



**THE CABINET OFFICE
NEW SOUTH WALES**

ATTENTION: Andrea Coulter

Mr John Cosgrove
Presiding Commissioner
Industry Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Dear Mr Cosgrove

I refer to the Industry Commission's draft report on the black coal industry. The following responses are made to the Commission's key recommendations:

- *Governments should facilitate improvement in mine management by increasing the choices available to owners and managers in managing mines. Legislation should not prescribe the management hierarchy at the mine site, the bundle of skills held by mine managers, or the responsibilities of mine managers.*

The regulatory approach to statutory positions such as that of mine manager is being reviewed as part of the implementation of the NSW Mine Safety Review recommendations. As part of the process, the NSW Mining Industry Training Accreditation Board has undertaken work in relation to competency standards and training resources.

- *Pricing principles and asset valuations for determining prices for access to rail infrastructure should be established and published by IPART. Freight customers should have a right of appeal to IPART regarding the application of these principles on a case-by-case basis.*

The NSW Government is the only Australian state to have developed a rail access regime. The regime was published in August 1996 and submitted for certification to the National Competition Council in June 1997. NSW is still engaged in discussions with the NCC about aspects of the regime. As part of that process, NSW has proposed publishing its methodology in setting a rate of return, and allowing an independent third party to examine the evidence in

relation to the issue and provide a view on the appropriate maximum rate of return to a business such as that of the Rail Access Corporation

- *NSW should bring its port corporations within the prices oversight jurisdiction of IPART.*

NSW sees no need for such a move at this stage. As the IC's report notes, Australian coal ports and terminals perform well by international standards in terms of physical throughput and pricing.

- *The Joint Coal Board should be abolished and its functions taken over by the NSW Department of Mineral Resources, WorkCover and private providers where appropriate. If it were decided to retain the workers' compensation role of the JCB, Coal Mines Insurance should be corporatised and required to compete for business against other insurance options.*

The Commonwealth has advised that it will be withdrawing from the Joint Coal Board. The NSW Government is currently considering how the functions of the Joint Coal Board will be performed after this takes place.

- *NSW should consider adopting a resource rent royalty on black coal. If such a method is considered inappropriate, NSW should consider adopting an ad valorem system as Queensland has.*

NSW has previously considered the feasibility of a resource rent approach to coal royalties. Concerns included the complexities of calculating the threshold rate of return, setting the royalty rate and calculating allowable deductions, and the mechanics of introduction, including the difficulties of equitably treating established versus new operations. Given the current weak financial position of the black coal industry, it is not an ideal time to be considering changes to the royalty regime.

The NSW Department of Transport has provided more detailed comments on the transport aspects of the report, and these are appended in full to this submission.

Thank you for the opportunity to comment on the draft report.

Yours sincerely,

Roger B. Wilkins
Director-General
The Cabinet Office

SUMMARY OF COMMENTS ON INDUSTRY COMMISSION DRAFT REPORT

(Commission's views in italics, Department of Transport comments following).

1. Freight costs

p152: *“Rail freight is a significant cost for exported black coal, averaging around 15 per cent of the fob cost of production.... However, for some mines freight is up to twice this share due to implicit royalties included in rail charges...”*

Comment: This is not supported by data or analysis. It would be expected that mines furthest from the ports would have the highest ratio of freight cost to total cost. This is more likely to be associated with freight costs over distance than with implicit royalties.

2. Freight task

p152: *“Around 81 percent of freight by volume carried in NSW ... is coal. In NSW coal contributed 49 per cent of freight revenue.. This compares with around 37 per cent of freight by volume and 33 percent of freight revenue for CSX Transportation (a major US rail company)”*

Comment: This is not supported by data, it is wrong and it draws an apparently irrelevant analogy.

Around 81 percent of FreightCorp's tonnage in 1996-97 was coal (including domestic tonnes). However, tonnage (weight) is not a volume measure.

