1. INTRODUCTION

The draft report released by the Productivity Commission from its review of rail reform in Australia contained 9 draft recommendations covering such industry issues as private sector involvement, access to rail infrastructure, safety and operating standards and competitive neutrality. The review included a review of industry reforms and performance during the period since 1990, when the previous industry stock-take was carried out and noted the slowness at which reform had occurred in this time as well as the lack of progress on many recommendations made at the time. Recommendations related to such issues as the increased involvement of the private sector and competition, the breakdown of the interstate base, standardisation of safety and operating standards and the leveling of the playing field vis-a vis road competition. It is noted that many of those recommendations have still been identified as relevant today.

General comments on the draft report are as follows:

- Overall, ARTC found this review to be reasonably thorough in its analysis and argument and we fully support many of the recommendations made. However, we felt that the Commission could be more emphatic in its conclusions and recommendations, given past experience in how active governments have been to take up recommendations and the imperative to continue and accelarate the reform process in order to ensure the long term viability and competitiveness of this industry.

- It was also felt that many parts of the review provided a statement of historical events and international experience rather than an assessment of the policy directions which have existed over the review period, in terms of the success or otherwise of industry outcomes and lessons to be learnt for the future. In this context, the productivity analysis, including relative comparisons with overseas rail systems, is very soft and does not drive home any real conclusions on relative efficiency.

- Given the significant change which has occurred in the industry over the past two years (eg vertical separation of the interstate network and the subsequent introduction of private sector operators, AN's privatisation and the corporatisation of state based railways), we felt that greater effort might be needed to assess industry performance during this recent period, which would be more relevant to identifying the appropriate approach to the future.

There are a number of more specific comments and observations which are outlined below. We have attempted to align these as closely as possible to the specific areas and recommendations made in the report.

2. COMMENTS AND OBSERVATIONS

- ## 2. Railways in Australia

  There were some comments made regarding the positions of railways which were somewhat outdated and, where more recent information has become available, comments should be updated. As an example, NR's financial profitability was stated at $4.8m (loss) in 1996/97. The most recent annual report, released late last year, shows that NR's operating loss has deteriorated to $9m (after-tax). A better comparison of NR's operating performance shows that it's operating loss before tax and abnormals has deteriorated from $14m in 1996/97 to $30m in 1997/98. This deterioration has largely been explained by a $20m reduction in freight revenue brought about by increased competition and a $25m reduction in shareholder compensatory payments, partially offset by reduced operations and maintenance expenditure. This deterioration continues a trend starting in 1995/96 (with the introduction of private rail competitors) and starkly illustrates the challenge NR faces in a competitive interstate environment. This point is relevant to the Commission's argument in this context.

- ## 3. Rail Reforms

  Points for inclusion in Table 3.8 'Key reforms in access in the 90's', are that the NT/SA governments have applied to the NCC to consider the effectiveness of their access regimes and that Queensland Rail has similarly applied to the QCA.

- ## 4. Performance in Rail

  There are a number of comments to be made about the measurement of rail performance employed by the Commission, many of which were highlighted at the Commission workshop in April, with some taken on board by the Commission. In brief, ARTC is disappointed that the analysis was no more recent than 1996/7, a period where the industry has undergone most reform, and not disaggregated enough to provide meaningful information as to how policies have affected past performance and to what should be done in the future. It is understood that the amount and quality of operating and financial data available to the Commission is a major constraint. It is also understood that the aim of carrying out the analysis was to measure the impact of policy settings over the years on industry performance with a view to obtaining some direction for the future. This doesn't come through in the draft report and presumably more conclusive observations and recommendations will be presented when the work is finalised. The following specific comments are made:

- Given that it is currently mid-1999, there should be sufficient information available from organisations (particularly local) to extend the analysis to 1997/98. As it stands, the analysis ignores industry performance during the last 2 years, a period during which significant change to the industry has occurred, including vertical separation and the introduction of on-rail competition in the interstate market as well as railway internal separations, privatisations or corporatisations. The impact of these reforms on industry performance is most important to assessing future direction. It would be necessary to analyse and make adjustments for the impact of outsourcing and organisational separations.

- The Commision has presumed that railways in the United States and Canada represent 'world's best practice'. This has been an assumption made in many Australian Government reports on railway productivity in the past. One asks the question that when was an objective analysis conducted to confirm this 'fact' and, with significant reforms occurring in many countries over the last several years, has anyone else caught up, and even surpassed, these countries. Indeed, best practice may well be specific to certain types of railways, such as dedicated mining railways vis-à-vis long distance freight/passenger railways vis-à-vis short haul and urban railways.

