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Department of Transport and Regional Services

Secretary: I. Luther

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HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON TRANSPORT AND REGIONAL SERVICES

Dr Anna Dacre
Committee Secretary
Transport and Regional Services Committee
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Dr Dacre

Inquiry into Privatisation of Regional Infrastructure and Government Business Enterprises

I refer to your letter of 22 September 2003 to Mr Ken Matthews, Secretary of the Department of Transport and Regional Services, seeking input to the abovementioned Inquiry.

A short observation piece outlining the Department's experiences with privatisation of infrastructure is attached.

The Departmental contact person for this is Mr Will Cheeseman who may be contacted on (02) 6274 6724. If we can assist the Committee further, please do not hesitate to call.

Yours sincerely

J. Elliott

John Elliott
Assistant Secretary
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11 February 2004

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HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON TRANSPORT AND REGIONAL SERVICES - Inquiry into privatisation of regional infrastructure and Government Business Enterprises.

Introduction
The committee is inquiring into the impact of privatisation of regional infrastructure and government business enterprises on the achievement of the outcomes reported in this Department's 2001-2002 Annual Report.

In this submission the department seeks to briefly draw together recent developments and make some general observations that may be of use to the committee.

In doing so the Department notes that there is some difficulty in determining what constitutes regional infrastructure. This is because regions do not always have commonly accepted borders. Communities can simultaneously be part of several regions depending on the purpose for which identity is being determined, for example, grain-growing or tourism. Governments and communities sometimes define social, economic or environmental priorities on a regional basis to gain as broad and strategic a focus as possible.

Often the term "regional" simply denotes that areas outside of the capital cities are being considered.

A further definitional problem that arises in relation to the impact of transport privatisation on regional infrastructure is that regional transport links and facilities are generally not stand alone. Privatisation of facilities tends to have an affect throughout the whole network, whether it is located in metropolitan or regional areas.

1. The impact of privatisation
In the past, public sector provision of transport services and running of transport operations has not necessarily been as successful as it could have been and at times resulted in a lack of user/customer focus, cost overruns, high debt and continuing liabilities. There has often been a lack of commercial focus. In addition, governments have found it increasingly difficult to find the investment funds for publicly owned transport operations due to the competition for resources from other areas of their responsibility such as health, education and social welfare. Another driver for change has been the increasing need for Australian industries, and the transport infrastructure that serves them, to improve competitiveness in an international context. To overcome these difficulties, and harness potential opportunities, it has become necessary to look at the problem from a different perspective; that of drawing in private sector management expertise and investment capital. The result has been that some parts of the transport industry have been privatised.

The key objectives of privatisation have been to capture efficiency, management and investment benefits from the private sector. These objectives have been based on the observation that the private sector continually operates on the expectation of adequate returns on investment. The private sector has the capability of attracting investment capital from a wide range of domestic and international sources but there is then the necessity to generate a satisfactory return on those funds, and ward off any potential flight of capital to other more promising opportunities. These conditions have generally therefore created a more dynamic and commercially-oriented operational management focus. Furthermore, every dollar raised and invested in infrastructure by the private sector can potentially free up public funds for infrastructure and services in other arenas. The combination of new investment capital and fresh management techniques has thus provided a sound base for privatisation.

However, there have been other benefits of privatisation, including a return to the taxpayer through the retirement of debt. A recent example of the rationale and outcomes of a privatisation approach in this portfolio is the airport leasing program which the Australian Government has been progressively moving towards since 1997. The culmination of this process has been the final sale of Sydney basin airports; Bankstown, Camden and Hoxton Park. All of the major international, interstate, general aviation and training airports originally owned and operated by the Federal Airports Corporation (FAC) – a Government Business Enterprise, have now been progressively transferred through long-term lease arrangements to private interests. Total sales proceeds from the sale of airports amounted to a little over $9.9 billion.

The airports were transferred with a clear developmental objective, including a mandate for the new owners to capture viable commercial opportunities. To enable this to happen, one of the policy objectives set out in the tender/bidding evaluation criteria was to ensure that new operators had the necessary financial strength and managerial capability to operate and develop the airports over the lease period and to commit to effective development of airport services. As part of the sale conditions, obligations were imposed on new owners to guarantee their commitment to long term aeronautical investment. The airports were sold on long-term leases with options to extend. These arrangements were designed to ensure that owners/operators have time to reap the full commercial rewards from their investments.

