AUSTRALIAN RAIL TRACK CORPORATION LTD

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HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON TRANSPORT AND REGIONAL SERVICES

Inquiry into the impact on regions of privatisation of infrastructure and government business enterprises

ARTC SUBMISSION

Please find attached a submission prepared on behalf of the Australian Rail Track Corporation in response to your request for submissions in regards to the above Inquiry released in September 2003.

The submission contains no information considered 'commercial-in-confidence'. A copy of the submission has also been forwarded to your office via email.

For further information regarding the preparation of this submission, could you please contact Mr. Glenn Edwards, (08)82174292 (Ph), (08)82174578 (Fax), gedwards@artc.com.au (Email).

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Chief Executive Officer

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON TRANSPORT AND REGIONAL SERVICES

Inquiry into the impact on regions of privatisation of infrastructure and government business enterprises

ARTC SUBMISSION

Background

The House of Representatives Standing Committee on Transport and Regional Services has sought submissions from interested parties with regard to its inquiry into the economic and social impact on regional and rural Australia of the privatisation of infrastructure and government business enterprises (GBE's). In particular, the committee is to examine the benefits and disadvantages of privatisation in the rail, road, aviation, ports, power and industrial manufacturing sectors. It will also consider:

- ways of assisting the development of world class infrastructure,
- the role of governments and the private sector in providing regional infrastructure, and,
- ways of monitoring, evaluating and reporting government privatisation program.

ARTC welcomes the inquiry as it provides an opportunity for the Australian Government to consolidate the experience obtained so far from the many privatisations of national and state owned infrastructure and GBE's by governments, as well a similar international experiences, with a view to improving the framework and rationale for future privatisations, and maximizing the benefits for all participants. Whilst ARTC's submission will primarily be focused around the relevant events and outcomes in the rail sectors, many lessons learned in this sector could be applied in a broader context.

ARTC was created after the Commonwealth and mainland State Governments agreed, in an Inter-Governmental Agreement (IGA), in 1997 to the formation of a 'one stop' shop for all train operators seeking access to the national interstate rail network. The IGA had a term of 5 years. ARTC is a company, under Corporation Law, in which shares are owned by the Australian Government through the Ministers for the Departments of Transport and Regional Services and Finance and Administration.

Under the IGA, ARTC would be responsible for negotiating access to the national interstate

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rail network between Brisbane and Perth by virtue of direct ownership or lease of certain parts of the network, or under wholesale arrangements to be negotiated with State Government owners of other parts of the network as applicable.

ARTC commenced operations in 1998 with the following charter:

- Improve performance and efficiency of interstate rail infrastructure
- Increase capacity utilisation
- Listen, understand and respond to the market
- Operate on sound commercial principles
- Provide shareholders with a sustainable return on capital invested

ARTC currently has responsibility for the management of 4430 route kilometres of standard gauge track, mainly in South Australia, Victoria and Western Australia. ARTC owns the following rail corridors:

- Adelaide – Wolseley
- Adelaide – Pt Augusta – Kalgoorlie
- Pt Augusta – Whyalla
- Broken Hill – Crystal Brook
- Tarcoola – Alice Springs (long term lease to Asia Pacific Transport, operators of the Alice Springs – Darwin Railway)
- Parts of the Adelaide metropolitan track between Dry Creek and Outer Harbour.

In Victoria, ARTC leases the two mainline interstate standard gauge corridors from the Victorian Government, being:

- Melbourne – Wolseley
- Melbourne – Albury

ARTC also manages access to the connection from the interstate mainline network to the Appleton Dock precinct in Melbourne.

Over these corridors, ARTC is responsible for:

- Selling access to train operators
- Development of new business
- Capital investment
- Operational management
- Management of infrastructure maintenance

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The remainder of the interstate network is still controlled by various State Government agencies or private entities, as follows:

- Brisbane – Sydney (Queensland Rail / Rail Infrastructure Corporation (NSW))
- Sydney – Broken Hill (via Lithgow and Cootamundra) (Rail Infrastructure Corporation (NSW))
- Sydney – Albury (Rail Infrastructure Corporation (NSW))
- Kalgoorlie – Perth (WestNet Rail, track manager subsidiary of the privately owned Australian Railroad Group (ARG) which has a long term lease arrangement with the West Australian Government)

The IGA provided for ARTC to negotiate wholesale access arrangements with each of the track managers described above, which would give ARTC exclusive right to sell access for interstate operations within these jurisdictions.

