

**INSTITUTIONAL CONSTRAINTS TO
CORPORATISATION AND PRIVATISATION OF
TRANSPORT INFRASTRUCTURE**

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ABSTRACT

The pace of reform has varied between modes of transport and within the same mode in different geographical or institutional regimes, partly in response to the relative ease or difficulty of separating operations from infrastructure, and the ability to cost accurately and to price separately the two elements.

This paper reports on the microeconomic reform process in transport in Australia, and covers aviation, rail, road, urban transport and ports. The role of independent review in maintaining momentum in the reform process and in overcoming institutional constraints is assessed with particular reference to fixed infrastructure such as airports, roads, rail track and port facilities.

The paper draws on a range of independent reports prepared during the 1990s by agencies such as Treasuries, other central agencies, the Industry Commission, BTCE, BIE, EPAC, and NRTC, including several in which the authors have been directly involved: IC report on Urban Transport, National Transport Planning Taskforce (including BTCE input), the Economic Planning Advisory Commission's Taskforce on Private Involvement in Public Infrastructure, and the National Road Transport Commission's recommendations for heavy road vehicle charges in Australia.

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Introduction

There are differences in the pace of reform in transport: some modes have moved faster than others, and within the same mode changes have occurred at varying rates in different geographical, ideological or institutional regimes (Prebble, 1996). But in most cases the reform of services or operations has been faster than reform of infrastructure, particularly track and terminals. This is partly due to the relative ease or difficulty of separating operations from infrastructure, and the ability to cost accurately and price separately the two elements

Does it matter that the pace of change varies, so long as improvements in efficiency are reflected in improved service? While accepting that the pace of reform will vary, it is vital that improvements in some modes, or parts of a mode, do not blind us to the lack of change in other areas. For example, the search for a 'level playing field' is elusive, providing an everlasting excuse for poor performance by some players. We need to keep in sight the poor performers and those protected by regulation or design e.g. the contrast between New Zealand and Australia in bringing competition to the taxi and hire car business is dramatic - regulatory capture is strong in most Australian states (IC, 1994)

This paper looks at the reform process, with particular reference to fixed transport infrastructure such as airports, roads, rail track and port facilities. The influence of institutional structures and cultures on the pace of transport reform, actions taking place to remove or overcome such constraints, and further action required to continue the transport reform process are described.

Transport Reform in Australia

Australian aviation “has been subject to reform pressures almost continuously since 1987” (BTCE, 1993). This is reflected in the abolition of the domestic two-airline policy in 1990, the acquisition by Qantas of Australian Airlines, British Airways’ acquisition of a share of the privatised Qantas in 1993, Ansett’s move on to international routes and the 1996 link to Air New Zealand. Changes are taking place on the Trans-Tasman routes, though not in the form or with the speed that might have been envisaged when the CER Agreement was signed. Whilst there is still a fairly sharp distinction between Australian domestic and international air services, the direction is towards seamless operations. “Overall, the impression is one of progress the gains are clearly larger than the losses, to the extent of some \$100m per annum” (BTCE, 1993).

From a slow start, rail transport is undergoing change on a number of fronts. In 1991 the Industry Commission reported that reform of government railways could increase Australia’s GDP by over \$5billion p a. “but first, managers of public railways have to be allowed to introduce reforms” (IC, 1991). In the intervening years, separate business units have been established for different rail traffics in most government railways, the National Rail Corporation has been established, and private train operations are seen on government-owned lines. The performance of New Zealand’s railway will be closely watched by proponents of privatisation in Australia.

The advent of the National Road Transport Commission has expedited reform in three aspects of road transport in Australia: charging for heavy vehicles (NRTC, 1993), greater uniformity in technical standards and more efficient administrative procedures covering motor vehicles. The pace of reform has varied in these three areas, and while some might think these changes could or would have occurred without the NRTC, nobody can deny the focus the Commission’s existence has brought to the implementation of reforms in five years that otherwise might have taken twice as long. Bear in mind the NRTC’s reforms are to an industry that has been deregulated (for

interstate movements) since the mid-fifties and progressively deregulated for intrastate freight in the following four decades (NRFII, 1984).

Long-distance bus services have also been deregulated gradually. However, competition is still restricted in some states, and reform is painfully slow - protection of single operator coach routes has replaced protection of railway passenger services in some States.