Greater private sector investment and participation has also been an important ingredient to increasing the competitiveness of the rail industry.

Historically, railways in Australia were owned by State and Federal governments, with separation between the systems being geographical along State jurisdictional lines rather than functional.

Within that environment, the role of railways in performing the transport task declined steadily over a long period of time compared to road, and struggled to remain competitive. Over time, the industry developed an unwieldy structure that perpetuated high staffing levels, outmoded work practices, poor inter-system coordination and poor customer service. In turn this led to high debt, continuing liabilities and a lack of investment. Clearly, for rail to be a viable alternative to road transport, measures were needed to remove the impediments, adopt a more commercial focus and break the cycle of poor performance and under investment.

A 1996 report for the Australian Government into the Australian National Railways Commission (ANRC) and its share of the National Rail Corporation (NRC) found that the arrangements were unsustainable financially and had little hope of becoming commercially viable. To overcome the impediments to change, the Australian Government decided to privatise its shareholdings in above-rail operations. Most States have followed suit and also privatised their rail assets.

The Commonwealth, New South Wales and Victorian Government shareholders also decided that the National Rail Corporation be sold to private interests.

Selling the NRC provided an opportunity for the interstate rail freight industry to become more responsive to customer needs and increasingly competitive in terms of price and service quality, and thus more effective in contributing to an efficient and viable domestic freight industry.

A complementary initiative undertaken by the Commonwealth was to set up the Australian Rail Track Corporation (ARTC). The ARTC was established as a Government Business Enterprise to manage infrastructure development on the interstate rail network following an Inter-Governmental Agreement (IGA) in 1997. The purpose of the agreement was to facilitate a commercially viable Australian rail industry through the introduction of new infrastructure and access arrangements. The objectives of the IGA, and hence of the ARTC, were to provide seamless and efficient access to users, pursue a growth strategy for interstate rail through improved efficiency and competitiveness and better asset management, as well as improved technical, operating and safeworking procedures. In the first four years of operation, the ARTC achieved significant improvement in the provision and standard of rail infrastructure between the east and west coasts and, combined with reduced freight pricing brought about by competition, enabled rail to significantly improve its overall competitive position against road transport on these corridors.

The ARTC is presently negotiating with NSW to lease the Mainline and Hunter Valley tracks as one the final steps in taking over the management of the interstate system in line with the an Inter-Governmental Agreement. Ministers announced agreement on the arrangements in December 2003 and ARTC is expected to take over the NSW tracks in the second quarter of 2004.

As part of the proposal to lease the tracks in NSW the ARTC has undertaken to invest $872 million during the first 5 years of the lease to address the backlog of works. This investment will be largely undertaken in rural and regional areas. The significant benefits to these areas that will result would not occur without the impetus of privatisation of the 'above track' operations.

A copy of the ARTC's 2002/03 Annual Report is attached.

While the main thrust of privatisation in the transport industry has been to capture private sector management expertise and capital, there have been several other considerations.

Selling elements of the transport system to the private sector allows operators to get on with the business they know best. However, this needs to be complemented by public sector retention of a necessary regulatory role to ensure that the travelling public can be confident that safety and security are not compromised and reasonable access is available to new entrants into the business. In the airport case it has been necessary to establish a complete set of environmental, safety, building and development constraints under the *Airports Act 1996*.

Another consideration of privatisation is the extent of risk transfer. During the airports sales process, it was important to ensure that there was an effective transfer of risk to the private sector, the objective being to minimise the public sector's exposure to residual risks and liabilities associated with the facilities. The process also acknowledged and ensured fair and equitable treatment of former FAC employees, including preservation of accrued entitlements.

An ongoing consideration of the privatisation process is that privatised airports must remain Australian-owned and controlled and encourage local participation from the community in which the airport is located. This can be particularly relevant to regional airports where the demand for air services is less evident than from capital cities.