- The Commission has chosen to amalgamate AN and NRC over the period of analysis, on the presumption that one organisation has largely been borne from the other. We believe that combining the two organisations, particular for the purpose of comparison with other railways in Australia is unrealistic on two counts. Firstly, the comparison itself between railways in Australia has limited meaning given the significant differences in business mix. NR is purely an interstate train operator, and meaningful comparison over time or between systems should preserve this role. Combination with AN merely distorts this picture by introducing different business such as Leigh Creek coal and the intrastate grain operations. Secondly, amalgamation with AN alone, ignores the significant asset and functional relationships between NR and PTC/SRA.

  To address both of these problems, a greater effort needs to be made to disaggregate (as best as can be done) railway businesses over the period. Such disaggregation should at least enable a split between interstate business and intrastate business to be extracted. Even better would be a split of intrastate business into general freight and bulk, and bulk into key products, specifically coal and grain where comparison with similar private (and presumably best practice for Australian conditions) railways might be possible. Also once an interstate split is made, inclusion of state sourced costs in NR statistics might be more appropriate. This would also resolve the issue relating to the abnormal SRA and PTC results in 1994/5. Obviously, there would be no national entity with which to compare NR, however comparison with some predominantly long haul, general freight US

Railroads may be possible. In any event, a comparison of productivity performance of interstate freight over the period would provide an indication as to the result of prevailing policy settings (creation of NR, vertical separation, introduction of intramodal competition).

As it currently stands, most trend graphs provided in the report are only partially meaningful in the context of looking at trends for an organisation over time. There is little to be drawn from inter-railway comparisons (for example, rate comparisons for railways operating with vastly different business mixes, Figure 4.12).

- A suggestion was made at the workshop that some effort be put into establishing a relationship between the level of investment in the industry (above and below rail) and productivity improvements. ARTC fully supports this approach. The IPART in NSW have proposed a weighted average cost of capital of 8% (real, after-tax) for the purpose of capping RAC's access prices. Whilst it is understood that this rate has largely been established in the context of RAC's relatively low risk coal task, it is at a level which will make the attraction of new investment (particularly private) to the industry difficult. Almost all parties in the industry agree that the major impediment to growth is the lack of investment that has occurred in the industry and more particularly in the rail network itself. The investment community needs to observe evidence that investment in the rail industry will result in significant improvement which can be translated to investment yield. This, of course, assumes that this is the outcome of any such analysis.

- When making comparisons, particularly internationally, it was felt that the many underlying differences between entities (apart from scale of business) were under-emphasised. For example, the infrastructure in the United States allows for far greater axle loading than that in Australia. This would have a major impact on productivity, but any comment in the report is inconspicuous. The ability to double-stack containers would also have a marked affect on productivity. With regard to axle loading, the report quotes Hames as stating a 22 tonne axle loading for Australian interstate. It should be mentioned that current interstate freight axle loading can vary between 19 and 23 tonnes depending on speed and track capability.

- It has been stated that one of the greater risks to the validity of conclusions drawn from the international comparison was the difference in scale of operations of the Australian rail system compared to the US Class 1 system. A more useful international comparison could be made with individual Class 1 railroads in America, of a similar size and business mix to the Australian system, or even larger Class 2/3 railroads. As a stands, a reader could draw the conclusion that the Australian rail system is already operating at world's best practice given the scale of it's operations, and is unlikely to become a great deal more efficient without a quantum leap in task. It would be difficult to imagine this to be the case.

- It has been noted in the analysis that track (specifically track kms) has been used as an 'environmental/uncontrollable' variable. This was done on the basis that railways have greater difficulty in changing track length than other inputs in the short term. This statement is probably correct. The analysis effectively reviews the output of a railway compared to it's inputs, where inputs are numbers of rollingstock units, personnel and kilometres of track. Whilst the quantum of track kilometres is relatively fixed compared to the other inputs, the capacity of the track to produce output may well be just as much as controllable as the capacity of other inputs to produce outputs. That is, personnel capacity to produce is controlled by training, organisational improvements; locomotive capacity is controlled by maintenance, horsepower mix; wagon capacity is controlled by maintenance and structural modification whilst track capacity is controlled by maintenance and structural modification (eg alignments, loop lengths etc) as well as methods of managing available infrastructure. ARTC believes that the changing capacity of the rail infrastructure has been ignored (or under-estimated) as a determinant of productivity trends in the industry, when compared to other inputs.