To date, ARTC has negotiated an agreement with the West Australian Government (assigned to WestNet Rail) that gives ARTC such exclusive rights with respect to new agreements or the novation of existing agreements. WestNet Rail still effectively controls the maintenance, investment and operations between Kalgoorlie and Perth. As yet, no operations are being conducted on this part of the network pursuant to an access agreement developed under the wholesale arrangements.

ARTC has been not been able to develop satisfactory wholesale agreements with the track owners in NSW or Queensland. In order to gain greater control over the management of the key north-south corridors, ARTC, with the support of the Australian Government, is currently negotiating a long term lease arrangement with the NSW Government, which will effectively give ARTC the same control over the interstate network in NSW as it has on its own network and deliver the same continuity of access management on the north-south corridors, as currently applies to the majority of the east-west corridors.

The arrangement will also deliver to the interstate north-south corridors significant performance benefits designed to improve rail's competitiveness on these corridors and bring about substantial modal shift, through the investment of $870m in targeted improvements on these corridors. These improvements are designed to achieve rail performance outcomes (reliability, transit time, availability, cost efficiency) contemplated in the National Audit undertaken by ARTC on behalf of the Australian Government in 2001.

The interstate rail network interfaces with many branchlines in all states along its route that are either privately owned (following government sale of these assets) or still remain in government hands. These branchlines primarily service regional grain storage facilities for

transfer to port. Many of these movements also traverse the interstate mainline, together with the more dominant interstate movements of general freight and steel products.

Under the IGA, ARTC was required to submit a voluntary access undertaking in accordance with Part IIIA of the Trade Practices Act (1974) (TPA) to the Australian Competition and Consumer Commission (ACCC). An undertaking was submitted by ARTC in January 2001, and approved by the ACCC in May 2002. The undertaking applies to the interstate network controlled by ARTC, and sets out the framework under which access to that network can be negotiated with ARTC in a fair and balanced way. In endorsing ARTC's access undertaking, the ACCC recognized that a large part of ARTC's revenue is derived from rail operations that compete in markets subject to strong intermodal competition, particularly road. The ACCC also indicated that it saw ARTC's access undertaking as laying a foundation for the development of a consistent 'national' rail access regime in conjunction with other state based jurisdictions.

Access to other parts of the interstate network is currently governed by state based access regimes (NSW / WA) which are not certified by the National Competition Council (NCC) for the purposes of Part IIIA of the TPA. As such, these parts of the interstate network are potentially subject to possibility of declaration under the TPA, which would effectively take the negotiation of access away from the umbrella of the state based regime, and within the arbitration powers of the ACCC under Part IIIA of the TPA. Whilst state based regimes share a number of common threads with ARTC's access undertaking, there are still fundamental differences (including the identity of the regulator / arbitrator and pricing approach) that add to the difficulty of obtaining access to the interstate rail network.

With regard to safety and operational regulation on the interstate network, ARTC has been an active participant in the development of a more consistent national regulatory framework, designed to reduce the difficulty of operating on the interstate network, as well as cost of regulation to the industry. A consistent approach is necessary for interstate rail to compete on the same terms as road in this area. ARTC has vigorously pursued uniformity of operating standards and safety standards across the interstate network including:

- Adoption of uniform reporting and regulatory interface processes and a single Safety Management System in all five jurisdictions in which ARTC holds accreditation
- Contributing to the development of uniform national safeworking and safety management standards
- Adoption of the first three volumes of the Code of Practice for the Defined Interstate Network
- Encouraging centralisation of rail safety incident investigation and reporting, and information sharing

- Facilitating regular industry safety forums.

ARTC's Approach

In order to achieve a key objective of increasing utilisation of the interstate rail network, ARTC has adopted a strategy of growing the use of rail for the movement of interstate freight in Australia by improving rail's competitiveness within the broader freight transport logistics framework. ARTC can only assist the industry in this way within the context of its role as a track manager, currently of only part of the interstate rail network. Rail's competitiveness is also a function of the activity of rail transport operators (ARTC's customers) and the extent to which rail is able to effectively integrate and communicate with other elements of the transport and distribution supply chain within various interstate and international transport markets.