2. Some observations

Regional Impacts

There is a continuing need for new infrastructure and for maintenance of existing facilities. A familiar mix of population growth, ageing facilities and sometimes a high degree of deferred maintenance, as well as increasing fiscal pressures, has forced governments at all levels to seek new approaches to ownership, operation and financing of infrastructure. As has been mentioned, such approaches include involving the private sector.

Governments are more and more turning to previously untapped sources of funding and expertise in the private sector. Generally, the private sector is quite able to attract investment monies, and "big-ticket" infrastructure projects are a natural conduit for these funds. However, population density outside of capital cities and large provincial towns often precludes even basic consideration of projects by the private sector. There are several reasons for this. There is a strong perception that a lack of critical mass in regional areas will not generate sufficient demand to provide adequate returns on investment. In these circumstances, and to make a facility viable, prices must be increased for the services offered. Furthermore, the size, and therefore the capital cost of facilities in some regional areas may be relatively small but up-front development costs associated with such structures are relatively high, requiring these costs to be recouped through premium pricing. Premium prices impose a further financial burden on users least likely to afford such impost.

Nevertheless, to maintain their competitiveness and existing standards of living, regional communities and business need better and cheaper access to services and infrastructure. Many communities though are concerned about the potential risks and cost increases associated with privatising infrastructure and services currently provided by government. More remote regions are often unable to exclude people from using the facilities, thereby restricting their options for developing a user-pays system. It is therefore important when making decisions about privatising infrastructure and Government Business Enterprises, that consideration be given to the potential costs, benefits and impacts on different regions.

From an economic perspective, privatisation should proceed where there are overall net benefits. However, where privatisation will result in negative impacts for particular regions, consideration needs be given to ways which will ensure regional standards of living are maintained and the costs of doing business locally is contained. For example, the Rail Reform Transition Programme (RRTP) was a $20 million programme put in place in 1997 and was designed to assist local economies adjust to the changes caused by the Government's rail reform initiatives. Funding was made available to regions in several states and territories where job losses were likely as a result of the sale of Australian National Rail. The objective of the RRTP was to support measures that would create real and enduring jobs through economic development of the regions most adversely affected.

The role of the three levels of government and the private sector

The three tiers of government have individual and collective roles in the provision of infrastructure. There is also considerable overlap. The private sector is also now playing a more extensive and important role in the provision of infrastructure.

It is difficult to allocate responsibility for the provision of infrastructure wholly to a particular level of government. The Australian government, for instance, has a focus on national and strategic co-ordination. State and Territory governments provide for their respective states and territories, but transport networks and power grids now frequently cross state and territory boundaries, and the provision of utilities is being increasingly provided by the private sector. Local government plans, develops and maintains key infrastructure for its communities, but again this is increasingly difficult to consider in isolation. Local government also has planning responsibilities that affect the provision of infrastructure, whether by government or business.

The web of funding for publicly provided infrastructure is also complex and reflects, not simply a disparity in revenue raising powers, but a desire to influence and co-ordinate as our national economy is integrated more closely into world markets. Sometimes this influences the type of funding for infrastructure. For example, the Australian Government's Local Government Financial Assistance Grants to all local councils are untied and councils may spend the funds according to local priorities. However, funding for the National Highway system is influenced strongly by national priorities.

Local Government is also involved in the Australian Government's successful *Roads to Recovery* Programme. In January 2004, the *Roads to Recovery* Programme was extended for a further four years until 30 June 2009, providing $200 million per annum. Additional funding of $100 million per annum for individual projects of regional significance also will be made available from 2005-2006.

The new strategic component of *Roads to Recovery* aims to enhance the ability of regional industry and communities to compete in the national and global market place. It recognises that many land transport infrastructure projects in regional Australia are worthwhile and strategically important but may not be competitive against major infrastructure projects focusing on the national network under a single AusLink funding pool approach. These may be projects that extend beyond the boundaries, interests and financial capabilities of individual councils. Many regions may need additional funding support as a result of their rapidly growing agricultural, industrial, manufacturing and/or tourism sectors or have significant social connectivity needs combined with inadequate transport infrastructure.

