Submission To The Productivity Commission In Response To Progress in Rail Reform Draft Report

INTRODUCTION

FreightCorp made a presentation to the Productivity Commission ("the Commission") Inquiry into Progress in Rail Reform on October 27 1998.

That presentation provided an overview of progress in reform at FreightCorp, and discussed the key reform issues for FreightCorp – rail access, and competitive neutrality.

This submission provides comments on the Draft "Report on Progress in Rail Reform" ("the Report") issued in March 1999. It should be noted that these comments are based on FreightCorp views which do not necessarily reflect those of the NSW Government.

Since the Treasurer announced this Inquiry on 5th August 1998, FreightCorp has expanded its geographic range of operations to include services from Sydney to Melbourne and Brisbane, and the haulage of coal from Leigh Creek in South Australia to Port Augusta.

These developments highlight the accelerating pace of change in the Australian freight rail industry. In this respect, whilst the commentary in the Commission's report incorporates the latest developments, the termination of much of the data analysis in 1996/97 means this analysis does not show the further improvements made over the last two years.

COMMENTS ON RECOMMENDATIONS

Draft recommendation 6.1: Governments should consider the scope for, and assess the potential benefits and costs of, further private sector involvement as an integral part of their approach to rail reform.

FreightCorp supports the recommendation that increased commercial focus is the key to future improvement in the rail sector. Greater private sector involvement is but one of a number of strategies to achieve this change.

Since becoming a State owned Corporation in 1996, FreightCorp has achieved a rapid and accelerating growth of commercial focus in all areas of its operations. Progress towards commercialisation has however varied across different sectors of the industry.

FreightCorp has found the greatest barrier to acting as a completely commercial organisation to be the perceptions of other Governments, which have acted to prevent FreightCorp bidding in the privatisation of rail assets.

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

FreightCorp supports the Commission's conclusions that none of the existing access regimes provide a completely adequate, efficient, or fair allocation and pricing of track access. Further development of access systems is therefore required.

In responding to the Commission's recommendation, the following general comments are offered on the pricing and allocation of train paths:

A. Existing Practice

1. The practical allocation of train paths is difficult in any jurisdiction. The issue of allocation of paths has not been adequately dealt with in any of the jurisdictions in which FreightCorp currently operates. The solution has generally been to allow existing users to retain their path allocations ("grandfathering"), with additional paths for new entrants fitted around these.

2. While the current practice of grandfathering path allocations preserves the rights of incumbents, it can also:

    1. **Impede the growth of competition.**
    Grandfathering favours incumbents over new entrants. As the Commission recognises, in some circumstances this can be a deterrent to the growth of competition from new entrants. As the encouragement of competition was the principal reason for setting up open access to infrastructure, grandfathering therefore weakens the effects of micro-economic reform.

2. **Lead to inefficient use of the infrastructure.**
   Grandfathering allocations leads to inefficient use of the infrastructure. As infrastructure owners are unable to amend the paths provided to existing users, new paths have to be scheduled around these. When new paths are added, these are likely to include scheduling inefficiencies required to avoid interference with existing paths. Often, significant improvements could be made to large parts of the timetable if some of the existing paths could be adjusted.

   When all services were managed by one operator, rescheduling of paths could be done by internal management. However, under current practice, there is no power for the network controller to mandate changes to existing paths, and no imperative or reason for an incumbent to voluntarily accept changes designed to remove inefficiencies suffered by a competitor.

   The NCC has indicated it is not prepared to authorise a NSW Rail Access Regime unless this incorporates a capacity transfer mechanism. FreightCorp agrees that this requirement is essential, and considers it needs to be part of a comprehensive path allocation mechanism which:

   - Protects the rights of incumbents;
   - Facilitates competition; and
   - Ensures efficient and effective use of the infrastructure.

B. The Commission's Recommendations

The pricing and allocation of train paths based on the value a user places on the track – presumably through a bidding process – is a preferred theoretical solution, but has many practical issues that will limit its usefulness and applicability: the large variations in achievable paths; and system complexity:

1. Path Variability

Train paths are not physical objects and it is possible to have an infinite variation of paths due to the types, power, and lengths of trains. Trains also start and finish at different locations and the management of capacity on each specific line section of track may become more important than consideration of the entire path.

With rail it is crucial that each particular train enters and exits the network at a particular location and time. This requirement leads to a fundamentally different system for the allocation of capacity than is required for the distribution of electricity and gas. As electricity and gas are homogenous, the guiding principle is whether additional product can be added to the network at a particular time. It is immaterial which product exits the network at which location so long as the quantity is appropriate. This is not the case for rail.

2. System Complexity

Co-ordination is made more difficult by the requirement to run trains through more than one jurisdiction.

A workable mechanism is required to achieve an equitable and economically efficient allocation of train paths. Whilst the Commission's recommendation sets a desirable objective for this allocation system, it is our belief that significant practical difficulties remain in achieving this including further development of access regimes in some jurisdictions prior to their authorisation by the NCC.