The more usual measures for the rail industry are tonne kilometres (gross - gtk and net -ntk). These measures are used because tonnages do not produce meaningful indicators of efficiency, costs and prices.

The data presented in the Report relates only to FreightCorp. However, other rail operators in NSW also haul rail freight. At present the largest of these is National Rail Corporation. Inclusion of National Rail Corporation's task would bring the NSW task more into line with the cited CSX figures.

The relevance of the comparison with CSX is not clear. The Report draws no conclusion from the comparison. It might be noted that the comparison apparently indicates that Australian systems have less per unit commercial reliance on coal ie. the ratio of revenue to volume share of coal in total system business is lower in Australia.

It is not clear why a comparison is made with any US railroads, let alone CSX. It is somewhat puzzling that comparisons are later made with railroads such as Burlington Northern and the combined US class 1s, but not with CSX.

The relative size of the Australian and US class 1 systems is not detailed in the chapter, although this arguably is the single most important fact in the relative efficiencies of the industries. The relative sizes of the organisations would indicate, prima facie, the irrelevance of performance comparisons.

3. Bureau of Industry Economics Report

p155: *“In its report on rail freight performance for the BIE, Symonds Travers Morgan (1996).....”*

Comment: This appears to be an error since the BIE report was published in 1995.

4. Government royalties in freight rates

p156: *“Freight rates of NSW and Queensland railways have been significantly higher than overseas rates, largely because of governments’ use of rail freight to collect implicit royalties from the coal industry”*

Comment: No evidence is presented to support this assertion. Evidence is presented to show that ntk rates were higher some time ago, however, there is no concrete analysis of causal factors.

5. Average revenue per ntk

p156: *“The BIE (1995a) found that for 1993-94 average coal revenue per ntk in NSW (5.7 cents) was over three times the average for US class 1 railways (1.8 cents)”*

Comment: This information is out of date and may be wrong. It relates to a time prior to the structural reforms in NSW and the Government’s announcement to eliminate what the coal industry calls “monopoly rent”.

The chapter later cites Barlow Jonker (1997) data, which presumably should be used as the basis for any comparison. However, this data appears to indicate that average freight rates per ntk in NSW are now higher than in 1993-94. Given that freight rates for most hauls have fallen considerably since 1993-94 an explanation of the Barlow Jonker results is required.

6. Standardised operating costs

p160: *“Standardised operating costs of both NSW and Queensland rail freight systems were estimated to be about 37 per cent above WBP in 1993-94”.*

Comment: This information is out of date.
It relates to a period prior to the NSW structural reforms.

The data also conflicts with other evidence cited in the chapter, for example:

- . ARCO reporting of QR (at p.160):
“We know that as a railway it is a fairly efficient railway”
- . Exxon reporting of FreightCorp (at p.174):
“Exxon has been pleased with the performance to date of FreightCorp....”.

7. World best practice

p160: *“The results of the JAG and BIE studies indicate that provision of coal rail freight in Australia is somewhat less productive than best practice overseas railways”*

Comment: This conclusion is supported neither by the data, the analysis, nor indeed the coal industry evidence.

The JAG report (Queensland only) related to 1992-93 operating costs compared with Burlington Northern. This is out of date and not relevant to NSW.

Also, BHP disagrees with the Report’s interpretation of the JAG study (at p160): . *“...QR performed reasonably well performance wise. We’ve never had a major complaint with their performance...”*

The BIE report is out of date as indicated at (6) above. As noted earlier in the chapter, the BIE did not disaggregate Australian (or international) systems into coal traffics and other traffics. The BIE does not separate out interstate rail freight, which was then carried by National Rail Corporation. This artificially lowers the reported efficiency of SRA. The BIE report did not analyse the relative efficiencies of the coal hauls.

8. Efficiency gains

p161: *“However, many coal producers have observed that the lack of competition in rail services has been a barrier to making the broadly 20 per cent efficiency jump to better practice levels”*

Comment: The 20% figure is apparently not supported by any evidence or analysis. It may relate to a 24% figure (at p.160) which was the BIE’s estimated gap between freight operating costs of Australian systems and world best practice in 1993-94.

