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Progress in Rail Reform
Productivity Commission
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Submission on Progress in Rail Reform

Australian Transport Network Limited (ATN) was incorporated in July 1997 and purchased the Tasmania rail system (Tasrail) from the Commonwealth in November 1997 as part of the Australian National sale. Tasrail subsequently purchased the Emu Bay Railway from Pasminco in May 1998.

ATN's shareholder's comprise Wisconsin Central (the largest regional railroad in the United States), Tranz Rail (New Zealand's largest transport company), Berkshire Partners (a private equity firm based in the United States) and Fay, Richwhite (a private equity firm based in New Zealand).

ATN's objective is to develop a significant rail business in Australia initially through acquisition and then by improving and growing the rail properties acquired. For example, since acquiring Tasrail, it's revenue has increased by approximately 50% and the company has been returned to profitability. ATN is currently assessing a number of investment opportunities in the rail industry including further privatisations and "brown field" projects.

This submission focuses on three issues which we believe are critical to continued progress in rail reform:

(1) The benefits of private ownership
(2) The urgent need to address the lack of competitive neutrality between transport modes
(3) The benefits of operating a vertically integrated railway

1. Benefits of Private Ownership

Rail Authorities throughout Australia have recently completed the Corpratisation process. The benefits are already emerging with improved customer focus and commercial decision making. However for these businesses to realise their full potential, the process needs to be completed by their privitisation. By doing so, government is able to cement in reforms and avoid the risk of the businesses reverting to non-commercial objectives.

Advocates of the privatisation process recognise that Government's goals are different to private shareholders'; Government's give more weight to non-economic factors, they are risk averse owners limiting the businesses growth potential, and they lack in-depth knowledge of the business.

Conversely under private ownership greater incentives and accountability can be ensured through management shareholding and bonus payments on the performance of the company. Ownership becomes contestable with access to the capital markets for equity funding and the company's board and management are exposed to the scrutiny of stockbrokers and analysts. Privatisation also removes the implicit Government guarantee sitting behind a corporatised business.

The privatisation of the New Zealand Railways is widely regarded as an excellent example of the benefits of privitisation. New Zealand's rail system achieved significant improvements in customer focus, efficiency and financial performance over the 10 years from the time the business was corporatised. However the constraints of Government ownership prevented the business from reaching its full potential.

Since its privitisation in 1993 the company has put in place more productive labour agreements and work practices, sold non-core assets, rebranded its corporate identity, improved customer satisfaction and technology and upgraded its asset base. This has resulted in:

- A 47% improvement in Labour productivity (measured by RTKs per employee)
- Improvement in asset utilisation (eg. the number of trips per month for freight cars has increased by 44%)
- A 32% increase in traffic levels (measured by revenue tonne kilometres)
- A 85% increase in operating profit

These gains could not have achieved without the injection of skill and expertise from private rail operators and the removal of the inevitable constraints burdening management under Government ownership.

2. Lack of Competitive Neutrality between Modes

An issue requiring urgent attention is the lack of competitive neutrality between the rail and road sectors. This has resulted in significant inefficiencies in Australian industry and the misallocation of resources throughout the economy. Until these Government imposed imbalances are rectified progress in rail reform will be greatly hindered.

This has been recognised in New Zealand where the Government is undertaking a major review of the organisational form, management and pricing of the country's roading network. The review is substantially complete and the key recommendations likely to be implemented are that:

- Roads should be managed under company type structures and these companies should recover their costs, including a return on capital costs;
- The reforms should promote modal equity to remove distortions in usage and investment and to eliminate subsidies;
- A direct charging regime should be implemented for road used to ensure they face the true costs (including capital costs) they impose on the roading network
- The reforms will result in move efficient and equitable transport, no subsidies, no distorted usage and investment decisions, better road safety, lower environmental damage and less vehicles on the roads.

One outcome of these changes which is widely recognised is that heavy truck operators will face higher road usage charges in the future. Despite paying four times the level of charges imposed in Australia, the current road pricing regime in New Zealand still results in a significant under recovery of the costs imposed on the roading network from heavy trucks.

The attached paper prepared John Kirk, Executive Director of the Australasian Railway Association summarises the key imbalances between road and rail in Australia. Addressing this inequity must be a fundamental plank for any policy to ensure continued progress in rail reform.