ARTC's corporate mission statement is:

'Through innovation and creative strategies, satisfy our customers, expand the industry; provide efficient access, across modes, to the interstate network; and assist in the development of an integrated national transport logistics network."

ARTC's strategy for improving rail competitiveness is largely built upon the following aims:

- increasing the reliability of interstate rail transport
- reducing interstate rail transit times
- reducing the real cost of access to the interstate rail network
- increasing the level of above rail competition on the network
- increasing the degree of consistency in the application of access and safety regulatory frameworks on the interstate rail network.

To date, ARTC investment and maintenance program, and its approach to pricing and access, have largely been focused on achieving these aims.

On the east-west corridors (Brisbane / Sydney / Melbourne / Adelaide – Perth), where ARTC has greater control over infrastructure performance, ARTC has strategically invested in infrastructure improvements designed to reduce rail transit times and increase service reliability (longer crossing loops, capability for heavier axle load operations) as well as enable more efficient above rail operations. On these corridors rail transit time has reduced (by around 2.5 hours, Melbourne – Perth) and service reliability has increased (65% to 68% on time exit) since 1997. Operators have been able to improve above rail

productivity (running longer heavier trains) which has resulted, in combination with a real reduction in access pricing over the last four years, in a real reduction in cost of access for east-west interstate freight users of over 20%.

The combined effect of improved reliability and transit times and lower cost of access has, together with the effect of above rail competition on the east-west corridors, enabled rail it's share of the land transport market from the eastern states to WA by aver 15% (from 65% in 1995/96 to over 81% currently). This has meant a reduction in the use of road by around 350 journeys per week across the country than otherwise might have been the case.

Similar improvements have not been achieved on the north-south corridors.

ARTC's strategy of growing freight volume on rail also underpins ARTC's approach to pricing, which has been endorsed by the ACCC. ARTC has sought to set access pricing at a level that will enable rail to be competitive with road in markets served by the interstate network. With the current level of utilisation of ARTC's network, however, pricing at the level results in the amount of revenue collected by ARTC not being sufficient for the long-term economic sustainability of its network. As such, ARTC is taking a degree of long-term commercial risk in order to achieve its objectives. It is ARTC's strategy to grow volumes in the long term, such that rail can remain competitive and achieve long-term sustainability of its asset.

ARTC considers that this strategy is only realistic one available to achieve long term sustainability on the interstate rail freight industry in an environment where its main competitor (long haul, heavy road transport) is not paying for the full cost of the infrastructure it uses.

With regard to the other aims of increasing the extent of above rail competition on its network, ARTC has adopted the principles of efficiency, equity and open-ness in its approach to facilitating access to the network. ARTC's access undertaking largely encompasses these principles. The ACCC has endorsed ARTC unit maintenance costs as being efficient. In its access undertaking ARTC has voluntarily committed to making its access pricing publicly available and committed that the same pricing will be available to any train operator, regardless of ownership, operates under the substantially the same terms and conditions, and in the same end market as another train operator. ARTC sees these principles as providing confidence and encouragement to potential access seekers that they will be able to use the network on an even playing field with other competitors.

ARTC Infrastructure Maintenance Activity

As an access provider, maintenance of the ARTC network represents a large component of the company's current cost structure. These services are outsourced and managed under Alliance contracts entered into on commercial terms as a result of a competitive tender process. Almost all current Alliance contracts are with private sector engineering companies. ARTC has adopted this practice with a view to ensuring that the company's cost structure represents efficient infrastructure practice and to develop capacity and flexibility in the market for these services.

Since 1998/99, ARTC, and its Alliance maintenance contractors, have been able to improve the efficiency of maintenance practices by around 33% in real terms, despite increased volumes, and whilst maintaining network condition. This has enabled ARTC to maintain profitability levels whilst offering to its customers real access price reductions in the order of around 13% since 1997/98, which, in combination with the ability of operators to reduce effective access cost by operating more efficiently (better loading, longer trains), has resulted in real average cost of access (cents per net tonne kilometre) to the ARTC network falling by more than 20% over this period.

ARTC unit maintenance cost in 2001/02 was below $1.50 per 000GTK[1]. Despite allowance for the differences in network terrain and climate, this is significantly below what was considered to be 'world's best practice' infrastructure maintenance cost for Australian conditions in 1994[2] and has been independently considered as low by current national standards[3].