However, this statistic predates contestability in rail, and is averaged over all systems (not just NSW and Queensland) and over all traffics (not just coal).

p161: *“FreightCorp indicated the significant efficiency gains that could be achieved in operating costs. For example, it outlined large planned reductions in its workforce”*

Comment: The workforce reductions are across all areas of FreightCorp rather than merely coal transport.

9. Infrastructure maintenance costs

p161: *“The RAC estimated that up to 30 per cent savings will be achieved in its infrastructure maintenance and upgrading costs as a result of competitive tendering. Rail maintenance costs fell by over \$100 million in 1996-97”*

Comment: There are a number of problems with using this estimate:

- . It relates to the entire NSW network, including the Sydney metropolitan area, not simply the lines used for coal;
- . The basis for RAC’s assertion is unclear and has been questioned;
- . It needs to be considered against maintenance tasks and costs at a specific point in time and be related to a specific period. For example, if 30% was achievable at 1 July 1996 (the date of the structural reforms), a lesser percentage would be achievable from this time forward.

Competitive tendering could not have resulted in \$100m of cost reductions in 1996-97 because at 30 June 1997 some 98.7% of track kilometres were not covered by the competitive tendering program.

p161: *“The NSW Government recently announced a moratorium on competitive tendering for RAC maintenance work until mid-1999 in order to provide job security for existing Government rail maintenance workers. This decision will reduce significantly the short-term cost savings available to the RAC and commensurately increase charges for rail access”*

Comment: The Government’s decision was to place competitive tendering on hold to allow for the corporatisation of the Railway Services Authority. Corporatisation of the Authority is aimed at ensuring that it competes more effectively with the private sector. If anything, this strengthening in competition could be expected to drive down costs, including private sector costs, below what otherwise would occur.

The assertion that there would have been cost savings to RAC assumes that contestability is the only mechanism for reducing costs. Such an assumption is wrong. A system of benchmarking will be introduced to ensure that the cost savings to RAC during the suspension period are at least equal to those achievable by contestability.

Also incorrect is the assumption that access charges, including for coal, are strictly related to maintenance costs.

10. Rail reform

p162: *“The pace of change (in rail reform) has been gradual”*

Comment: This is wrong. Major changes have rapidly occurred since mid 1996.

p162: *“In 1995 the Government owned NSW State Rail Authority was separated into four separate businesses all reporting to the Treasurer...”*

Comment: This statement is wrong on several counts:

- . The structural reforms took effect on 1 July 1996;
- . Prior to this date, there was contracting out of various functions and services;
- . Interstate rail freight has been conducted by a corporation jointly owned by the Commonwealth, Victorian and NSW Governments - NRC since 1993;
- . From 1 July 1996, the two NSW rail corporations report to the Treasurer and another Minister (RAC to the Premier and FreightCorp to the Minister for Sport and Recreation);
- . The two other wholly owned NSW government rail businesses - State Rail and the Railway Services Authority (RSA) - report to the Minister for Transport; and
- . RSA is to be corporatised in the near future and then will report to the Treasurer and one other Minister.

11. Natural monopolies

p164: *“While above track freight services are contestable, below track infrastructure services are generally seen as natural monopolies”*

Comment: This is an oversimplification of the complex issue of market definition. Monopoly depends more on market definition than the physical nature of the facility. It may be that, in some markets, road transport is a significant competitor to rail. If so, the track infrastructure service is not a natural monopoly.

12. Government ownership

p165: *“In the short term, the existing dominant position of incumbent government freight providers suggests reasons for them remaining in government ownership”*

Comment: This is irrelevant to the issue of rail reform.

It is hard to determine the line of logic as the reasons for Government retention are not outlined.

It may be that the Commission wishes to suggest that Government would find tempting the financial gains arising from market dominance. However, such financial gains could be exploited equally through immediate sale as through retention, since a buyer is likely to pay a premium equal to the present value of the net income stream arising from market dominance.