3. Benefits of Vertically Intergrated Railways

Infrastructure separation was considered in New Zealand at the time the railways were privatised, but after careful analysis, including a visit by Government's advisers to see the unique "Swedish model", its was rejected, for commercial reasons. These reasons included:

- The wish to maximise clear transmission of commercial signals throughout the system, without divorcing the technically oriented part of the railway through separation. If reforms were to be successful in business terms the penetration of market forces into technical areas had to be maintained.
- Investments had to made solely on business grounds. Investments made on the basis of cost benefits analyses taking into account factors outside these were in appropriate in a competitive environment. They led to non-market solutions. There is of course nothing to prevent a government from contributing to a particular investment, or even promoting one, for social reasons.
- The desire to make rail commercially viable without subsidy led to the conclusion that New Zealand should have a single, integrated commercially effective operation. This may not have been the goal in those countries that have chose separation.

- The recognition that rail faces competition in all its operations, to a degree sufficient to ensure fully competitive rates. If a customer is not happy with the service or price offered by Tranz Rail, its ready alternative is to use road or coastal shipping; or alternative means of exporting its product (by using different ports, or even building new ones).

The heavy transaction costs of separation, both in setting up an infrastructure company, organising and formalising its myriad interactions with the operating companies, and in its everyday running, also penalises rail in relation to its main competitors. The heavy cost of setting up Railtrack in the United Kingdom, for example, is effectively borne (where there are not subsidies) by the railway operators and their customers.

As well, separation diffuses safety responsibility. While there can be much debate over the cause of an accident, in an integral railway the cause is much more likely to be able to be sheeted home to the one organisation responsible for all aspects of its operation. Let me give you some real examples:

- We occasionally have derailments at curves or turnouts, which can cause significant damage and injury. Are they due to driver error? Loading irregularity? Track misalignment? Signal malfunction? Rolling stock failure?
- We have had a serious accident involving a shunting locomotive footstep being caught by a track – and buckling. The cause could have been with the footstep, the driving of the locomotive, or the track.

With an integrated organisation there is no institutional motivation to debate the cause. In an integrated railway we can readily identify the problem, take responsibility for it, and deal with it. In a separated model, either there is an artificial division of primary responsibility, and later debate and settlement; or the prospect of litigation and significant costs. In the latter case, organisations and individuals will be motivated to deflect responsibility with the operation of heritage trains. A significant effort has gone into identifying responsibility for a particular incident, (which caused no damage or injury) and in setting out ground rules for the future.

To take an example from another transport sector, highways (which of course has separated operations and infrastructure). In New Zealand, at least, there is no sanction for providing an unsafe road. The vehicle operator bears all the responsibility. The interaction between vehicle and track is only recognised in a general sense, through speed, construction, and other rules. Such a skewed result is possible with separation on the railway too.

Innovation and Investment

Our experience of integration is that it fosters targeted innovation and investment; investments made where they are most efficient in both infrastructure and operations. For example, increasing axle loads is integrated between marketing, mechanical (wagon constructions) and infrastructure departments. Tranz Rail is progressively increasing axle loads on certain lines carrying bulk commodities. There are many further examples of how integration helps with decisions to improve the company's competitive response.

They include:

- Remodelling of marshalling yards to make operation of modern, wide wagons easier and safer.
- Improving clearances at tunnels and other overhead structures, to enable higher wagons and containers through the system. These investments are paced to match demand and to control costs.
- Integration of freight terminal and marshalling yard design. We are currently rebuilding a marshalling yard to fit in a new freight handling terminal. It even features building across operating track to speed up construction. Integration enables quick decisions, quick construction, and on intercompany arguments (or vetoes).
- Capacity improvements to allow traffic increases (improvements rather than wholesale new construction, directly related to serving the customer needs and not undertaken from the point of view of a monopoly track provider.

In considering the options for improving capacity, our choices are not biased by organisational structure of ownership. We have the flexibility to make the most efficient trade offs. We can also recognise the wider impacts of these trade offs. By controlling the infrastructure function, we are also able to assist the customers with sidings including main line connections, without delays or other external intervention. All the issues are ours to deal with in an integrated manner.