ARTC Experience with Rail Industry Privatisations

The landscape for carrying freight and passengers on the interstate rail network, and regional networks has changed significantly of the last 10 years. The structure of the industry has altered, the players have changed and asset ownership has effectively changed. There are two key circumstances that have brought about this transformation.

The first change agent was the continual improvements in efficiency and competitiveness of the heavy haul road transport sector that have occurred over the last 20 years or so. These improvements have largely resulted from new technology being introduced to the sector (larger and more fuel efficient trucks) and relaxation and standardisation in regulatory requirements on the road network (mass limits, licensing etc).

[1] Gross Tonne Kilometres – a measure of network utilisation incorporating the entire mass of a train as it traverses of the network. Generally accepted driver of variable network maintenance expenditure.
[2] Bureau of Industry Economics, Report 95/22 - 1995 Rail Freight International Benchmarking, December 1995, and other information sources.
[3] Currie & Brown, Report on Review of ARTC's Access Undertaking Submission to ACCC, prepared for the ACCC, December 2001.

The second change agent was the introduction on National Competition Policy legislation, and 'competition payments' for state reform in 1995. This has resulted in the opening up of previous government owned essential infrastructure with monopoly characteristics to third party access and competition.

The early 1990's

In the early 1990's, the interstate and regional movement of freight and passengers by rail was almost entirely undertaken by State and Australian Government owned railways which were vertically integrated (where infrastructure and operations are owned/controlled by one party), but were geographically disparate. Each state based rail network had different operating requirements; operations at interfaces between state based network was cumbersome, where rollingstock needed to be changed; different rail gauges required cumbersome rollingstock changes at certain locations; network infrastructure planning and investment was uncoordinated; and rail customers needed to arrange freight movement with several different railways. Significant changes were needed to these arrangements in order for rail to effectively compete with road transport (with very few of these encumbrances) particularly for interstate movements.

National Rail Corporation

The first significant change was the agreement by most states to create corporatised national freight rail operator (National Rail Corporation (NRC)), which would be able to act as a 'one-stop-shop' for the movement of interstate rail freight, would move with a single unchanged consist over all parts of the interstate network, and would operate in a commercial way, relatively free of government constraints on decision making. In 1993, all interstate freight business was transferred from state railways to the new corporation, together with a gradual transfer of assets required for the purpose over time. Prior to transfer of any functions, NRC would pay for the costs of assets and services provided by state railways, at efficient levels. The corporation continued to receive shareholder government support, by way of wedge payments, for the first 5 years of its existence.

It had been originally intended that state railways would transfer terminals, crews, wagons and locomotives sufficient (and efficient) for the interstate freight task, as well network control and track and signaling infrastructure. The corporation would effectively be vertically integrated.

In its first 2-3 years of NRC's operation, the total cost of interstate rail freight reduced substantially, although it could be argued that the corporation was able to commence in a 'greenfields' manner, leaving much of the original inefficient costs with the state railways

whilst paying only efficient rates for them. This has a significant impact on manning levels in the state railways, resulting in a fairly rapid downsizing of personnel previously associated with interstate freight in both metropolitan and rural regions in the early to mid 90's. NRC inherited significant terminal assets in prime metropolitan locations, which were upgraded by the corporation. NRC also upgraded large parts of its rollingstock fleet during the mid 90's. By and large, external borrowings were used to fund upgrades and acquisitions during this period.

During the early to mid 90's, rail continued to lose market share to road (interstate and regional) despite this reform, and probably because rail was still unable to be dynamic and entrepreneurial enough to compete with the rapidly improving road service offering during this period.

National Competition Policy and Government Railway Reform

In 1995, the advent of National Competition Policy and associated required reforms of government owned assets and services led to a decision not to transfer control of the interstate network to NRC; but to open up the infrastructure to third parties that could compete with NRC. It was intended that the introduction of the private sector to the competitive above rail market would give rise to a number of benefits including:

- the introduction of private sector competition putting further downward pressure on interstate freight pricing and improving rail service levels

- the combined impact of the above would improve rail competitiveness vis-à-vis road

- The introduction of the private sector would give rise to greater product differentiation, and enable market forces to drive industry improvement and investment, and bring about a stronger commercial focus.

On the below rail side, a number of government reforms also occurred although not consistently from a national perspective. In 1995, the Australian and NSW Governments chose to apply a 'vertical separation' model to their rail networks, whereby those elements of the railway with monopoly characteristics (below rail) would be institutionally separated from those contestable aspects (above rail). The Victorian, Queensland, WA and SA Governments retained a vertically integrated approach, whilst still allowing third party access under access regimes developed by those states.

