and the commencement of competition in the movement of containers.

The Draft Report cites examples of participants' concerns regarding the complexity and high cost of current access arrangements. The NSW Government does concede that some complexities have been encountered whilst negotiating access. However, it should be noted that the rail industry is undergoing a transitional phase, and thus many of these concerns will be resolved as the industry structure beds down.

With respect to the cost of negotiating access arrangements, the benefits derived from the new lower access charges justify the expenditure involved many times over. Furthermore, where participants to the inquiry have complained of the high cost of negotiation most of these cases involved applicants unsuccessfully expending resources by arguing for unrealistic terms. It would be unreasonable to expect the RAC to simply agree to unreasonable conditions demanded by applicants in order to

minimise applicants' negotiation costs. The RAC is a commercial identity and, as such, must earn a commercial return.

The NSW Government rejects the proposed application of auctioning techniques to allocate access to rail infrastructure. An auction system would entail high set up costs and familiarisation costs. In addition, the benefits in terms of improved allocation of train paths and providing better incentives for investment in track would not be great, given the small number of bidders likely to be involved for any given bundle of train paths.

(8) Safety regulations and standards

Draft recommendation 8.1: A single annual fee for accreditation should be payable only in the jurisdiction of principal activity.

The NSW Government disagrees with the recommendation that a single annual fee should be payable only in the jurisdiction of principal activity. The levying of another full annual accreditation fee in the jurisdiction in which mutual recognition is granted is justifiable for the following reasons:

- The majority of benefits derived from mutual recognition are captured by the applicant and the rail industry. Furthermore, since the benefits received far outweigh the regulatory costs associated with monitoring and compliance testing, these costs should be borne by the applicant;
- The costs associated with mutual recognition are becoming quantitatively less significant as the teething problems arising from the new regulatory environment are gradually being overcome;
- There is no evidence to suggest that the current duplication of accreditation fees is imposing a barrier to entry into the rail market; and
- Individual jurisdictions impose different safety and operational requirements in light of the unique geographic and historical conditions pertaining to different jurisdictions. The traversing of freight trains through the complicated and densely operated Sydney suburban rail network, for example, imposes significant risks. As a result, the NSW Transport Safety Bureau conducts more onerous compliance and auditing activity than regulators in other jurisdictions and hence incurs greater costs. These costs should be recoverable from the applicant seeking mutual recognition.

Draft recommendation 8.4: The Commonwealth Government should take a leadership role in hastening the removal of regulatory impediments to interstate rail operations.

The NSW Government strongly supports this recommendation. In establishing a nationally consistent regulation of safety and operating standards, national safety regulations need to take account of NSW requirements in relation to urban passenger rail safety, particularly on the Sydney passenger network.

(9) Competitive neutrality

Draft recommendation 9.1: Governments should apply a more commercial approach to railways and the provision of road infrastructure.

Draft recommendation 9.2: The Commonwealth Government should clarify and state explicitly the objectives of the diesel fuel excise. The objectives would determine any adjustments required to the fuel excise and heavy vehicle charges.

NSW believes that moves to address competitive neutrality, while important, are likely to be particularly challenging.

Taking taxation and charging arrangements as an example, although there have been some recent announcements by the Commonwealth on taxation proposals affecting the competitive position of road and rail, the effect of these is not entirely clear. The Commonwealth Minister for Transport and Regional Services in a recent speech (the Road Transport Forum, 1 May 1999) indicated that the Commonwealth did not consider diesel fuel excise to be a road user charge, and that fuel excises were taxes and the revenue generated has no correlation to road or other funding provided by the Commonwealth. However, it is understood that the arrangements for the introduction of a goods and services tax will include a reduction in the diesel excise for certain road users and a zero rate for rail users, which appears to be in conflict with the current position.

As a further example, full competitive neutrality among the modes would appear to require the levying of some environmental taxation against rail proportionate to its environmental impacts if road transport was subject to taxes on environmental grounds. Fine calibration of taxation or economic instruments to deal with competitive neutrality issues may prove challenging in this regard.

Changes to organisational structure may also be needed to achieve competitive neutrality under the Commission's preferred commercial approach. This approach may ultimately require a structure for roads to be provided on a commercial basis eg. corporatised road authorities. However, in several places, the Commission argues that corporatisation has not worked for the rail industry, and further options are proposed. It may be useful to consider the implications of this for roads if competitive neutrality is to be pursued through organisational structure mechanisms.

Hence there remains the question as to how competitive neutrality may be achieved in infrastructure provision given a commercial organisational structure for rail and a non-commercial organisational structure for roads at least for the foreseeable future. This implies that it is too early to dismiss the approach of establishing mechanisms to advise governments on cross modal issues and on transport strategies and plans encompassing both road and rail.