The Commission would be aware of the previous Government's attempts to sell the Hunter system to the coal industry.

p165: *"In the longer term the transparency and effectiveness of introducing competition into rail freight may be best served by selling government freight carrying services"*

Comment: There are three problems with these assertions:

- . There appears to be no prima facie reason to assume a relationship between transparency and the nature of an organisation's owners
 - The Report does not explain why private sector ownership would result in greater transparency;
- . The assumption that the objective is "introducing competition", whereas a more accurate statement of goals would be: "to introduce competitive pressures"
 - The difference between visible or ostensible competition and competitive pressures may be important in rail where operating efficiency is related to scale economies. That is, artificially induced ostensible competition may result in inefficiencies. Unfortunately, this issue is not explored in the chapter; and
- . The Report does not explain why Governments should sell rail operators rather than rail track.

p165: *"The benefits of the NSW structural separation model may appear somewhat illusory to potential competitors when both the infrastructure and freight providers are government owned with the Treasurer as a common shareholding Minister"*

Comment: This is a serious allegation by the Commission, namely that NSW favours its own operator over potential competitors. The claim is not substantiated by evidence, argument or reference to the view of any organisation.

13. Removing royalties

p166: *"However, there will be some situations in which the transport choice has been distorted by royalty-inflated freight rates. In these cases the removal of royalties from rail will enable mines to choose the most economical form of transport, unaffected by royalty considerations"*

Comment: This assertion is not backed by data or examples.

It also is illogical. To the extent that choices between road or rail are affected by a "rail royalty", rail would not be used. If rail is not used, no "royalty" is paid. Hence, there is no point in imposing a rail "royalty" unless rail continues to be used ie. the choice of transport mode is not affected.

p.167: *“the NSW Government obtains monopoly rent through the rail system in the form of excess coal freight charges for selected mines.....”*

Comment: The substance of this comment is correct, although the expression is inaccurate. “Monopoly rent” is collected through access charges which influence, but are not the same as, freight charges.

p168: *“With the creation of RAC and FreightCorp, and in preparation for the introduction of competition in rail freight, the monopoly rent component and the loss on hauls not covering avoidable costs have been estimated...”*

Comment: This is wrong. “Monopoly rent” and losses were not estimated in preparation for the introduction of competition. Rather, they were estimated in association with the reforms which introduce competition. The point is that the particular level of “monopoly rent” does not affect on-rail competition, provided it is paid to and by all freight carriers.

More importantly, the reforms do not have an objective of increasing ostensible competition - of growing the number of competitors on the network. There was and is no Government expectation or objective about the number of rail operators, or indeed the number of trains, on the network. The success of the reforms should be judged in terms of transport task, rather than the organisational composition or industry structure supporting that task.

p168: *“The monopoly rents and subsidies as estimated by the NSW Government are being phased out over four years to July 2000”*

Comment: The “monopoly rent” phase out period is now two years. The Government has not made a commitment to phase out subsidies.

p168: *“In the interim the NSW Government will still receive monopoly profits in the form of an implicit company tax (paid to the State Government)”*

Comment: Company tax is based on the income of corporations. It is paid directly to the Commonwealth Government. The alleged “monopoly profit” collection is not based on mine income. It is not related to whether or not the mine is owned by a corporation. No direct payments are made by companies to the Government. Therefore it is not a company tax.

In other parts of the chapter, the term “monopoly rent” is used rather than “monopoly profits”. The significance of the different terminology - “rent”, “profit” and “tax” - is not clear.

p168: *“However, the Government would need to make greater contributions to the RAC and the SRA now for loss making services previously partly financed by monopoly profits”.*

Comment: This comment apparently relates to freight. However, SRA no longer operates freight services. It does not and will not receive any support for coal freight.

There also appears to be an assumption that freight subsidies would be paid to RAC rather than to the freight service provider. It is not clear why such an assumption is made.