In 1997, the Australian and all State Governments agreed to the creation of a corporatised one-stop shop for access to the national interstate network being ARTC whereby the

corporation would assume ownership of that part of the interstate network previously owned by the Australian Government railway, Australian National (AN), would lease the interstate network in Victoria, and would seek management arrangements for the interstate network in other states. Below rail government owned infrastructure managers in other states, included Rail Access Corporation (NSW – vertically separated), QR Network Access (QR vertically integrated), VicTrack (Victoria vertically integrated) and Westrail (WA vertically integrated). Prior to the creation of ARTC, an AN business unit Track Access was the infrastructure manager of the network owned by the Australian Government. Initially after the creation of ARTC, it would still be necessary for a prospective interstate above rail operator to negotiate access with four separate access providers in WA, SA / VIC, NSW and Queensland.

Private sector entry to the contestable above rail market.

The opening up of the rail network in 1995 brought initial forays into the contestable market from the private sector by TNT and Specialised Container Transport (SCT) in mid to late 1995. Both of these entities were NR customers and commenced operating their own trains on the Melbourne – Perth corridor. This corridor was seen as offering greater potential than other interstate corridors because of rail's competitive position, the opportunity for substantial above rail productivity improvements on the corridor, and the need to deal with only two access providers in jurisdictions where operational requirements were not dissimilar.

The introduction of private sector competition to this corridor brought a number of improvements and benefits to business and the community in the short to medium term. These included:

- Substantial freight rate reductions, as NRC sought to take on new competition.
- Service quality improvements as the private sector operators introduced a stronger customer focus and demand for improvement.
- Further reductions in the industry cost structure.
- Greater product differentiation.
- Some investment in above rail assets.

The potential for market growth on the corridor also saw targeted investment in the infrastructure, the challenging of previous infrastructure constrains and improved network management aimed at improving rail service reliability and transit time, reducing cost of access, and consequently rail competitiveness.

The outcome of this was a significant improvement in rail's market share of the east-west land transport market from a low of around 65% in 1995/96 to over 81% currently. Business, regional and community benefits included lower transportation costs, more reliable and faster transport service provision, and reduced environmental impacts resulting from less use of heavy haul road vehicles.

A number of other private sector rail operators have since entered (and departed) into east-west markets as well as a number of other markets (including regional markets). These include:

- Patrick (Melbourne – Adelaide)
- Australian Railroad Group (Sydney – Adelaide, Melbourne – Adelaide)
- Freight Australia (Melbourne – Adelaide and regional Victoria)
- Australian Transport Network (Southern NSW – Melbourne)

ARTC is of the view that the introduction of the private sector to the contestable above rail market has brought about significant benefits to business, regions and the community as described above. The benefits have been most evident in the east west market where it is fair to say that there were a number of 'low hanging fruit' ready to be picked. For various structural, ownership and infrastructure related reasons, private sector competition is either limited or non-existent in other interstate and regional markets.

Whilst the adverse affects of the introduction of the private sector to this market, the most obvious being reduced rail employment in metropolitan and regional communities, ARTC believes that the growth in rail volumes, lower transport costs and improved logistics networks will assist in further stimulating economic growth and investment, as well as reduce the social cost of transport in Australia, so bringing about significant community benefits in the medium to long run.

Privatisation of Government owned rail enterprises

Since 1995, there have been a number of privatisations of Australian and State Government owned rail enterprises. These have occurred for a variety of reasons including:

- Government desire to reduce ongoing support for loss-making rail enterprises
- Improve the ability of Government owned rail enterprises to compete with the private sector in markets opened up to competition.

- Improve transport efficiency and service levels through private sector management.