The Commonwealth Government has traditionally grant funded road investments, whereas funding of the interstate rail corridors has been left to State Governments. This funding imbalance should desirably be addressed using a cost-benefit framework that encompasses both modes.

Draft recommendation 9.3: The Commonwealth Government should establish an inquiry into the provision, funding and pricing of roads in Australia.

This recommendation is not supported as a way of progressing this issue, considering the plethora of reports that have already been conducted into this issue.

7.3 Comments on specific issues

Detailed comments follow the text of the draft report.

p17: public sector investment in railways. The Commission notes a sharp increase in the level of public investment in railways since 1991-92 citing the Tracking Australia report. The data appears to be based on current prices, and if so, real growth is considerably below that shown in the chart. This should be clarified.

p21: network independence. While it is noted that the Sydney metropolitan network is not independent from other networks ie. it is shared by passenger and freight trains, the implications of this arguably are understated in the report. It is not possible for freight trains to arrive within at least 65 kilometres of Sydney without using the electrified network, which is intensely used by passenger trains. The scale of this is such as to present a situation which is unique in Australia and possibly the world. This has major implications for interstate freight on both road and rail, urban transit and transport infrastructure. This was recognised at the 1997 Rail Summit where parties agreed to develop a plan for the provision of dedicated freight track(s) through Sydney.

p24: interstate network. The statement that the Commission is unaware of any competition for the market in rail operation on this network is incorrect.

p25: interstate network. The comment that SCT and Toll Rail would only remain in the market if they earn, or expect to earn, a commercial return needs to be viewed in the context of the capital and resources they put at risk in these operations. At p.17 the report indicates that there is little evidence of significant private sector investment, although SCT commented that it is presently investing tens of millions of dollars into rail terminals. It appears that in most cases private train operators are leasing and not purchasing equipment. It may be relatively easy to report good returns in such cases, and if so, performance is not necessarily related to the ownership of the enterprise.

p34: Commonwealth movement out of the industry. The Commonwealth has moved out of the rail operations side of the industry but has sought an increased

role in rail infrastructure, through the ARTC. However, to date this increased role has not been matched by funding. That Commonwealth funding is inadequate is recognised in a series of reports most recently Tracking Australia and Revitalising Rail.

p45: NSW rail access regime. Following consultations with the NCC NSW established a revised *Rail Access Regime* which addressed all matters raised by the NCC. Additional matters have been raised by the Commonwealth Minister for Financial Services and Regulation which cannot be addressed until later this year.

p50: coal pricing. Apart from the transitional pricing mechanism, the IPART recommendations on pricing definitions as adopted in the *Rail Access Regime* ensure that there will be efficient and fair prices for coal access in NSW.

p53: NSW Minerals Council comments on consultation on the NSW Rail Access Regime. The comment that there was no consultation whatsoever is false. The Regime, or an aspect of it, has been subject to extensive public consultation on seven occasions, three times through the NCC, three times through references to IPART and once on gazettal of the amended regime.

p54 and following: performance assessment. It may be possible to make comparisons with individual US class 1 or 2 railroads. There would appear to be little comparability with the aggregate of US class 1s. Equally the comparability with Japanese and South African railways is open to question, especially in relation to urban transit.

p55 figure 4.1: the productivity index should be adjusted for the National Rail Corporation effect. Also, National Rail and AN should be separated. The technique for aggregating all freight is questionable for a number of reasons including different haul lengths and whether track is integrated into the operations.

p68 figure 4.3: the real freight rate index should be adjusted for the National Rail Corporation effect. It is questionable whether cents per ntk is a good measure because of cost factors such as haul length and cycle time

p69 figure 4.4: this should refer to cents per passenger km.

p72 figure 4.6: the on-time running should be adjusted for the National Rail Corporation effect.

p72 urban passengers: It may be misleading to use on-time running as the indicator for passenger train services. The availability of services (number) and capacity of services (standing to seating measures) would appear to be at least as relevant.

p74 and following: the difficulties with measurement as reported on p74 would seem to indicate there is little point in discussing returns on assets in detail. Also

worth noting is a trade off between financial returns on assets which are measured in this process, and social returns from the use of assets which the Commission has not, but should, assess.

p78 real labour costs: it would be more useful to assess real labour costs per unit of output rather than per unit of labour. The comparison in terms of unit per labour is merely the average wage rate. The case of National Rail Corporation and single man crewing may be instructive on this point – this would increase real labour costs as reported by the Commission but increase by a greater amount labour productivity in terms of output per worker.

p88 summary: the Commission does not attempt to attribute changes in performance to the reforms made in the mid 1990s. However, because it does not do so, it is difficult to demonstrate empirical support for the recommended approach.