Waterfront reform continues to be the achilles heel for Australian transport reform. Despite a mountain of reviews and even a very expensive buy-out of labour program, improvements have been relatively poor. Cabotage remains, which restricts the opportunity to utilise spare shipping capacity. Reform of ports and the waterfront involves labour practices, stevedoring, ownership and capital investment issues, and intercity (or intergovernmental) competition (BTCE, 1995a).

Based on Bureau of Industry Economics international benchmarking exercises, Australian ports continue to perform poorly relative to overseas best practice. For example, on the basis of a survey of ship operators "..... out of 18 Australian and overseas [container] ports, Brisbane ranked 12th, Adelaide 15th, Melbourne 17th and Sydney 18th in terms of speed and reliability of waterfront services such as pilotage, towage and stevedoring" (BIE, 1995a).

Despite improvements made during the Waterfront Industry Reform Authority (WIRA) process, performance still needs to improve markedly to match the best overseas ports. Most overseas ports have improved productivity, whilst Australian productivity levels have generally declined. The main source of concern for Australia's waterfront performance lies in poor stevedore productivity, which may have more to do with poor equipment quality and employment practices than employment levels. The WIRA process productivity gains need to be consistently maintained for long periods of time before Australia enjoys the benefits of improved ship schedules and further reductions in freight rates (BIE, 1995a).

Urban transport reforms embrace suburban railways in all major mainland Australian cities, trams in Melbourne and Adelaide, public and private bus services in all large cities and small towns, taxis and hirecars, community transport, the private car, cycles and motorcycles, and the wide range of urban freight vehicles. Reforms are slow compared to the advances made in inter-capital and country (rural) transport, but the franchising or contracting out of former government bus services in Melbourne, Adelaide and Perth and some smaller cities has contributed to an expansion of the market for the private bus sector, to overall improved productivity, and to creation of a critical mass of private bus operations in all cities (Hensher & Daniels, 1993). Conversely very little reform has taken place in the high cost urban rail sector or in the tightly regulated taxi industry (IC, 1994).

Against this background of change to transport services, we intend to examine in more detail the reforms to transport infrastructure.

The Case of Infrastructure

[This section summarises the findings (insofar as they relate to transport) of Chapter 2 of the Economic Planning Advisory Commission's Task Force on Private Sector Involvement in Infrastructure. Copies of the two volume Interim Report and the Final Report are available from the authors or from EPAC.]

Australia's total stock of infrastructure, valued at around \$A400 billion, accounts for about one-third of the nation's capital stock. About 70% is economic infrastructure, including roads, railways, ports, airports, electricity transmission and distribution, water storage and supply, sewage treatment, pipelines of gas and oil, and telecommunication networks. The remaining 30% is social infrastructure such as schools, hospitals, prisons and public housing (EPAC, 1995a).

The public sector owns the major part of Australia's infrastructure; only about 10% of the economic infrastructure is privately owned, but most of that is in the transport and

communications sectors. Also, whereas equipment accounts for about 55% of privately owned infrastructure, it is only 16% of public infrastructure. In total some 20% of the nation's infrastructure stock is equipment.

All three tiers of government are involved in providing infrastructure. The Commonwealth directly undertakes a quarter of annual public investment, and State/local governments 75%. However, some 40% of the funding of the State/local sector's revenue comes from the Commonwealth in the form of general and specific purpose payments for infrastructure and other programs. While the Commonwealth is constitutionally responsible for the communications industry, it has expanded its role, over time, to provide national highways, railways, airports, etc. Transport and communications infrastructure accounted for 76% of Commonwealth investment in 1992-3 (EPAC, 1995a). The States are responsible for a broad range of economic infrastructure including roads, railways, power stations and ports, while local governments provide roads and some airports and (in some areas) water supply and sanitation.

Private involvement in infrastructure is not new, but in recent years greater reliance by governments on contracting out, BOOT-type arrangements and privatisation has led to increased private sector participation. The trend towards greater private sector interest in both economic and social infrastructure in Australia is likely to continue.

Airports

Airports represent a significant opportunity for the private sector. Ownership and management of all major airports and many small aerodromes and airstrips were traditionally tasks of the federal government department responsible for aviation. As early as 1958 the Commonwealth began divesting itself of ownership of local airports and developed the Aerodrome Local Ownership Plan, under which financial and technical support would be provided to the new local owners. However, the

process was very slow, until given a major boost in the late 1980s with a revision of the arrangements after which local airports were encouraged to levy user fees. As a result over 200 'small' airports are owned and/or operated by their local community. Some of those serving larger towns and tourist regions have substantial terminals supporting regional air services (BTCE, 1993).