Significant privatisations that have occurred (notwithstanding the franchising of metropolitan transport operations in Victoria) include:

- Sale of Australian National business units and assets (excluding infrastructure) by the Australian Government (1998)
  - Long distance passenger train operations to Great Southern Railway (Serco)
  - Intrastate freight train operations and branchline infrastructure to Australia Southern Railroad (Genesee & Wyoming)
  - Infrastructure maintenance to Transfield
  - Rollingstock maintenance to Clyde

- Sale of the Victorian intrastate rail operations and lease of the infrastructure by the Victorian Government (1999)
  - Excludes interstate rail infrastructure
  - Integrated sale
  - Intrastate freight train operations and branchline infrastructure (45 year lease) to Freight Victoria (now Freight Australia)(Rail America)

- Sale of the Westrail freight business by the Western Australian Government (2000)
  - Includes interstate rail infrastructure
  - Integrated sale
  - Intrastate freight train operations and rail network (50 year lease) to Australian Rail Group (Genesee & Wyoming / Wesfarmers)

- Sale of the combined business of the National Rail Corporation and NSW Freight Rail Corporation (FreightCorp) by the Australian and New South Wales Governments (2002)
  - Above rail assets only
  - Interstate freight train operations and NSW intrastate freight train operations to Pacific National (Toll / Patrick)

The outcome of the first three sales was:

- The introduction of new private sector rail operators primarily focused around regional markets, but with the ability to move into operations outside the state jurisdiction (including interstate operations and regional services in other states). This created a number of different operators able to compete in any interstate or regional market against incumbent operators. ARTC considers the resultant increase in competition and private sector involvement offers significant benefits to communities using both interstate and regional rail services.

- The regional (intrastate branchline) network in the three states involved effectively became privately owned / controlled (under long term lease) and vertically integrated with an incumbent above rail provider. Also, that part of the interstate network in WA is also privately owned and vertically integrated. Locally based access regimes regulated by a state based regulator would be the mechanism to sufficiently encourage third party access on the intrastate networks so as to provide the local community with the benefits of competition.

  The governments have clear 'price maximisation' incentive to offer such assets on a vertically integrated basis (and preferably with limited threat of competition to the purchaser for at least a period of time), which must be weighed up against the longer term benefits of competition on regional networks to the community.

  While the jury is still out on the best industry structure (separated v integrated) with regard to the lightly used regional branchlines predominantly used for grain haulage, the argument for separation is stronger on heavily used coal and mineral networks, and on the interstate network. Nevertheless, evidence since these privatisations suggest that access regulation of privately controlled vertically integrated regional networks has not created an environment conducive to competition. There are few, if any, third party operators utilising regional networks in WA, SA or Victoria. This is despite the fact that state regulators have put substantial resources into developing rules and guidelines to be observed by access providers, as well as the fact that the state based access regime in each of the first three cases is not certified by the National Competition Council, meaning that the infrastructure is potentially open to the threat of declaration under Part IIIA of the Trade Practices Act.

  The above evidence suggests that the potential for competition on the rail network is more dependant on the industry structure adopted (and the impact this has on the commercial motivations of participants), than on the extent of private sector involvement and the effectiveness of the regulatory framework.

Impact and prospects resulting from the combined sale of FreightCorp and National Rail to create Pacific National

The last and most recent sale has the potential to significantly alter the competitive landscape in the rail freight industry both intramodal and intermodal, and with respect to both interstate markets and regional markets. ARTC sees the purchase as having the potential to provide significant benefits to the industry (and wider community and regions) as well as posing risks in the same regard.

Potential benefits arise from the fact that the private sector owners of Pacific National are strongly integrated into other elements of the transport logistics network including forwarding, road transport, intermodal terminals and ports. It has generally been accepted by industry participants and governments that the success of rail as a viable transport mode in Australia depends on the ability of the industry to successfully (efficiently) integrate with other parts of the transport logistics network. As well as improving internally (reliability, transit time, pricing, information), rail needs to improve interfaces with road connections (via intermodal terminals) and ports. In all, this will improve the efficiency of freight movements between states and from rural regions to capital cities and ports and ensuing market growth will improve investment prospects in the industry. Toll and Patrick's heavy involvement in freight forwarding, road transport and ports will greatly assist in the efficient integration of Pacific National in major freight supply chains, as well as provide commercial rigour (by more closely aligning owners and management and through access to capital markets), which was not previously available to the government owned predecessors.

It has also been previously identified in industry inquiries that the lack of a level competitive playing field brought about by government-controlled competitors is a significant barrier to the private sector entry into the market.