FreightCorp would suggest a model that incorporates both a bidding and negotiation approach. We would be happy to elaborate on our preferred model if this would be of assistance.

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

FreightCorp agrees with the principle of paying a single yearly fee for national accreditation, however it believes that payment only in the jurisdiction of principal activity will create implementation problems especially with the continued transition of the market from the historical state-based focus.

The proliferation of private railways and the nature of the market itself are forcing the railways to extend their activities into new geographical areas. For example, FreightCorp now has a significant operation in South Australia, while Freight Victoria has indicated that it will substantially expand its presence into both NSW and South Australia. NRC has always operated over the entire Australian standard gauge railway network.

FreightCorp suggests the issues associated with multiple track owners and multiple accreditation bodies could best be resolved through a single fee payment to a Commonwealth government agency or national regulator.

This would enable reduced administrative costs and a simplified system that would have flow-on benefits to other areas considered in this report including safety accreditation and mutual recognition, removal of regulatory impediments to interstate rail operations, and the ability to manage the interstate rail infrastructure on a national basis.

This would bring the rail industry into line with the road industry which recently introduced changes to implement payment of accreditation fees to a single national body.

Care is required to ensure a single accreditation system is equitable to all industry participants. Accreditation fees are currently related to scale of operations. FreightCorp supports a system where accreditation fees are instead based on the regulatory tasks provided. The scale of operations does not directly relate to the level of accreditation services needed.

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

FreightCorp strongly supports any move to further improve the legislative structure to facilitate interstate competition.

FreightCorp has sought and gained accreditation as a train operator with the four entities managing safety accreditation in four States (NSW, Queensland, Victoria and S.A.). FreightCorp was required to prepare a separate submission for each accreditation body, each with different content requirements. In some States, mutual recognition of existing accreditation streamlined the process. However, this has not been our experience everywhere. There are still unnecessary costs associated with the accreditation of a train operator moving into new jurisdictions.

FreightCorp has also experienced unnecessary duplication of effort with infrastructure owners who require train operators to undergo a process similar to accreditation to assure themselves that the operator will not pose a safety hazard to other network users. While these requirements differ somewhat between owners, in some instances there tend to be overlaps between the requirements of the safety regulator and the infrastructure owner.

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

FreightCorp has raised the investment in transport infrastructure, as a key issue in its earlier presentation to the Commission on October 27 1998. The current disparity in the quantum and focus of road/rail investment should be addressed at a national level and consider the economic and social costs of intermodal shifts.

Historical evidence shows that, the Commonwealth Government has invested more heavily in road vs rail infrastructure to the extent that rail infrastructure improvement has significantly lagged behind road infrastructure.

FreightCorp suggests that a consistent approach to all future transportation funding decisions is required, and that an excellent case exists for additional funding being made available to address the current imbalance.

FreightCorp would suggest that the above recommendation is insufficiently specific. A commercial approach to railway infrastructure must examine its current poor quality that is due to past years of low maintenance expenditure. Similarly, any commercial focus for either road or rail must take into account the effects of modal shifts in task, particularly on externality costs.

Finally, care appears necessary in applying commercial concepts to rail infrastructure until the commercialisation process has been fully applied to roads, including road charging as recommended in 9.3 below.

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.

FreightCorp strongly supports this recommendation. It has argued in a number of forums that the diesel fuel excise is a hidden tax on the rail system and should not apply to rail as an off-road user.

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

FreightCorp supports this recommendation. Such an inquiry forms a key step in developing competitive, transparent and efficient land transport infrastructure in Australia.

COMMENTS ON TECHNICAL ANALYSIS

Productivity Analysis

The Productivity Commission has developed its analysis and thinking based on the rail systems in place in 1991. At this time the country was dominated by the State-based vertically integrated railway systems, of which the State Rail Authority was one.

However, as the Commission recognises, by 1998 the nature of the railway industry had significantly altered. In NSW the vertically integrated SRA had been split into 4 separate entities one of which was Freight Rail Corporation ("FreightCorp") which assumed above rail freight activities.

In other States, vertically integrated structures remain. As the detailed commentary in the Report recognises, there are significant differences in the rail systems compared – two above rail and three vertically integrated systems are considered. The report also notes the major limitations in the sensitivity of the DEA model.

FreightCorp has appreciated the opportunity to work with the Commission on the data analysis. FreightCorp has also sought the assistance of consultant company Booz Allen & Hamilton regarding the productivity analysis that has been undertaken as part of this inquiry into Progress on Rail Reform. Detailed comments are attached in the technical appendix.

FreightCorp welcomes the development of a new and potentially powerful modelling tool. However, given the reservations expressed by the Commission regarding the state of development of the model, and the systems issues outlined above, FreightCorp considers the unqualified conclusions drawn in Section 4 of the Report to be premature.