14. Rate of return

p168: *“The scope for price discrimination allowed by such a high ceiling rate (in NSW) gives some cause for concern”*

Comment: The source of concern is misplaced. In the general provisions of the Rail Access Regime price discrimination is allowable irrespective of the ceiling rate of return.

Coal pricing is not covered by the general provisions of the Regime. RAC is not free to price discriminate among coal hauls under the Regime reviewed by the Commission. This is because coal access prices are set rather than negotiated.

The ceiling rate of return in such circumstances has no relationship to RAC’s price discrimination.

p169: *“To the extent that the ceiling rate is considered excessive, monopoly rents will still be earned even after 2000 on those contracts paying ceiling or close to ceiling prices”*

Comment: This is inaccurate. For “monopoly rents” to continue, the ceiling rate must actually be, rather than merely considered to be, excessive.

14. Competition in coal rail transport

p169: *“...there are likely to be inefficiencies created by the long period of absence of competition in providing rail services.”*

Comment: As there is now competition, it is difficult to see the point of this statement.

p169: *“The benchmarking studies cited in section 7.3 suggest that such implicit monopoly costs were (sic) could be 20 percent or more.”*

Comment: A large part of section 7.3 in the Report is devoted to pointing out the deficiencies in the cited benchmarking studies. None of the studies indicate a 20 percent cost penalty, let alone one attributable to monopoly conditions.

A figure of 24 percent cost inefficiency is cited for 1993-94, however, this had been falling “steadily” from 52 percent in 1989-90. Continuation of such steady progress would see the cost penalty at around 11 percent now in 1997-98. In addition, the comments by participants in the Inquiry process acknowledge coal operations to be more efficient than general freight (as indicated in section 6 above).

p169: *“The inability of the RSA to compete successfully for most of those maintenance services that have been put out to tender indicates some of the costs involved in inefficiencies generated by past monopoly provision. The RAC indicated savings of 30 percent...”*

Comment: There is no reason to assume that the results of the competitive tendering process to date, of RSA not winning contracts, would be replicated for lines used for coal is not valid.

In any event, information suggests that RSA was cost competitive in previous bids. In fact, there have been complaints that RSA was offering to undertake works at lower prices than private contractors. This invalidates the assumption in the Report. RAC’s comments are discussed in section 9 (above).

p169: *“The NSW Minerals Council (sub.52) observed that under current access pricing arrangements, delaying the introduction of competitive tendering for maintenance work meant the coal industry would continue to pay for such inefficient costs.”*

Comment: The Minerals Council’s observation is wrong. It assumes that the suspension of contestability must result in higher track maintenance etc. costs than otherwise would be borne. However, this is not the case.

Benchmarking, supervised by the Independent Pricing and Regulatory Tribunal, will be introduced to ensure that maintenance costs are, at most, equal to levels which would be achieved by competitive tendering.

15. Access and competition

p170: *“The competition policy agreement reached by the Commonwealth and State*

governments in 1995 recognised that only the network infrastructure of rail services required monopoly provision and that freight carrying services could be opened up to competition..”

Comment: The Agreement did not “recognise” rail infrastructure as indicated. Indeed, the Agreement referred to rail only in respect of exempting access to coal transport from the general provisions until November 2000 ie., the moratorium on coal access.

16. Declaration processes

p171: *“The NSW Government has not sought at this stage to use s.78 to thwart the NCC proceedings”*

Comment: It is unclear what the NCC “proceedings” may be. They are certainly not against NSW. NSW has not and will not “thwart” any NCC proceedings. Indeed NSW is working with the NCC to ensure its Rail Access Regime is certified as “effective”. The NCC has commented (emphasis added):

“The Regime was found ineffective in the context of the NSW Minerals Council application for declaration. The Council advised the NSW Government of its concerns and thanks the NSW Government for its commitment to developing proposals to overcome these concerns. While some issues regarding the phasing of coal pricing need further clarification, the Council considers that the Regime will meet the CPA criteria, after including the changes proposed by the NSW Government.....”

p172-173: Discussion of NSW Rail Access Regime including: *“Under the current NSW access regime freight customers such as coal companies do not have any rights of appeal. At present, FreightCorp is the only party with recourse to appeal to IPART regarding disagreements with RAC on access conditions”*

Comment: This is misleading because NSW has submitted a proposal to the NCC dealing with the matter.