On the other hand, the sale involved the amalgamation of two significant government owned players in interstate and regional rail freight markets in Australia. Despite the entry of private competitors to the interstate rail freight markets, National Rail was still the dominant user of the interstate network, as well as having control of key industry assets including the major freight terminals in all capital cities, the vast majority (in terms of quantity and quality) of rollingstock used on the interstate network, and the most valuable train paths on the interstate network. The major competitors in interstate rail general freight markets included Toll, Patrick and SCT. FreightCorp was effectively the sole operator of intrastate rail service provider in NSW. Markets served included the Hunter Valley Coal industry (almost exclusive transport service provision), regional grain markets to ports in NSW as well as Victoria, and regional general freight markets in NSW. The only significant areas of above rail competition in NSW existed in the Hunter Valley, where National Rail provided transport services for a small part of the coal sector, and in southern NSW, where Freight Australia and Australian Transport Network competed for grain movement to NSW and Pt. Kembla. Also, Freight Australia has recently commenced interstate general freight operations between Melbourne and Sydney.

The purchase of the combined business of National Rail and FreightCorp by Toll and Patrick significantly reduced the number of competing players on the interstate network and increased the dominance of one player (Pacific National is now responsible for the movement of nearly 90% of general freight and steel (and over 80% of all freight) on the

ARTC network). Whilst it is accepted that strong competition comes from the road transport sector in interstate markets, in those markets where rail is already strong, such as east-west interstate general freight markets and regional grain and coal markets, the increased dominance of a major competitor and reduction in the number of competitors has the potential to constrain the benefits of competition (such as lower pricing and improved service quality) to the industry, as well as flow on benefits to the wider business and regional communities.

Further, Pacific National's control of an increased share of the interstate industry's scarce and valuable assets such as major city terminals, rollingstock and train paths has the potential to increase the barrier to entry for third parties.

ARTC would expect that the main source of any increased above rail competition in interstate markets is more likely to come from other major rail operators that are currently focused more on regional markets such as Australian Railroad Group and Queensland Rail. Both of these potential competitors currently still face significant entry barriers to the interstate market including access to suitable rollingstock (gauge and type), city terminals and competitive pathing. One would expect an increased presence in interstate markets by either of these players is likely to come through acquisition of smaller existing players rather than organically.

With regard to impact of the privatisation on regional communities, it could be argued that, whilst previous rail privatisations in SA, Victoria and WA may have brought about shorter term impacts on employment and access to services and infrastructure, there is now evidence in some cases of medium to longer term benefits of cheaper and more reliable freight transport, as well as investment, for these communities. Because privatisations have meant that the rail industry may well still undergo further significant changes in ownership and structure, it is too early in the process to draw any conclusion on the longer-term benefits to regions.

The most significant impact of the sale of National Rail and FreightCorp in regional communities is most likely to be felt in country NSW, where the grain industry has experienced significant change in ownership (both in the areas of transport and in grain handling and marketing) and operations. From the transport perspective, the development by the industry of more efficient handling practices (eg grain receival centres at key locations) will result in more efficient and cheaper transport of grain in the longer term, but will likely result in further rationalisation in service provision and branchline rail infrastructure as some existing lines become less viable. It is unlikely that privatisation of above rail operations on branchlines by itself will bring about this rationalization. Governments will need to examine the trade-off between sustaining these lines and the alternative cost associated with increased road usage and consequent maintenance in regional areas to support the resulting heavier short-haul road usage and the broader cost

of this to the community.

The benefits of increased competition and the introduction of the private sector on parts of the interstate network over the past several years have clearly resulted in significant longer term benefits to these parts of the community as has been evidenced on the east-west network above. The degree to which above rail competition is able to further develop will have a significant bearing on the maintenance and further improvement in rail pricing and productivity.

Observations and lessons from previous experiences

There is little doubt that the opening up of the interstate rail network to the private sector and the promotion of above rail competition has resulted in substantial industry and community benefits. The benefits have, by and large, been realized only in east-west interstate freight markets where the capability of the rail infrastructure was reasonable and had been substantially improved, and where rail was able to maximize its competitive advantage. Benefits have not been realized in north-south interstate freight markets because of the absence of significant above rail competition, the lack of private sector presence until recently, rail's weaker competitive position in these markets, the condition and capability of the infrastructure, and network management to facilitate improvements.

ARTC is seeking to address many of these constraints through its proposed lease of the interstate network in NSW.