After corporatisation of the major airports under the Federal Airports Corporation in 1988, a program to privatise the major airports was announced by the Labor Commonwealth Governments of the early and mid-1990s and is being pursued, with variations, by the new Liberal Commonwealth Government. Effectively, the airports are packaged and will be offered for sale or lease. The dominance of Sydney airport amongst Australian gateways will obviously reflect in the attractiveness and price of most airports. State Governments are taking an active interest in the sale process and growth in the tourism industry will create opportunities for the private sector to provide improved airport facilities.

The Bureau of Transport & Communications Economics (BTCE, 1995b) estimated for the National Transport Planning Taskforce that investment of \$2.8 billion to expand and upgrade aviation infrastructure is likely to be required over the next 20 years, two-thirds of that amount for terminal expansion. Third runways may be necessary at Melbourne and Brisbane after 2010. It is likely that governments will no longer be in a position to finance such extensive capital works programs, so private sector involvement will prove critical. Mechanisms must be developed to enable such private input, including an appropriate sharing of risk and returns.

Roads

Compared to the progress being made in the reform of aviation infrastructure, until very recently the ownership and management of public roads in Australia continued to be a function of State and Local Government departments and agencies, with the

Commonwealth responsible for financial arrangements covering the National Highway System (Dowcra, 1993). One of the major tasks assigned to the NRTC is to provide an independent assessment of the efficiency of roads and the public sector road authorities (NRTC, 1994). Another essential step in road decision-making is to strengthen the link between pricing and investment (Access Economics, 1992).

The Allen Consulting Group in a report to the Australian Automobile Association, drew attention to the institutional factors influencing road reform: "Decisions about the level and pattern of road investment are heavily influenced by political factors and institutional structures rather than market forces. There is little basis for believing that the present level and pattern of funding of road infrastructure is economically optimal." (Allen, 1993).

The involvement of the private sector in major road construction, particularly in New South Wales and Victoria, has caused a major rethink of the potential for reform in roads, and is a stimulus to consideration of road pricing - previously a political 'no-go area'. Such privately owned roads will become real-life laboratories for electronic tolling, differential charging schemes, and asset management programs - all potentially open to public analysis. When added to the conceptual frameworks developed for heavy vehicles (NRTC, 1993) and congestion pricing (BICE, 1996) the directions for reform of roads and road transport will become much clearer to the community.

The main examples of the private sector's involvement in the provision and maintenance of roads are found in the major eastern states' cities. In Sydney private concerns operate the M4 and M5 motorways, and work is proceeding on the \$A644 million M2 motorway. More recently the Victorian Government announced a private sector joint venture is to build and operate the \$A1.7 billion City Link in Melbourne. This project includes widening existing arterials, new road links and a tunnel linking the West Gate Freeway and the South East Arterial. As a result all these major highways are, or will become, tollways.

Contracting out of road maintenance is a well established process to reduce costs; BOOT-type projects are increasing to increase the level of market orientation; and electronic tolling allows for increased efficiency. Together they will allow better management of roads, over time, to replace the traditional public sector response of letting congestion build up until it is politically unacceptable, then adding new capacity.

The quantum of funds required for warranted road upgrading or replacement is demonstrated by the BTCE's identification of the Pacific Highway between Newcastle and Brisbane (\$A4.3 billion), the inland route between the same cities (\$A2.1 billion), the Bruce Highway in Queensland (\$A1.4 billion), and completion of the upgrading of the Hume Highway between Sydney and Melbourne (\$A1.4 billion) (NTPT, 1994).

Railways

The reorganisation of rail services management has forced attention to be given to the residual problem of what to do with, and how to pay for, track, stations, signalling and other fixed infrastructure. Many rail authorities have created an infrastructure business unit with access provided to train operating divisions and in some cases to third parties (ORR, 1996). The Commonwealth and State governments are now considering the creation of a new authority to unify management and control of the interstate rail network and its operation.

A rail access code has been developed as the basis for access to the interstate rail network, though we suspect that practice and negotiation will tend to modify the draft code, rather than the code and its contract template driving arrangements between access providers, users and potential operators. There is already extensive experience of third party operation of railways in Australia e.g. private passenger train operators in Victoria, access agreements involving TransAdelaide, Australian National (AN) and the National Rail Corporation (NRC) in South Australia, and private operators running freight trains across Australia in competition with NRC.