It is analytically deficient for two reasons. The first is outlined by the NCC:

“Providing access to persons other than accredited operators creates the potential for inefficiencies, which may arise from, for example, administrative costs incurred by RAC, effective monopolisation of access by “customers” not subject to the Regime, or misuse of access rights...”

This matter should be explored by the Commission.

The second analytical deficiency arises from the implied assumption that a rail operator would entirely disregard the interests of its customers in negotiating access, or would avoid arbitration which would benefit its customers. This supposition is wrong as demonstrated by the recourse to appeal by National Rail Corporation.

The Report is further wrong on this point because an access seeker, defined as an existing or prospective rail operator, always has enjoyed rights of appeal to IPART under the Regime. Appeal rights never have been limited to FreightCorp.

p173: *“in response to this application (by the NSW Minerals Council) the NSW Government submitted its rail access regime to the NCC for certification in June 1997.”*

Comment: The Government indicated in early 1996 its intention to submit the Regime for certification. Neither this nor the June 1997 submission was “in response” to the Minerals Council’s application.

p174: *“In September 1997, the NCC accepted the Minerals Councils’ application.... the NCC found that the existing NSW rail access regime was not an effective regime, largely because of the uncertainty and lack of transparency in pricing arrangements”*

Comment: The NCC made this finding primarily in relation to Specialised Container Transport’s application for declaration. A large part of the concerns there were related to the general - ie. non-coal - pricing provisions of the Regime, and lack of available information.

The NCC also found that the Regime was ineffective in relation to the Minerals Council’s application but, in doing so, paid more attention to coal prices and “monopoly rent” issues.

The NCC’s draft recommendation on certification of the Regime notes that these issues are in the process of being addressed. Most significantly from the perspective of coal pricing, the NCC concludes that the Regime meets the Competition Principles Agreement even though concerns regarding coal pricing will cease on 1 July 2000. That is, the Council accepts the imposition of “monopoly rent” in access charges for a transitional period.

Coal prices are set in the Regime, and there is a written commitment from the Government to reduce the adjustment component. Given this, it is difficult to conceive how coal prices could be made more certain or transparent.

p174: *“in November 1997, the NSW Premier rejected the NCC recommendation”*

Comment: The NSW Premier did not accept the recommendation, which may be

interpreted as a rejection.

17. National Rail Corporation

p174: *“The NSW Government also has not given the necessary permission for the National Rail Corporation (NRC) to compete in the NSW freight market”*

Comment: This is misleading for two reasons. First, NRC’s primary purpose is to compete in interstate freight markets, including that in NSW. NSW is the only Government to have actively and consistently supported NRC since the inception of the Corporation.

Second, it was understood that NRC would seek permission on a case by case basis for activities outside its core interstate rail functions. NSW provided the relevant permission for every such activity sought by NRC. There was only one instance of delay - as a response to the refusal of the other Government shareholders to meet their legal obligations to the Corporation.

NRC did not seek permission to haul coal in the Hunter Valley.

The Commission might have noted that on 10 February 1998, 2 months before publication of the draft Report, NSW provided NRC with blanket permission for any freight activity, including coal haulage.

18. NSW Rail Access Regime

p175: *“despite an initial positive response by the NSW Government... the proposed access arrangements raises (sic) questions concerning the extent of the Government’s commitment to seeking the full benefits offered by competition in rail freight”*

Comment: The Report does not identify any part of the access arrangements which reduces the benefits of competition in rail freight.

p175: *“Eighteen months after the NSW access regime was introduced, there is still no competition in coal rail freight”*

Comment: This is analytically deficient. The supposition is that contemporaneous operation is the only indicator of effective competition. The problems with this assumption are self evident, and are amplified in an industry characterised by scale economies.