Clearly there are sections of the transport task that should continue to be handled by the appropriate tier of government, or are more appropriate for private sector management. There are also inevitable areas of continued overlap. But overwhelmingly, in the face of international competition, there is a need to better utilise the public resources available, both human and monetary. Various Parliamentary Committee reports (*Tracking Australia, Planning Not Patching, Revitalising Rail,* and *Time Running Out*) have called for a more co-ordinated approach to transport infrastructure planning and investment. The evidence suggests that effective longer-term planning for the national land transport network should look beyond piecemeal investments, individual modes and separate jurisdictional responsibilities. It is especially important that transport network planning is integrated with land-use planning. However, while land-use decisions continue to be made by various levels of government, there is little incentive for effective integration of land-use and transport planning to meet national objectives.

The Australian Government's proposals to address the need for better planning and co-ordination of transport infrastructure are set out in the Green Paper, "AusLink – Towards the National Land Transport Plan," which was published in November 2002. A copy of the Green Paper is attached. It is expected that a White Paper will be published around the time of the 2004 Budget.

Mechanisms for monitoring, evaluating and reporting on Government privatisation programs

Carefully managed privatisation of infrastructure has the potential to deliver net benefits to the Australian community. To help ensure these benefits are achieved, privatisation needs to deliver value for money and be both transparent and accountable.

Value for money It is important that proposals for private infrastructure provision be rigorously tested against a public sector comparator to ensure that value for money is obtained. A public sector comparator is, in effect, a methodology which compares the outputs and costs of private sector provision against what a similar project would cost the public sector to provide. In this way, the cost of providing a facility cannot be artificially inflated. It is also important that testing be assessed on a whole-of-life and whole-of-government basis. However, there may be cases when it is a better option to have the public sector build a facility even though it is more costly to build than if done by the private sector, due (say) to overwhelming issues of public interest. Other considerations when assessing project proposals for value might include the potential implications for tax revenue flowing from private sector involvement. It is not unusual for some private proponents to claim that a project is commercially viable provided the Government is willing to forego tax revenue. However, while tax revenue can contribute to the benefits stream of any given project, it is a real cost to the public purse

The extent to which risk is transferred to the private sector is also an important consideration in evaluating benefits of private sector provision. Where private sector provision adds to public debt, such as when some form of joint private-public venture is undertaken, it decreases the amount of public funding elsewhere. Assessment of the opportunity cost of public money used in these projects also needs to be considered.

Transparency and accountability There is a continuing need to ensure transparency and accountability in any form of infrastructure provision, public or joint venture, just as firms in the private sector seek to understand their suppliers' and customers' costs.

Conclusion

The key objectives of privatisation have been to capture efficiency, management and investment benefits from the private sector. To harness these benefits in the transport portfolio, rail and airport assets previously owned by the Commonwealth have been progressively transferred to private ownership.

Privatisation of the railways has the potential to make a significant improvement in the standard of rail infrastructure, particularly where the transport task is better suited to carriage by rail. It may be too early to draw definitive conclusions on this and further reforms, eg to the regulatory environment which may be necessary. However privatisation and separation of 'above track' and infrastructure operations has gone some way to enabling rail to achieve greater competition with road transport.

Federally owned airports were sold with a clear developmental objective, including a mandate for new owners to capture viable commercial opportunities. However, while privatisation of airports has provided significant opportunities for commercial enterprise, essential elements of the industry, including safety and security, remain in the hands of government.

To maintain their competitiveness and existing standards of living, regional communities and business need ready access to services and infrastructure, and are likely to be concerned about the potential risks and cost increases associated with privatisation of infrastructure currently provided by the public sector. It may not be possible to retain access to all forms of transport infrastructure that have existed in the past due to the competitive pressures on the Australian economy from increasing globalisation. However it is important consideration be given to the potential costs, benefits and impacts on different regions, alternative modes of access and the interconnectivity that infrastructure provides between regions and cities.

ADDITIONAL INFORMATION HELD BY THE COMMITTEE

ATTACHMENTS TO SUBMISSION NO. 30

ATTACHMENTS, APPENDICES AND PHOTOGRAPHS PROVIDED WITH SUBMISSIONS ARE HELD IN THE COMMITTEE OFFICE