Again this is breaking down the traditional institutional constraints, where vertically-integrated government-owned railways called all the shots within their own territory. Governments may choose not to continue to own railways in future, for financial or other reasons, as evidenced by the reaction to the Brew inquiry of AN and its relationships to NRC.

Whilst there is a great need for investment in rail infrastructure in Australia - the BTCE identified that some \$A2 billion is required for the Melbourne-Sydney-Brisbane corridor alone - the reform taking place in railway operations in Australia is slow in being complemented by change to the infrastructure ownership and management (Affleck, 1996). If major projects such as the Alice Springs to Darwin railway or the direct Melbourne to South Queensland 'inland railway' are ever to proceed, they are likely to require clear economic justification and substantial private investment.

Ports

The involvement of the private sector in ports has been slow and gradual. State Government statutory authorities control most Australian ports, including the major city ports. Corporatisation of port authorities has resulted in contracting out or privatising non-core services such as cargo handling, wharf and terminal construction, towage, security services, recreational boating facilities etc. For example, nearly all cargo through NSW ports is now handled through leased or privately owned berths. In addition, private operators run fifteen of Australia's ports under agreements with State Governments. In 1996, the Victorian ports of Geelong and Portland have been privatised.

The Australian Financial Review (3 June 1996) suggested that "a landmark enterprise agreement hailed as a key to waterfront reform is failing dismally, leading to a productivity slump and a multi-million dollar labour costs blowout at P&O Ports Pty.

Ltd.'s Sydney container terminal". The CEO of P&O Ports was reported as suggesting that the initial results of the Productivity Employment Program "made him wonder whether there was any hope of achieving workplace reform using existing waterfront labour" (AFR, 3 June 1996). The PEP scheme was supposed to increase container lift rates towards 24 an hour, but during the first two months of the trial the rate dropped to an average of 12 to 14 an hour. Employers are looking to leverage the new Commonwealth Government's Workplace Relations Act is expected to introduce, through aspects such as a regime of legally enforceable orders against unlawful strikes and industrial action.

Much of the momentum to reduce port costs comes from the pace of reform of New Zealand's ports, which in turn was initiated by the threat of port reform in Australia! The difference is that the New Zealand reforms were much more comprehensive and faster than those proposed for Australia. BIE benchmarking shows the performance of Australian ports to rate poorly: the ".....New Zealand government implemented their reforms at a faster pace and took their reforms further. The benefits reaped by the New Zealand economy have been consistently sustained since the reforms were implemented. In Australia institutional arrangements have meant that stevedoring and port authority reform have progressed separately "The federal government pursued WIRA, but improvements in port authority performance depends on actions by various state governments " Hence, Australia is currently in a 'catch-up' phase relative to New Zealand. Recent set-backs in some aspects of Australia's performance have led to questions about the sustainability of Australia's reforms" (BIE, 1995a).

Whilst reforms are being achieved at Australian ports through the corporatisation or privatisation of government port authorities, many private sector monopoly operations remain or have developed, such as pilots and stevedores, which together with labour are all able to exert market power to a significant degree and hence can thwart reforms (IC, 1993). The nature of the institutional structure means that port authorities have no direct control over the actions of most of the key port players, with break-throughs reliant on other institutions, such as the ACCC and industrial tribunals.

Urban Transport

The privatisation of urban bus services is made easier by the lack of fixed infrastructure directly associated with the operations - essentially only terminals and depots.

However, the reform of urban rail and tram services in Australian cities has been inhibited by the need to resolve the issues of track, signalling and stations. Given the experience with bus contracting in Adelaide, one possible course of action to ensure rail is included in the S.A. Government's franchising program is to call for expressions of interest for all or part of the rail network, to assess the level of private interest in the infrastructure as distinct from the services (Fielding, 1988). An associated development would require corporatisation of the rail section of TransAdelaide's activities, either along the lines of the corporatised public sector bus service companies or as a joint venture with a private organisation. The experience of New Zealand, wherein TranzRail contracts with regional governments to operate suburban rail services, is relevant, as is the British approach of privatising Railtrack at the same time as the railway operating franchises are being let.

Two major urban rail projects in Sydney involve investment from, and construction management by, the private sector, which will later be directly involved in management of the new facilities. The Pyrmont/Ultimo LRT line in the inner city is currently under construction (estimated cost \$A55 million), and the joint venture Airport Rail Link is being built by a private sector consortium that will own and operate four stations on the route. In the latter case, the NSW Government is funding approximately 75% of the total project cost.