As indicated earlier, it is surprising that the Report does not refer to this issue which is at the crux of any analysis of competition and efficiency.

The Report is further deficient in not identifying reductions in freight rates post July 1996 which clearly signal the impact of effective contestability.

19. Government intentions

p175 *“The desire to protect revenue and the interests of government rail providers may have limited the extent to which reform initiatives have been translated into action.”*

Comment: This is not backed by any evidence.

NSW has sought to protect some revenue but in a process that maximises competition. Equal access terms are offered to all, and this is most clearly the case in coal access where prices are set.

There has been no desire and no action to protect the interests of Government rail providers.

20. FreightCorp’s competitive position

p175: *“In the meantime, FreightCorp’s competitive position is being strengthened as it expands capacity to meet growing demand in a currently captive market”*

Comment: FreightCorp has greatly reduced freight rates, indicating - if anything - that its competitive position has been weakened.

The market is fully contestable, and in no way could be described as “captive”.

It is surprising that the Report appears to argue against development of capacity.

The Commission appears to be unaware that coal companies are investing in haulage capacity such as wagons. Some of these wagons are being used by FreightCorp. Such developments, of course, do not increase FreightCorp’s capacity. Moreover, they indicate a weakened market position.

p175: *“the introduction of access to rail infrastructure for coal freight services in NSW has been hampered by the lack of an effective access regime against which new freight carriers can confidently invest”*

Comment Even if the Regime was not effective (which is disputed - see above) all freight carriers - new and old - face the same access conditions. Consequently, they would appear to face the same competitive and investment environment.

It is curious that the Report criticises FreightCorp for investing and then suggests that there are investment disincentives. It may be that the

Commission is suggesting that the Regime should discriminate against FreightCorp. However, there would be major and obvious problems with such an approach.

21. Pricing

p183: *“The absence of a publicised average rate of return target on which prices are based creates uncertainty in the minds of coal producers that excessive rates of return are still being earned on coal freight”*

Comment: The essence of a negotiated price is that it will not be based on any particular rate of return - although it should be limited to a return less than the ceiling.

There appears to be some confusion in the Report about the level of prices and the certainty of prices. In some places, the Report appears to argue for flexible prices. However, basing prices on an average rate of return would appear to indicate a preference for rigid prices. Rigid prices, by their very nature, would ensure certainty, but with efficiency costs.

There is an obvious problem with linking prices with an average rate of return. If prices yielding an above average return are considered excessive, as is clearly implied by the Report, prices below the average would need to be increased.

p184: *“Establishment of pricing principles by independent pricing authorities would provide users with more confidence....”*

Comment: This appears to confuse pricing principles and actual prices. In any event, NSW is prepared to ask independent experts to investigate pricing matters.

p185 *“The practice of price discrimination raises the possibility of political intervention to subsidise particular mines indirectly”*

Comment: There is no logical connection between price discrimination and political intervention.

The NSW Rail Access Regime’s general pricing principles outlaw cross subsidisation by RAC.

p185: *“recourse to IPART... is available only to the freight carrier...”*

Comment: This is wrong.

p186: *“The Commission considers that industry requests for greater transparency in access*

pricing are soundly based. More information would be likely to improve efficiency of the price setting process..”

Comment: As coal prices are set, it would be difficult to ensure greater transparency.

p186: *“pricing principles and asset valuations involved in determining prices for access to rail infrastructure should be established, and published by the Independent Pricing and Regulatory Tribunal Freight customers should have a right of appeal to these bodies regarding the application of these principles on a case-by-case basis”*

Comment: There are four major problems in allowing a right of appeal to “freight customers”. First, there are many freight customers, and granting appeal rights to all may overload the appeals system. This issue was noted in section 16 (above).

