SUBMISSION 30.1

AUSTRALIAN RAIL, TRAM AND BUS INDUSTRY UNION

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SUPPLEMENTARY SUBMISSION

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS INQUIRY INTO RAISING THE LEVEL OF PRODUCTIVITY GROWTH IN THE AUSTRALIAN ECONOMY

1. In proceedings before the Committee on Friday 4 December, the Chair, the Hon. Mr. Craig Thompson MP requested that the Australian Rail, Tram and Bus Industry Union (RTBU) provide further information to the Committee. In that regard, Mr. Thompson stated:

   There have been a number of issues raised with you that we would like to hear a little bit more about from the union. In terms of investment, if the union were to provide us with a little bit more about their ideas on investment in rail, that would be good. There is a variety of models that that could take. We would be interested in all of those. If we were looking at private investment, we would be interested in how that could take place. You have raised some of the issues and challenges that are there with that. That would be on interest. But what would also be of interest would be the union's views on rail systems overseas and how they have operated and been able to manage some of these issues. Clearly, you have outlined some of the unique circumstances that we have in Australia with our geography, our population and the economies of scale. But at the same time we would be very interested in getting your union's views in terms of those issues and those comparisons.

2. This supplementary submission endeavours to address the issues raised by the Chair of the Committee in the abovementioned quote. In particular we seek to address the investment issue and the various models that may be available.

3. To set the "investment" context in which the issues are raised, we make the following points:

    - With the exception of privately owned railway infrastructure confined to moving minerals in the Pilbara region of Western Australia and some Branch Lines in South Australia, railway infrastructure in Australia is the property of Government – variously Federal or State governments

    - Railway infrastructure, with few exceptions, has suffered from years of underinvestment. This lack of investment has effectively "come home to roost" in recent years, including a number of privatized rail networks reverting to government ownership after a lack of investment by their private sector operators(whether foreign or Australian owned).

    - Encouragingly, the Rudd Labor Government has broken with tradition and is in the process of investing in excess of $2 billion in rail infrastructure and recognises that more is necessary over time. Traditionally, Federal Governments have denied responsibility for railways by claiming that railways are a State matter, particularly in the area of urban public transport. The Commonwealth rail operator – Australian National Railways Commission – was privatized in 1998 and the interstate railways including those in NSW and Victoria have been absorbed by long term leases into the ARTC network together with the NSW Hunter Valley coal network in 2004. A trickle of investment in ARTC's network was undertaken by the previous government under the AusLink program but the investment was weighted 14:1 in favour of road investment.

- In an endeavour to improve efficiency in the railways through an injection of "competition", a process of vertical separation and open access occurred in the 1990's as a result of competition policy. This process involved separating the ownership of infrastructure (or "below rail") from the operation of rail freight services (or "above rail"). This was based on the notion that competition required a situation where a rail operator did not simultaneously own the infrastructure that would be open for use by other rail operators. Upon separation, a regime was established whereby an institution of government (federal or state) would determine track access to various rail operators subject to the parameters of competition policy, competition law and oversight by the Australian Competition and Consumer Commission and state economic regulators. These measures are hotly contested in the international community with the largest rail systems in both the private and public systems continuing to operate as vertically integrated units.

- There were some instances where both the below rail and above rail activities were privatized as an integrated system. The regional railways in Victoria and the railways in Tasmania were such instances. However as private sector operation of a railways system they were both demonstrable failures, ending up back in the hands of the respective governments. This was after much angst, ownership changes, absence of investment, declining employment and general all round trepidation within the workforce in these systems.

- In Western Australia the non-urban infrastructure was privatized on a leasing arrangement. However it seems to be heading the same way as experienced in Victoria and Tasmania. Having experienced a number of owners, it ended up in the hands of Babcock and Brown Infrastructure, a company currently in liquidation. Further the WA Grains Council claims that the grain rail network itself needs a $400 million upgrade[1].

- Despite the establishment of open access regimes, the situation in 2010 is that the movement of freight by rail is dominated by two companies – Asciano (Pacific National) and QR National.

4. Before the Committee the RTBU expressed a preference for the public funding of railway infrastructure. To be clear, we do not say that funding must only come from general revenue but rather that government should be the investment vehicle and in that context government may source those funds from a variety of sources including the private sector.

   As noted above, much of the infrastructure is already publicly owned and the experience with privatization of rail infrastructure does not beg repetition.

   Further, according to RailExpress[2], quoting and referring to a recent speech to the AusIntermodal Conference, the General Manager Commercial of the Australian Rail Track Corporation, Mr. Simon Ormsby:

   "Rail networks have a range of uncertainty of contractual volumes...only 10 percent of access revenue on the interstate network is contracted through take or pay agreements." Ormsby said. It is also difficult for ARTC to identify public private partnership opportunities with Ormsby commenting that it's

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[1] Wallace P., Addressing market failure in WA: grain conference, www. Railexpress.com.au/archive/2009/april-08-09/ It should also be noted that the federal government held an inquiry recently into the grain networks in NSW and WA and both state governments are currently drawing up their responses.

[2] Challenging future for interstate rail investment: ARTC, www.railexpress.com.au/archive/2009/december-2-09/

hard to garner interest in financing a "crossing loop in the middle of the Nullarbor".

The article goes on to say:

"To introduce third parties into the financing of new assets, ARTC would need to provide some form of revenue guarantee. Consequently, ARTC will bear all, or the majority of the risk. In this environment, it is difficult to see how alternative financing structures could offer ARTC an acceptable risk and reward framework."

It is in the light of these factors and the context set out above, the RTBU's scepticism about the role of the private sector in rail infrastructure investment should be read.

