Ms Helen Owens
Commissioner
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 3000

Dear Ms Owens

Thank you for the opportunity to comment on the Productivity Commission Draft Report *Progress in Rail Reform.*

Queensland Rail congratulates the Commission on a comprehensive report and particularly commends the recommendation that there be an inquiry into the provision, funding and pricing of roads in Australia.

However there are a several issues where OR either has a concern or believes there would be benefit in the Commission further developing its treatment of the issue.

Comparison with US Class 1 Railroads

OR shares with the Australasian Rail Association a concern regarding possible interpretation of draft report material comparing Australian Freight railways with US Class 1 railways. Appropriate qualifications need to be prominently positioned to guard against misinterpretation. Notwithstanding this, OR is following with interest the use of the Data Envelopment Analysis approach to analysing Total Factor Productivity.

Financial Performance and CS0s

Queensland Rail has previously argued in its submission the importance of separating 'input CS0s' from well-defined government procurement. The submission highlighted that the notion of 'railway deficits' should not be confused with economically justifiable procurement by government of transport outcomes, either through the funding of infrastructure, or by allowing less than 100% cost recovery through the end user of a train service (such as an urban passenger service)". Moreover, well defined and explicit 'input CS0s' should be distinguished from ill-defined operational subsidies based on a 'top-up' methodology.

Until this kind of transparency is achieved it remains very difficult to evaluate the financial performance of the rail sector. The issue is highlighted in the draft report's figures 4.9 and 4. 10. Figure 4.9 denotes the Return on Assets, inclusive of CSO receipts. These CSO receipts will be a conglomeration of various subsidy and procurement elements, both well defined and poorly defined. Moreover governments may choose to fund CS0s through several methods including cross-subsidies, levies on users, direct cash transfers to consumers, direct funding of enterprises and the acceptance of lower rates of return.'

Acceptance of lower rates of return remains endemic and would directly affect Return on Assets. It is therefore very difficult to assess the meaning of Figure 4.9. As noted in Chapter 10, this type of CSO funding is ideally negotiated as cash flow subsidy payments - at least this is the ideal from the point of view of transparency and from the perspective of evaluating rate of return measures of performance for the rail industry sector.

Similarly Figure 4. 10 could also be misleading unless CSO-related assets were clearly identified and removed. By doing so, a more accurate analysis of the return on non-CSO assets would become evident.

Financial performance measurement will remain problematic while the whole area of government funding remains confused within government itself. These issues will remain critical regardless of how far the privatisation process is developed. Certainly the sale of V-Line freight involved a CSO cash flow commitment from the Victorian government.

Chapter 10 of the draft report has identified many of the important issues regarding the need for further work on the economics of public funding and on the clarification of subsidy issues. However this will require considerable follow up and institutional support. This institutional aspect requires special mention.

Land Transport Commission

Since the release of the draft Productivity Commission report establishment of a Land Transport Commission seems increasingly unlikely.

Queensland Rail notes that the draft report is sceptical of a Land Transport Commission (LTC) with wide-ranging powers. The Commission's preferred option is a narrowly focussed LTC with its role primarily restricted to progressing uniformity in regulatory standards and operating issues. Queensland Rail therefore takes this opportunity to re-emphasise the importance of a more broadly tasked national body.

Community Service Obligations some Definitional, Costing and Funding Issues; Steering committee on National Performance Monitoring of Government Trading Enterprises, April, 1994.

In dealing with the broader issues, an appropriately framed and tasked terms of reference is probably of greater importance than the exact form or name of any new body or institution. While issues of harmonisation and standardisation are important elements of the terms of reference, it is essential to extend the scope to fundamental issues of transport economics. This scope would need to be a step closer to applied policy than the focus of the Bureau of Transport Economics, and needs to be linked more directly to infrastructure and funding decision processes. The brief should include:

- *the elimination of intramodal cross subsidies,-*
- *environmental consequences of operation;*
- *methodology for costing and recovering externalities, and application of the concept of 'marginal social cost',-*
- *economically optimal modal share,- and*
- *interaction between standardisation, the investment associated with this and the cost and benefits associated with the investment.*

Queensland Rail believes that a number of the Productivity commission's draft recommendations can only be appropriately addressed within a new nationally focussed body, Specifically:

> *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 inquiry into the provision, funding and pricing of roads in Australia.*

Recent developments indicate the continuation of a major gap in national transport strategy, due to the absence of an appropriately tasked body to deal with fundamental issues of transport economics and related policy. Because of the nature of several Productivity Commission recommendations, the final report would benefit from commenting on the need to address this institutional gap.

Investment and Government Intervention

The Commission has examined two alternative approaches to investment allocation.. the Swedish approach and the commercial approach. The Swedish approach is not favoured because this approach tends to mask market orientated pricing and therefore private sector incentives and has the added burden of greater data collection. The more favoured approach, as noted in draft recommendation 9.1, is the commercial approach.