Second, there is no ready definition of a “freight customer”. It may not be possible or desirable to limit “freight customers” to those persons holding freight contracts with haulers. For example, major manufacturers, who deal with freight forwarders, are at least one step removed from haulers and it is not clear they should have fewer access appeal rights than forwarders when neither are access seekers. Also, coal mines which were negotiating with several potential haulers, but had signed with none, would not be covered by such a scheme.

Third, if freight customers were to enjoy appeal rights, there is a strong case that potential customers should have equal rights. Again, the number of possible appellants is a matter of concern.

Fourth, no reason is provided for restricting appeals to freight customers and excluding passenger customers.

In summary, the Commission’s proposal is not well developed.

22. Passenger services

p186: *“the potential exists for low access charges to be granted to passenger services with a commensurately higher proportion of infrastructure costs being allocated to freight haulage. Demand elasticities on which to base price discrimination for a service with significant government financing are problematic, leaving room for discretion in setting access charges. However, granting passenger services preference to freight service implies their access charge should be higher in such instances”*

Comment: This is misleading in that it suggests that passenger services present a unique problem for a rail open access environment.

There is no apparent greater reason for “granting” low access charges to

passenger trains than there is for “granting” low access charges to freight trains. In the case of low access charges for freight trains, there would be a “commensurately higher proportion of infrastructure costs being allocated to” passenger trains. It is unclear why the Report omits this.

The Report does not present any basis for the assertion that demand elasticities for Government financed services are “problematic”. Governments purchase many services including outside rail. Indeed, there has been a trend for Governments to restructure their relationship with their business enterprises to a purchaser-provider model. If demand elasticities were problematic, then the model itself would be problematic, as would be privatisation because the sale price based on CSO payments would be indeterminate. Given the importance of this issue, references to studies or evidence backing the assertion is necessary.

In the absence of such evidence, it should be assumed that Government demand for services has some elasticity. If anything, it could be expected that this demand is relatively strong and inelastic in passenger transport, leading to a passenger-freight outcome precisely the opposite of that suggested by the Report.

The Report apparently is confused about the concept of negotiated access charges. Access charges are negotiated between the infrastructure owner and an access seeker (or if the Commission’s views were accepted, between access seekers and “freight customers”). Of necessity, the infrastructure owner is not the access seeker, and the owner does not set charges.

The final comment, that service preference should require higher access prices, appears plausible. However, the Report’s treatment is superficial. The Report fails to recognise the link between preference and elasticity. Preferences must relate to the factors which affect elasticity, and these may not be the same for all rail traffics. For example, some traffics may require speed, others train length, and others reliability. The one dimensional characterisation in the Report is an inadequate basis for a conclusion that passenger traffic should pay more.

Substantial omissions

1. There is no analysis of economies of scale or scope. This is a critical deficiency in analysis especially in relation to:
 - . International comparisons with US class 1 railroads
 - the recent round of mergers of US class 1 operators might be noted;
 - . Optimum scale and performance benchmarks; and
 - . The presence of visible “on rail” competition.

To illustrate the importance of this point, the absence of apparent competition in NSW coal might be entirely explained by economies of scale. If so, most of the

Commission's conclusions about access and competitive pressures would be invalidated.

2. The report does not assess contestability as distinct from ostensible competition in markets. There appears to be an assumption that competitive pressures only occur when there is visible contemporaneous competition. This is related to the economies of scale issue, and potentially invalidates a large number of the Commission's conclusions.
3. The report does not indicate the extent to which freight rates have changed before and after the 1996 NSW reforms. Given the view that freight rates are an important indicator of efficiency, this is a critical omission from the analysis of the impact of the reforms. Put another way, it would be nonsensical to analyse the impact of the reforms by using data only relating to the period prior to the reforms.
4. The application of the diesel fuel excise to rail is not mentioned. This is surprising as the Commission has raised the issue in two other reports, and in this report it compares the coal hauls with iron ore hauls - but only the latter is exempt from the excise.
5. Coal haulage in South Australia is not analysed, even though there is a significant task and there are important policy issues.