5. In our submission there are a number of investment models for rail infrastructure investment that could be adopted:

   The first option is the establishment of Government special bonds. There is no reason why special bond issues can't be put in place to fund specific infrastructure projects and in particular for long term low risk projects. Where such bonds are inflation-indexed they can counter the criticism that they give too low a yield. It is interesting to note that the National Farmers Federation supported an investigation into the use of bonds to fund infrastructure as part of its 2004 federal election priorities statement.

   The second option is the establishment of dedicated infrastructure funds. These funds can be tailored to meet the strategic needs of the community.

   A third option is to establish what the policy of the ACTU terms a "National Infrastructure Financing Corporation". This corporation *would finance* *infrastructure contracts utilizing funds drawn jointly from the Future Fund and an investment vehicle comprising pooled superannuation funds.*[3]

A fourth option is a model described by the ACTU as *the adoption of a flexible and long-term fiscal policy stance that enables government to raise the funds needed for infrastructure investment from a mix of tax revenues, borrowing and bond issues.*[4] Under such an arrangement could be included the dedication of a percentage of the fuel excise revenue for rail infrastructure. Such a measure has operated successfully in the United States over a number of years.

There is some overlap between these options which should not be surprising given their common objective. Each however is designed to source funds that the Federal Government can use for rail infrastructure investment.

6. A criticism of such funding models is that they all rely in one way or another on the vehicle of debt as the means of raising funds rather than equity. In that context, it assumes that equity is always a better – and cheaper – means of raising funds.

   We reject this criticism for a number of reasons:

   Firstly the funds raised are being invested in revenue generating activities so over time the debt will be expunged.

   Secondly, overall the costs of borrowing by government are lower than the costs of borrowing by the privates sector.

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[3] Australian Council of Trade Unions ACTU CONGRESS 2009: POLICIES AND RESOLUTIONS, Australian Council of Trade Unions, Melbourne, 2009, p.99

[4] loc cit

Thirdly, given recent experience it is highly likely that any direct investment by the private sector will involve a high level of leveraging or gearing – in other words, debt. For example, the construction of the Lane Cove tunnel in Sydney involved companies with up to 70% gearing[5]. The holding of such a position by private corporations is undesirable if for no other reason than the opportunity cost. Further the cost of the leveraging is likely to be higher than the cost of the Government raising the funds.

Fourthly, the private sector is likely to demand higher returns (profit) than government and, as pointed out in the speech by the ARTC General Manager Commercial, push for certain guarantees from government to ensure what they assert are adequate returns on investment. In this regard, what will happen is that the risk will be inordinately borne by the government and effectively, the taxpayer. This may be an acceptable arrangement for the private corporation but it is hardly in the interests of the community that it be expected to guarantee a minimum level of return to that private corporation – particularly when other sources of funding can be utilized.

It seems to us that one way or another the use of debt – directly or indirectly - will be a major vehicle in funding infrastructure projects. Given the current global economic crisis and is genesis in a feeding frenzy of unsustainable private sector debt levels, government would, in our submission, be well advised to keep it under control. In that regard, recent experience shows that where finance and other important corporations hit the wall, the damage spreads well beyond the immediate corporation into the community and the government can, and has and is, called upon to clean up the mess.

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[5] Grigg A., Investors stung by $3.5 billion toll road losses, AUSTRALIAN FINANCIAL REVIEW, 12 January 2010, p. 1

7. A cursory glance at what happens in a number of overseas countries reveals, not unexpectedly, a mixed bag.

   In Europe, though the European Union Directive 91/440/EEC the structure and funding of railways began to change in the early 1990's. The Directive drove 3 key changes – a restructuring of railway deficits; the vertical separation of infrastructure and operations; and the establishment of track access regimes. For various reasons there is no uniformity between member states and the pace of change has also varied between the member states. Infrastructure funding tends to come from a combination of the member states and revenue from track access with the former predominating. Whilst there have been some call for private sector investment, it has not advanced very far.

   It is also worth noting that in 1996 the then Major Conservative Government privatized the State owned Rail Track. Rail Track owned the infrastructure and was responsible for its maintenance, upgrade and the construction of any new infrastructure. Just over 4 years later it was declared bankrupt and ownership and control reverted to the State.

   In New Zealand, the railways have recently been taken back into public ownership after a number of unsuccessful years in private hands.

   In the United States, the freight rail systems are, and always have been, privately owned. The railroads (to use the local vernacular) fall into 2 categories. Class 1 railroads are the larger companies that focus on higher density, long distance line-haul rail operations. Class 2 railroads, on the other hand, operate on a regional and short-haul basis, often feeding to/from the class 1 railroad. Unlike Australian and Europe, the US railroad system is vertically integrated – the rail operator owns the infrastructure it operates on. There is, to our knowledge, no suggestion in the US that this situation be changed.

With respect to passenger rail (urban and regional) operations in the US, they are a creature of the state. This includes Amtrak, the interstate rail passenger operator which is owned by the Federal Government.

Being privately owned and operated, the private railroads are responsible for much of their own investment. The same applies to investment in the passenger rail network. The US Government also invests in freight and mass transit systems through legislation that includes the allocation of an amount derived from the fuel excise for railroad development.

The above examples show a diverse and in cases inconsistent approach to railway operations. A glaring example is the polar positions taken on the notion of vertical integration as between various European countries and the US. The same applies to the notion of private ownership of railways. Not unexpectedly, it can be seen that each country's railway system and the modes of investment are a product of the idiosyncrasies of that country. Nevertheless it can be seen that the most important player in investment in the railways is government.