p95: competition for train schedules. The situation in NSW is that multiple traffics use various parts of the network. In such a case, vertical integration requires integration of the traffics into a single organisation. This would be contrary to the horizontal market separation sought by the Commission.

p104: vertical separation of the interstate network. Presumably the objective of such separation is intramodal competition. If the Commission's argument about horizontal separation is correct, it may be worth examining the relative strengths of intermodal competition on various corridors as these corridors in effect reflect different markets.

p113: Rio Tinto comment that there remain suspicions about cross subsidies to support uneconomic passenger services in NSW. NSW is unaware of this, and such suspicions are ill founded.

p137: applications for declaration under NCC processes. The NSW Minerals Council is not a rail operator, and as far as known, does not intend to be an operator. This is part of the reason for the amendments to the NSW legislation and access regime to allow access seekers, rather than just rail operators, to hold access rights.

p139: the comment by the Commonwealth that States have been slow to develop access regimes acceptable to the NCC. This is a surprising comment from the Commonwealth, since the Commonwealth has not developed a specific rail access regime or undertaking in relation to its track, and the Commonwealth was responsible for the lengthy delays in the establishment of a national track authority. NSW applied to the NCC on 12 June 1997 for a recommendation that its Regime was effective. The NCC made a recommendation to the Commonwealth Minister for Financial Services and Regulation on or about 23 March 1999, some 21 months after receipt of the Government's application. The Minister for Financial Services and Regulation has yet to make a determination in relation to the Regime and has requested further information in relation to aspects of the regime, some two years

after the NSW Government made its application to the NCC. The NSW Regime, or an aspect of it, has been subject to extensive public consultation on seven occasions, three times through the NCC, three times through references to IPART and once on gazettal of the amended regime.

p140: the conclusion that current access arrangements are complex due to the multiplicity of regimes and intricacies associated with each. This conclusion may be misleading. There may be good reasons for differences among access regimes eg. the amount and type of traffic on lines recognised earlier in the draft report. Also, the effect of complex arrangements is unclear. The question of complexity and inconsistency is probably most relevant in the case of traffic traversing several regimes eg. interstate traffic.

p143: the conclusion that access regulation is unlikely to improve performance in rail markets where it will only ever be cost effective for one train operator to operate, or where train operators and track owners have reached private agreement. This may require further analysis. In the case of one train operator only, the Commission's argument that structural separation is unlikely to be effective depends to the extent on which transparency can be achieved without separation. However, if structural separation has occurred, an access regime may improve the relationship between end market and infrastructure, given that the infrastructure remains a natural monopoly. Also, it may be difficult for Governments to ascertain whether and in what areas it will only ever be cost effective etc. For example, how would and why should Governments assess the final number of operators on a particular route segment, unless the Government is the principal customer of the operators.

p145 and following: pricing of coal services. It may be useful to differentiate between concerns as to transparency in prices and as to level of prices. It is possible to have an efficient level of prices which are not transparent to end users. Equally, it is possible to have transparent but inefficient prices.

p151: NSW Minerals Council costs in an access regime. The box is inaccurate and incomplete. For example:

- . the Council did contribute to the development of the Regime;
- . the process of the Minerals Council seeking a declaration of the NSW Hunter track was separate from the development of the NSW Regime; and
- . the Council agreed with the need for an independent view on certain pricing issues made in submission to IPART on the original Issues Paper and Draft Report.

Such costs were not imposed on the NSW Minerals Council. Rather the Council voluntarily incurred such costs.

p155: the conclusion that the pricing and allocation of train schedules should reflect the value that users place on the track. While this reflects accepted economic theory, there may be significant practical difficulties. For example in urban transit, this may

require very large and circular outlays by Government for no practical effect. Yet there would be significant administrative and regulatory cost especially in the vertically integrated system in which a very small number of time sensitive paths are sought by non-transit operators.

p158: comment that IPART has recommended a ceiling rate of return of 7.5 per cent (now 8.0 percent). This could be expanded by indicating that this applies to the optimised deprival value, and that the final recommendation has been included in the NSW Rail Access Regime.

p168: NSW Minerals Council comment regarding safety accreditation as a barrier to entry. This is not correct. Safety accreditation is no longer required to hold an access right and the safety accreditation process is quick and straightforward for rail operators.

p173: comment about duplication of safety audits. This has been identified as a concern and NSW is working to address this.

p173: comment that the track owner may set standards that are approved by the regulator but which differ from the safety requirements of the regulator. This would be unsafe and does not occur in NSW. It also is unclear whether such an approach would be consistent with the underlying purpose of accreditation.

p185: heavy vehicles are registered, not accredited.

p186: the support by the Commonwealth Department of Transport and Regional Services for a national safety regulator is surprising. The Commission might note the variance between prescriptive safety regulation for roads and the accreditation basis of rail safety regulation.

p196: chart. It is unclear how investment is defined.

p234: re contestability. RAC does not receive explicit compensation payments from Government because the system of benchmarking imposed on RAC and RSA provides savings to RAC during the suspension period in excess of those available to RAC through the previously operative contestability program (see RAC's submission to the Commission). Benchmarking non-contested areas against contested areas will continue until a further review in 2001.