- With regard to financial comparisons (specifically shareholder returns):

    - it is noted that returns, particularly with regard to passenger railways, are poor or non-existent (Figure 4.15). This is often seen as a reason for under-investment in rail generally. Highlight should be made in the report of the fact that, whilst the financial returns to the direct owners of passenger railways (and to a lesser extent freight railways), namely governments, are usually non-existent, there are additional returns to the 'real' owners (the taxpayer) which are significant. The report should emphasise the community benefits of externalities such as reduced greenhouse emissions, road congestion and maintenance. If such benefits cannot be directly measured then they should be qualified in the analysis.
    - Greater emphasis should be made of the limitations of using ROA as a comparative measure, specifically, its sensitivity to asset valuation methodology.
    - ROA is normally a measure of operating performance only (as opposed to ROE), and as such utilises earning before financing costs and tax (EBIT) rather than NPAT.

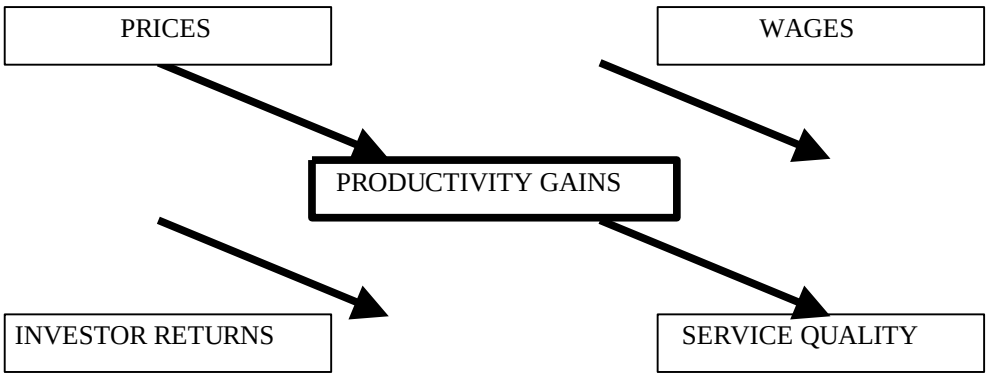
- With regard to comparisons of freight service quality, ARTC has several concerns as follows:

    - The Commission has chosen to use a single measure of service quality, namely 'on-time running', presumably because it is close to being a final output of railway service to rail users. The Commission recognises in the report that train arrival does not necessary reflect freight availability which is of utmost importance to users and the basis for user comparison with road. Some attempt should be made to illustrate performance with respect to the latter

measure. Workshop discussions revealed that some railways measure this statistic.

- Customer expectations with respect to timeliness and reliability can be different in different markets. An effort needs to be made to segregate railway performance into markets such as intermodal, steel, coal and grain (each with its distinct requirements) in order to provide a more meaningful result.
- As it stands, the comparison shows varying levels of performance between railways. A reason given for the better performance of the shorter haul railways is that shorter freight trips make it easier to reach a destination within schedule. This may or may not be true, as a late train also has less opportunity to recover over a short journey. In any event, it is a practice in some railways to declare long standing temporary speed restrictions as permanent and incorporate resultant delays into the train timetable (in other words, set the timetable to allow for the condition of the track). This approach will result in trains meeting a timetable more regularly. We believe however that such practice effectively shows an acceptance of deteriorating standards and inefficiency and is ultimately to the detraction of the industry as a whole, resulting in rail becoming less competitive vis-à-vis road. The practice also significantly reduces the yield on the capital invested in the network. A comparison of service quality considering on-time arrival (or availability) should be accompanied by a similar comparison showing trends in transit times (or average train speeds) in jurisdictions.

- At the workshop, gains in productivity were considered in the context of how they were absorbed in the industry, as shown in the diagram below.



The analysis has considered industry performance in three of these 'outputs'. A useful exercise would be to try and correlate the extent to which each of the outputs have change in order to measure the relative extent to which overall productivity improvement has been absorbed into these industry outputs. There may be similar comparisons available with respect to rail's competitors and/or other industries.

- ## 5. Structural Reforms

It is felt that the work done here should go further and be more emphatic in its conclusions and recommendation. The case for each type of business is well argued and the preferred structure for each type of business should be clearly enunciated and recommended. Specific comment with respect to each type of business is as follows:

- **Urban Passenger Transport**

  ARTC supports the Commission's preference for horizontal separation of urban networks from regional and interstate networks, and for contracting out or franchising of vertically integrated businesses to improve efficiency.

- **Low Volume Regional Railways**

  ARTC supports the Commission's argument that low volume regional networks should be horizontally separated and be privatised/franchised as vertically integrated business in order to effectively compete with inter-modal competition.