From its experience in the rail industry so far, ARTC considers that there are two important elements to improving the competitiveness of rail freight transport through competition and privatisation, in order to unlock potential longer-term industry and community benefits. These are:

- **An appropriate industry structure.**

  There has been significant debate in the rail sector over whether a vertically integrated structure or vertically structure creates a better framework for competition. The 'Progress in Rail Reform' Inquiry conducted by the Productivity Commission in 2000 concluded that the most appropriate structure depended on the type of rail network and market characteristics. The Inquiry concluded that a vertically separated framework may best suit the interstate freight network and, in some cases, high volume regional networks, whilst on lightly used regional networks, rail may best be able to compete against road in an integrated structure.

  The States have so far privatized their rail networks in a vertically integrated form.

The States have relied upon the existence of a rail access regime to promote competition where it is sought. To date, even with a third party access framework and regulator in place, the only significant competition on any type of network in Australia has occurred where the infrastructure is structurally separate from the operations.

- **To extract the full benefits of privatisation, it is desirable to create a structure and environment in which competition is promoted.**

  Without effective competition, the benefits of privatisation are either collected by government from sale proceeds, or by shareholders of the new operator. It is premature to evaluate if benefits will be returned to the market through lower pricing and improved service levels.

  The barriers to entry for potential third parties gaining access have not been sufficiently lowered merely by the presence of an access regime. Access to suitable rollingstock, terminal space or desirable train paths have inhibited the entry of third parties.

  Evidence would suggest that the choice of industry structure plays a greater role in the development of a competitive market than does the reliance on regulation. Whilst both models result in some cost to the industry, it appears that the former produces a better framework to extract the benefits of competition.

Privatisation and Investment

It has been anticipated that the introduction of private sector competition in the rail industry will provide improved funding sources for the industry, by exposing the industry to the private capital market, and by improving (or turning around) the attractiveness of the industry to private investment. In doing so, a much stronger financial discipline and rigour is required of investments than may have been the case under Government ownership and control. The AusLink framework proposed by the Australian Government has identified private sector investment as being the main source of funds for commercial rail industry developments, leaving government to fund development which result in community benefits but are not economically viable or attractive. This requires a far more rigorous approach to investment appraisal and audit than might have been the case in the past as has been proposed under AusLink. Further, to proposed approach seeks to recognise community and regional benefits that might otherwise not carry weight in private sector assessment.

AusLink also seeks to apply a more strategic, long-term approach to investment, which

may not gain the same importance to the private sector on a stand-alone basis, as well as harness entrepreneurial initiatives that can be extracted from private sector involvement in the industry.

A number of previous industry inquiries have identified the inefficiency of the rail regulatory environment as being a significant barrier to private sector investment and new market entry. Regulation of the industry occurs in several areas, including safety and access. By and large, responsibility for regulation in each of these areas has historically been with the states either through their railways or through separate regulation agencies.

With regard to safety regulation, in accordance with State legislation, ARTC and the rail industry generally still requires accreditation in each state and each state differs with regard to regulatory approach and methodology of oversight and standards. The industry has long felt that these differences imposed unnecessary costs on companies seeking to provide interstate services and sometimes onerous requirements could be used to protect the position of previous government owned railways. It has previously been stated that, since its establishment, ARTC has actively participated in industry efforts to create greater consistency between state requirements. Significant efforts have been made to reduce the differences in standards and regulations with limited success. ARTC welcomes the establishment of the National Transport Commission, which will be responsible for creating a national approach to rail safety regulation in Australia, and ARTC will participate in the development of this role for the new entity. ARTC is also addressing this issue through active leadership of implementation of the National Codes[4] and has initiated development of an active framework for managing safety regulation.

With regard to access regulation, ARTC has sought, through participation in regulatory consultation, to achieve greater consistency between State based regimes and ARTC's Access Undertaking with some success on the interstate network. ARTC's wholesale arrangement in WA enables access for interstate operations to that part of the interstate network to be negotiated with ARTC within the framework of ARTC's Access Undertaking. An interstate operator needs to negotiate with one access provider for operations between Melbourne and Perth, two for operations between Sydney and Perth, and three between Melbourne and Brisbane. Each negotiation is carried out within the framework of a separate access regime. Should ARTC achieve a lease of the interstate network in NSW, an operator should be able to negotiate access to almost the entire interstate network with one access provider and under the provisions of one access regime. This will significantly reduce this barrier to entry to, and investment in, the interstate network, with corresponding benefits for the movement of freight between capital cities and regions.

[4] National Codes of Practice for the Defined Interstate Rail Network