8. SUMMARY AND CONCLUSIONS

Very substantial changes have occurred since the Commission last reviewed the rail industry in 1991. Open access, vertical separation and the introduction of competitive pressures have fundamentally changed the industry.

These changes have given rise to a number of transitional issues. Included among these are substantial matters including the evolution of organisations in the new environment, skills and management development, and issues arising in the evolution of National Rail Corporation. Most of the transitional issues, which might also be characterised as internal to rail, are being addressed.

The changes have revealed some more fundamental issues which go to the future of rail and transport policy. These issues have important State dimensions and effects but largely are strategic national issues. Chief among these is “competitive neutrality” among the modes, which remains an unresolved question. Failure to address this matter would leave open questions such as whether private investment in rail can be adequate, whether reform initiatives can only have a limited impact on total transport outcomes and whether rail can play its full role.

APPENDIX: NATIONAL ISSUES RELATING TO RAIL SAFETY

Rail safety administration in NSW relies on an accreditation approach in which railways propose, for regulatory acceptance, systems and standards to be used in rail operations. Regulatory acceptance is evidenced by “accreditation”. The relevant legislation is the *Rail Safety Act 1993*.

Under the *Rail Safety Act 1993*, rail owners and operators are required to be accredited. Rail owners include owners of infrastructure. Rail operators include those responsible for the movement of rolling stock.

NSW is a signatory to the InterGovernmental Agreement on National Rail Safety (1995). Among other things, this Agreement:

- . provides for an Australian Rail Safety Standard;
- . requires participants to establish an accreditation system of rail safety administration;
- . seeks to allow for mutual recognition of accredited operators interstate; and
- . provides for certain investigatory procedures and information exchange.

The Agreement was intended to support a nationally consistent approach to rail safety which ensure there is no barrier to the entry of third party operators.

There has been some debate on the application of the Agreement, in particular mutual recognition. Mutual recognition is defined such that an owner or operator accredited consistent with the Rail Safety Standard in one jurisdiction (State) is to be accepted as having met all requirements of the Standard in all other jurisdictions. This appears to be intended to mean that the owner or operator accredited in one jurisdiction is suitable for immediate accreditation in all other jurisdictions, “subject to any local requirements”. The debate centres on whether these principles are followed in practice.

The central issue is to resolve infrastructure conditions and differences. It is well known that there are differences in infrastructure across the States. The most visible is the different gauges. However, even on the common gauge “national network” there are numerous other differences as indicated in the Study of Rail Standards and Operational Requirements prepared for the Australian Transport Council by Maunsell Pty Ltd (February 1998).

The main point is that if the infrastructure determines the conditions facing rail operations, and if these conditions vary across the national network, then it may not be possible to have safe and uniform rail operations on this network. If this is the case, safety would be enhanced by not having complete mutual recognition of rail operators – rather, mutual recognition would need to be tempered by “local” considerations.

While accreditation may be said to be aimed at “system” level matters, rather than prescriptive or descriptive rules, the point remains. Under jurisdiction based accreditation, the track owner proposes the infrastructure system and conditions for acceptance by the regulator, rather than vice versa.

To allow for this type of approach, the Australian Standard is not highly prescriptive in terms of actual content or precise operational safety rules for infrastructure, but rather focuses on the characteristics expected to be incorporated into a complete functioning system.

One purpose of accreditation is to allow for initiative among railways as to how they will address safety matters. This is seen as reducing barriers to entry and promotion of competitive pressures. It envisages the possibility of variance among the systems and procedures for railways.

It is becoming evident that the application of mutual recognition to track owners needs to rest on another reason, as track owners do not exert competitive entry pressures on each other. It is unclear how mutual recognition is relevant to the accreditation of track owners, at least when track owners are within jurisdictional boundaries.

Under accreditation processes, track owners across Australia can propose different safety systems, and such differences may require variations in operator accreditations to maintain the safety of the railways.

In summary, full but safe mutual recognition of rail operators, in terms of identical rail operations, would seem to require at the minimum uniform track and infrastructure access conditions across all of the national network.

The Australian Transport Council has commenced a review of national rail safety arrangements.