- **High Volume Regional Railways**

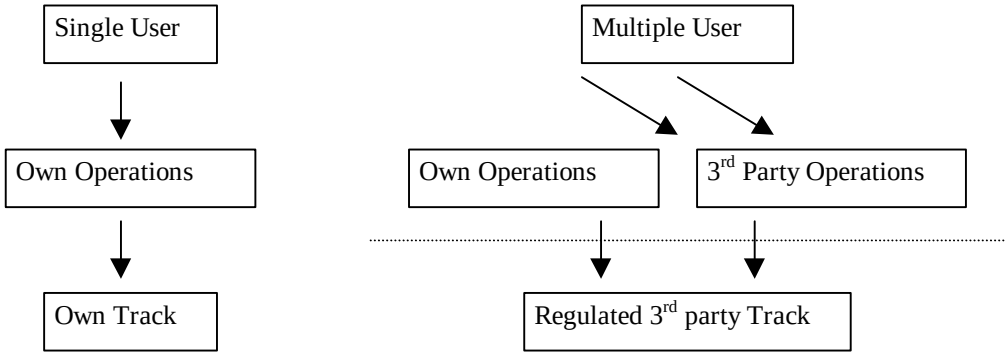
  The Commission seeks views on the appropriateness of vertical separation in the case of high volume regional railways. It is ARTC's view that vertical separation of railways into separate track (possibly with regulated access) and train operations would be of benefit in all but a few unique circumstances. Where a vertically integrated railway currently exists, as is the case in the northern WA iron ore industry, significant problems are being experienced in opening up this industry to competition and perhaps greater efficiency. A case in point, is the current application by Robe River Iron Associates to 'declare' (and subsequently operate on) part of the private line owned by Hamersley Iron in the Pilbara region, where a real possibility exists that the application could be unsuccessful and Robe River may end up have to build a second parallel railway in order to enter this business.

  It is accepted that in a few limited circumstances the railway line may be so entwined in the overall production process of a single company that the introduction of a third party train operator on the line may be severely detrimental to the competitiveness of the track owner. In many cases, the owner is operating in international markets in which strong competition already constrains pricing and necessitates efficiency.

  Where there is more than one potential rail customer or commodity relevant to a high volume regional network (as is the case in for many government owned and operated networks, the case for vertical separation is much stronger. A vertically integrated owner of such a network would have a business imperative (particularly in the case of an integrated production line operation) to stifle third party access to

the network, inhibiting competition and efficiency improvements in the same or other industries.

There is no reason why a separate track owner could not adequately meet the needs of all operators on the network. The diagram below represents ARTC's recommended approach.



- **Interstate Network**

  The current interstate track infrastructure is separated from train operations in South Australia, Victoria, New South Wales and Queensland.

  ARTC fully supports the Commission preference that greatest efficiency gains can be made on the interstate network through the vertical separation of the track from train operations and through the integration of management of this network. Almost without exception, major participants in this segment of the industry demand a rapid conclusion to the creation of this type of structure in the interstate rail market. Many participants are also keen to see the market achieve competitive neutrality both on-rail (privatisation of NR) and intermodally.

  Negotiations between ARTC, QR, RAC and WR to achieve a common one-stop shop wholesale agreement are proceeding to an advanced stage. Current investment in the interstate network, involving the extension of crossing loops on the TAR and in Victoria together with concrete resleepering and rerailing between Melbourne and Adelaide are expected to yield real and coordinated operational benefits on the East-West corridor.

Given the imperative of industry reform on the interstate network and in many other segments of the industry in Australia, it is important that the Commission emphasise its preference for industry structure via key recommendations in its final report.

6. Private Sector Involvement

Draft Recommendation 6.1
Governments should consider the scope for, and assess the 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.

ARTC supports this recommendation. Currently, a significant proportion of ARTC expenditure is out-sourced to the private sector, the result of which is an ability to reduce access pricing by an average of 7% in real terms since the advent of ARTC's predecessor (AN Track Access) in 1995. To complement this, 'real' gains which have accrued to network users over this period, resulting from a more commercially focussed maintenance and network management effort include:

- increased network capacity,
- improved service quality, and,
- changes in allowable train operating parameters relative to standards, such as increased train lengths, which enable the operator to derive significant above rail productivity benefits leading to increased yields.

In recent times, publicly (state) owned and managed rail entities existing in NSW and Queensland in particular, have made several attempts to expand their operations outside of state boundaries. This has met with mixed success with anecdotal evidence of:

- some entities employing non-commercial pricing in order to compete with and out-bid the private sector (lack of competitive neutrality), and
- bids from public sector (or related) entities for outsourcing/purchase opportunities in other states are not being considered regardless of the commerciality of the bid.