The Productivity Commission is no doubt aware that there is already extensive Government intervention in investment, especially in road investment (including at Federal level, as per funding of roads of national importance).

Given some of the draft report comments on a Land Transport Commission, it is worth emphasising that appropriate tasking of a federal body with a transport economics brief does not imply greater intervention. It implies a more logical basis for existing levels of intervention and a better framework for rational investment decisions.

But there is more to this than the "commercial approach as emphasised in draft recommendation 9.1. Fundamental to achieving better intervention is a distinction between the economic and the ’commercial’. An investment evaluation framework will facilitate ’economic’ investments that may or may not be commercial in terms of end-user pricing.

Part of the institutional brief that is currently lacking is:

- An agenda of developing methodologies for investment evaluation and using institutional influence to disseminate these approaches into national and state jurisdictions.

- The application of these methodologies to national infrastructure proposals and determining the appropriate 'net cost to Government' and appropriate end-user cost recovery.

Public and Private sector participation

It is central to Queensland Rail's business strategy to participate in public/private sector partnerships, in the pursuit of value for money and innovation. Recent Queensland Rail partnerships have included the Brisbane Airport Rail Link (BARL) and the Great South Pacific Express venture with Venice Simplon Orient Express. Therefore Queensland Rail supports the essence of draft recommendation 6.1, which states:

> *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.*

Contemporary trends in the role of government include an increasing focus on the function of the state as 'purchaser of outcomes' on behalf of the public and taxpayer. This worldwide trend is reflected in Queensland through Treasury documents and policies such as 'Managing for Outcomes' and 'Policy Framework for Private Sector Involvement in Public Infrastructure and Service Delivery'. Associated with the development of this trend is:

- increasing use of public and private sector partnerships in the form of both build-owner operate-transfer (BOOT) related mechanisms and competitive tendering and contracting (CTC) processes.'

- reductions in the role of government as 'hands on' asset and property manager.' and an increasing need for government to involve itself in partnerships with the private sector in projects which are economically viable but not commercially viable ie which require substantial government contribution because of externalities or social obligations.

A managing for outcomes framework creates a number of challenges for government in terms of process, culture, attitude and skill base. Two of these are worth specific mention.

Firstly, there is the issue of specifying major projects in output terms rather than input terms. For a transport project, this would involve specifying a traffic task capacity rather than specifying the actual standard or type of transport infrastructure. It may also involve specifying other service parameter standards (eg on-time-performance standards) but would not involve specifying how to achieve this (eg a particular type of technology or a particular staffing level).

Specifying outputs requires a willingness to forego a certain level of control and a willingness to entertain non-conforming bids. It may involve a different kind of industry knowledge on the part of government or a willingness to hire strategic industry knowledge for proposal appraisal purposes. To the extent that a change of mindset is achieved in this respect, government will be able to use the private sector to enhance innovation through accessing a wider knowledge base, new ideas and/or new technology.

Secondly, associated with the capacity to specify in output terms, there is a need for competence in valuing the broad net economic-social benefit of infrastructure project outcomes. This aspect has been given considerable attention in the EPAC Private Infrastructure Taskforce Report (1995) and also in Fred Argy's report on 'Private Sector Investment in Queensland Infrastructure: Opportunities and Challenges' (1997) for the infrastructure Association of Queensland.

EPAC spoke of the "need for agencies to keep up to date with rapidly improving techniques for valuing or otherwise incorporating non-priced benefits and costs". (EPAC, 1995, p. 166). The report also highlighted that in the taskforce's view, the need to account for wider benefits and costs is particularly important in the transport area" (EPAC, 1995, p. 165).

But to do this, government needs to have a clear view of what a particular project is worth to the state in broad social-economic terms. It can then go to tender or pre-tender to evaluate whether the net benefit to the state is sufficient to justify the best practice price to government of providing that infrastructure. Or, at the time of calling for submissions, government can reveal the maximum level of support (whether by up front capital, on-going subsidy or other means) they will contribute to the project.

Government departments that do not have appropriate competencies in this regard will tend to focus on "no net cost to government" projects or will find it difficult to progress transparent arrangements for infrastructure associated with externalities or social obligations. And there are certainly plenty of contemporary examples of these kind of difficulties in terms of infrastructure proposals at state and federal level.

This conceptual framework for private sector involvement and investment appraisal has been recognised and supported at several points within the draft report of the Productivity Commission, including in section 9.2. But again it is not following through to institutional recommendations. In arguing that a land transport commission will undermine a "commercial approach the report is silent on mechanisms for achieving a challenging shift in government perspective's and processes.

Conclusion

Again, Queensland Rail thanks the Commission for the opportunity to comment on the draft report. Despite a belated response, it is hoped that these comments will provide some value in the development of the final report.

Yours sincerely

Vince O'Rourke
Chief Executive

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