An infrastructure authority planning and implementing these investments would have to second guess the market and duplicate resources. Those closest to the market know best what it wants.

Train Control

The extension of infrastructure separation into train control separation would further divide operations from the market. In Tranz Rail's case, train controllers (dispatchers) make decisions in real time between passenger and freight, and between types of freight. We have gone further and established priority freight trains which we aim to run 98% on time (within 15 minutes). Thus we couple the train control function very directly into the market offering. The controllers have a vital part to play in achieving the service levels the market wants. This also impacts on infrastructure, with possessions agreed to end earlier before these trains.

Time performance is critical to market success in many of our markets. It would be difficult to express the discretion and responsibility we give our controllers in a contract with a third party; even more difficult to give their controllers the direct motivation the customer service culture provides.

Expanding on the role of train controllers, we are centralising their function into National Control Centre, and directly linking them (in location and organisation) with an Equipment Management Centre (wagon allocation) and a Customer Service Centre on a 24 hour basis. This deeply integrates the functions to give active management of priorities, all with a customer focus.

Some Motivations for Separation

Countries in Western Europe appear to have embraced separation in response to open access pressures. In our view, the two need not be linked. Integrated railways in the US, for instance, have had a form of open access regime in New Zealand, claims for access to our rails may arise. These are best handled as commercial negotiations between commercial identities.

An interesting analogy arises in telecommunications. In deregulated telecommunications markets, there is no separate network authority, yet access is still negotiated between network and telecommunications business owners – often between competitors.

A similar argument is that separation is necessary to bring in contestable bidding for key supply contracts, ie outsourcing. In fact, the whole separation move could be seen as a collateral, "back door" attempt to reform rail; to shake it up and thus improve its efficiency. Our experience is that it is much better to tackle these problems directly. Being in an integrated organisation is no barrier to external supply: our workshops, for example, bid against external suppliers for wagon building contracts.

A further argument for separation is that it enables rail investment to be made on a comparable basis to road. To do so in a manner that contributes massive subsides to each seems grotesque. While there is no doubt that inequalities in funding exist in many countries, it is much more appropriate to reform roading so that it is run on commercial lines, and earns commercial returns on its investments. Such an approach is being actively considered in New Zealand. Subsidies for services the market will not support economically can then be provided to any mode (or, as often happens, the justification for subsidies can be reconsidered).

Long Term Stability

We may also ask whether vertical separation is a stable form of organisation long term. Railways do benefit from scale economies, and the advantages of integration I have outlined will eventually be sought by those on one side or the other of separation in those place it exists. Train operating companies may seek to re-purchase lines – starting for example with freight-only lines where there is only one customer and only ever likely to be service provider. The same principle could then extend to busier freight lines, and to passenger lines. In Australia the separation being established on main routes will not extend to the isolated Tasmanian railway, for example.

Already some elements of the dis-integrations of the former British rail have reintegrated (particularly in freight). Market forces will continue this trend unless artificially prevented (as they are likely to be).

On the other hand, I would not be surprised to see the track authority in countries with separation trying to build economies of scale in the future by offering rail services.

Train control services have moved to Banverket in Sweden, and Rail Access Corporation in New South Wales, Australia. Also in Sweden, in an effort to encourage small operators, there have been suggestions of providing access to marshalling services for third parties on a competitively neutral basis. Is the next step to provide a locomotive and run "mixed" trains of private wagons for those who do not have the business for a full train? Or organise wagons for those who do not own them? At that point, you have re-invented the integrated railway. That this possibility is real is confirmed by the prohibition in Railtrack's licence from supplying services which use its infrastructure.

The results of separation might be perverse in the end, by weakening the rail operators economically. A group of independent researchers at Chalmers University in Gothenburg, Sweden showed that the Swedish railway's cost increased with separation. This undermines rail's ability to compete with road and sea, and thus reduces its economic contribution to society.

Regrettably, as Vince O'Rouke, the CEO of Queensland Rail in Australia points out, "separation will lead to an environment where infrastructure investment will have to be underwritten and most likely subsidised – by Government, or alternatively not happen at all".

Thank you for giving us the opportunity to make this submission. We would like to discuss it in more detail during the hearing process.

Yours sincerely

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