The former situation would act as an impediment to private sector involvement and investment in the industry; a situation which would only be resolved through the complete privatisation of above rail operators in Australia. The latter situation may well act as incentive for current governments to privatise their rail operations in order to effectively compete with the private sector in future opportunities (eg WA/NR sales).

A significant impediment to private sector investment in rail infrastructure is the lack of recognition that such investments:

- are long term
- are illiquid (sunk) investments
- often offer less than competitive financial returns (often as a result of pricing regulation and other regulatory requirements), but include social benefits which are often ignored.

The current investment environment, with a propensity to seek out shorter term gains for shareholders is not conducive to infrastructure investment. Similarly, the current taxation framework (as mentioned in the draft report) largely discourages investment to the point of not being able to compete on neutral grounds with other investment opportunities. Also, the direction in which business tax reform appears to be heading where the removal of accelerated depreciation benefits to capital investment appears to be the trade-off for a lower corporate tax rate will further detract from the attractiveness of rail infrastructure as an investment.

These issues have been alluded to in the report, but given current events in other government circles, a strong recommendation on steps which could be taken which might place rail infrastructure investment on a more even footing with other investments should be made. Significant change or removal of the onerous s51AD is an example.

7. Access to Infrastructure

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

ARTC fully supports this recommendation and has proposed in its previous submission that the 'auctioning' and 'secondary trading' of paths and 'pay for capacity used' represent means by which allocation and pricing on this basis could be achieved. ARTC has noted some resistance to this approach, primarily from larger encumbent rail operators, who may see such an approach reducing certainty to their current operations. Two points should be clarified with respect to ARTC's proposal. One is that it is not intended to introduce auctioning of train paths until all likely privatisation of key players has occurred, to ensure competitive neutrality. Secondly, the time frames for which paths can be contracted can be quite flexible, subject to 'use it or lose it' provisions, enabling certainty of business to be established. Secondary trading of train paths also enables the owner of the path to enhance the returns available to the owner from a given path.

ARTC is, however, concerned that the terms proposed by the Commission may encourage the use of 'market-based pricing' (Ramsey Pricing) by monopoly track owner with respect to some commodities. **It is ARTC's view that the market should be the determinant of value differences, not a monopoly seller of access.**

- ## 8. Safety Regulation/Operating Standards

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

Draft Recommendation 8.2
Changes to safety accreditation and mutual recognition processes for the rail industry should apply the principles of best practice regulation, including Regulatory Impact Statements.

Draft Recommendation 8.3
In developing codes of practice for the rail industry, best practice regulation should be adopted.

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

ARTC sees no reason why a national safety regulator with responsibility for the interstate and regional networks would not be appropriate. There is a case for suburban networks, which operate in a significantly different and isolated environment (physical and political), to that which might apply to the interstate and regional freight networks, to be regulated under a state based regime or if thought appropriate, a national urban transport safety regime.

- ## 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.

Draft Recommendation 9.3
The Commonwealth Government should establish an enquiry into the funding and pricing of roads in Australia.

ARTC supports the recommendations made, but feels that, given the progress (or lack of it) made since 1991 in these areas, as well as the current debate on many of these funding issues, the recommendations should be more emphatic and prescriptive in nature.

As stated earlier, the inability of rail infrastructure to compete as an investment alternative to other forms of investment largely revolve around the regulation of rail returns brought about by government involvement in the industry and the failure to recognise less tangible external indirect economic benefits of such an investment. Commercialisation of railways will remove regulatory barriers and improve the attractiveness of investment in the industry. The recognition of the avoidance of externalities associated with other modes as a benefit will not be a consideration in the investment decision making process in a commercialised railway. It is only necessary that this be a consideration in current decision making largely because the valuation of externalities is not a consideration with respect to investment in other transport modes. As the rail industry becomes commercialised, the only way in which competitive neutrality between land transport investment options is to be achieved is to consider the full costs and benefits of an investment regardless of mode.

These conclusions have also been drawn in the body of discussion of the draft report, but become lost in the recommendation finally made. The recommendation could be more prescriptive as to how governments might approach road and rail investment.

With respect to the diesel fuel excise, ARTC feels that the case that rail is disadvantaged under the current regime, and will be further disadvantaged under proposed tax reform, has been made in the report. The recommendation made should be more prescriptive, particularly given the current debate about the excise under the tax reform agenda, and the fact that similar recommendations made in the previous enquiry of this type has failed to produce competitive neutrality in the regard. That is, the Commission, as an independent body, should make a recommendation as to how the excise should be treated (probably in the context of road user pricing, generally) and applied if competitive neutrality is to be achieved.