The Pace of Reform

The slowness with which transport reform takes place is illustrated by the authors' own optimism in the abstract for this paper. We stated: "By mid-1996 the IC Review of Rail Transport reform and Intermodal Transport will be well under way, the National

Transport Policy Framework working groups on pricing, competition and infrastructure have been progressed, Track Australia may be established, rail separation reforms be in place in some states, and airport privatisation provide examples of progress.” A gambling person would, on most counts, have lost his or her shirt! Why is the pace of transport infrastructure reform so slow?

There are several reasons; economic and financial considerations are dominant. In many cases the facilities are not only uneconomic, but hopelessly so. Whereas short-term bridging contracts and/or subsidies may ease the path of corporatisation of services, this approach can not be applied easily to long-lived assets. Much of the debate in and before the EPAC Infrastructure Task Force covered such matters as infrastructure bonds and other financial instruments, taxation, and innovative financing. However, if the infrastructure project is not economically viable one has to query why it is being constructed at all.

For that reason one of the continuing roles for government is the appraisal of projects. Where need can be established and viability demonstrated, the private sector can and will be involved. On the other hand, governments continue to promote and/or build transport projects with apparently little reference to economic viability. Suspect analysis and/or poor results are being promoted as acceptable e.g. a B/C ratio of 1.3 is quoted for the Adelaide runway extension or Alice Springs-Darwin railway, yet road projects with 2 or above are not being built. Environmental impact statements are being endorsed by approving bodies when little or no attempt is made to justify the project, effectively ignoring the EIS guidelines. Such misuse of the process is mirrored in technical improvements being made to road transport without recommended complementary charges being imposed.

In some ways the economic constraints are a subset of the institutional constraints that beset the infrastructure planning process. The Infrastructure Task Force felt very strongly that “efficient outcomes also require that decision makers are accountable

and that decision making is transparent. Transparency is important in aiding public acceptance and support for private involvement in infrastructure provision” (EPAC, 1995b).

How good is the basis of the analysis for assessing returns? Do we need to reconsider how we choose infrastructure projects? There is considerable evidence, particularly from reports of government auditors in Australia, that the processes are not transparent and a level playing field does not exist for potential participants.

Among the six policy requirements suggested by the EPAC Taskforce to help ensure that good projects are chosen and delivered efficiently, the first was “getting the planning and regulatory framework right” i.e. a commitment to project evaluation. Others were improved coordination across sectors and governments, so gains and savings made in one sector or region are not wasted elsewhere; pricing more effectively and encouraging open access to infrastructure networks; and more transparent planning and regulatory processes (EPAC, 1995b). The aim should be to reassure the community the right investment decisions are being made, before going on to secure the best providers and the most efficient financial arrangements.

We cannot ignore the social constraints, which often loom large in politicians’ minds. The biggest problem in transport is an aversion to tolls and charges, partly because the public feels it has already paid its way through taxation. Another is the real or perceived problems of exclusivity, particularly where long-term contracts are involved, and where project variations are permitted after the contract has been let. Such problems will arise where risk is not properly apportioned early in the project or where transaction costs or profits of some consortia or their members are seen to be high.

Equity is important in the provision of essential infrastructure services, and measures to ameliorate the impacts of economic pricing on disadvantaged groups will be necessary; this requirement is the same under commercialised public provision as under private provision. Clear policy definition and costing of CSOs are required as an element of

transparency in the pricing structure and, in general, the adoption of competitive neutrality principles will be important in achieving a change in culture (BIE, 1995b).

Conclusion

Significant opportunities exist for further private provision and management of transport infrastructure. The efficiency of private involvement and the different forms of private provision will vary on a case by case basis. Whether public ownership with contracting out, a BOOT-type arrangement or full privatisation best meets the community's needs, will depend on incentives for efficient project delivery, financing costs, regulatory costs, and the potential to meet social and environmental objectives. Monopoly constraints must be lessened e.g. at wharves or on railways, and reforms already identified need to be pursued e.g. the labour market and access regulations.

The significance of private investment in Australia's transport infrastructure will continue to increase. The pace of that increase will be mainly a response to need, but any institutional inertia slowing progress can be overcome by regular review from central agencies of government, independent research and policy organisations and peer example. If the review process is an open one, it will assist a better informed public to recognise and overturn poor decision making.

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