

## Privatisation Policy and the Changes to Victoria's Railways

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### INTRODUCTION

1. This paper sets out to review the changes to rail policy and management in the state of Victoria, over the past decade. Like many other publicly-owned railways outside Europe, Victoria's rail system had decayed slowly after World War II to the point where its continued operation was seriously questioned. By 1992, after 20 years of "cost containment" policies, the railways were only a shadow of their former glory: its network halved, cost recovery levels at around 30%, morale destroyed and its management caught firmly between politics and expenditure. Three years later, the state's rail services may well be poised for an economically viable future well into the next century. Miracle, myth or reality?
2. Transport analysts are accustomed to dynamic change but usually where it concerns breakthroughs in technology, the provision of capital, or real changes in labour productivity. In Victoria, in less than 3 years, the state's rail system has gone from "basket-case" to "commercial possibility". Raw facts alone suggest the cause is the most profound change in management policy since 1859, when government first took up the operation of railways from the private sector. Should the transformation be sustained, we will have a new precedent to apply to public policy.
3. Given that this paper is the first step of work-in-progress, it aims only to review the changes to policy, legislation and management, and to identify the

commensurate changes to operations and to financial performance. (In the longer term, it would be appropriate to examine not only the economic benefits of the new approach to railway management, but also the costs of large scale restructuring ... but that must wait for another day). To meet these initial objectives, this paper is divided into three sections: the first identifies the scope of change to policy and regulation, the second deals with the financial turnaround, while final section makes some observations about the potential to sustain this process.

## POLICY AND REGULATION

4. The change of government in Victoria in 1992 was particularly significant for the administration of transport in the state, and more so for the state's rail services - urban and non-urban. The last major attempt at an overhaul had been over a decade before, when the Liberal Transport Minister, McLellan, had revamped the state's public transport administration into a Metropolitan Transport Authority (rail, bus and trams) and a 'nominally' business oriented state railway. In the next ten years under Labour, this administrative approach was continued, although the Transport (Amendment) Act 1989 (44/1989) restructured the administration of the various public transport authorities back into one centralized authority: the Public Transport Corporation. Policy, however, remained conservative, with an emphasis on 'cost-containment' and incremental adjustment.
5. The dramatic change of government, with its landslide victory in 1992, gave the incoming Minister, Alan Brown, carte blanche to reform Victoria's public transport system and the moribund railways in particular. As is usual in Australian politics, the incoming Minister was heralded by a fanfare promising change, structural reform, corporatisation and new opportunities for private sector participation. Unusually, the Minister has been true to this rhetoric, and that is precisely the agenda that has been followed.
6. The initial changes in 1992 focussed on administration and staffing within the Department of Transport, as the means to impose a new organisational culture. One of the first steps was to restructure the composition of the PTC Management Board through the Transport (Amendment) Act 1992 (85/1992) which, amongst other things required the Chairperson to have a background of "... outstanding success in a commercial environment". Thus, from the outset of the Liberal administration, it has been apparent that the old, traditional public sector approaches were not going to be allowed to control the process of change. The same Act also curtailed the institutionalized 'consultative' role of some vested interests, although it is ironic that the railway unions themselves had been arguing for change at the national level for several years (RIC, 1990).

7. The current policy programme marks a radical departure from all past practices in Victoria. If implemented in full, it will provide a fascinating experiment in the effects of competition and ownership on transport efficiency. Moreso, because the new policy has not altered the State's commitment to public transport, which will "... continue to be provided in the public interest" (DOT, 1995:3). The core of policy, which once viewed the physical operation of public transport as a state obligation, now argues that the more appropriate responsibility is to ensure that safe, efficient and effective services are delivered - but delivered by the best organization (public or private) able to do so.
8. To bring this approach into being, three fundamental changes are required to Victoria's competitive structure; and, in fact, these are currently in the process of implementation, viz:
  - (i) the need to remove the remaining regulatory restrictions on competition effecting the road passenger industry (both urban and non-urban);\*
  - (ii) the need to restructure the state-owned PTC as a business enterprise, perhaps with a legislated requirement to achieve "... commercial best practice standards ..." (DOT, 1995) in the delivery of public transport services (in effect, making the PTC another operator able to compete for service contracts); and
  - (iii) the need to create a competitive environment within the State's rail transport sector. This, itself, involves three further reforms to administration, viz:
    - (a) separating the rail infrastructure from rail services, with the infrastructure under its own commercially-oriented management;
    - (b) providing an equitable means to price access to the infrastructure for all public and private service operators; and
    - (c) providing an appropriate means to administer rail safety procedures on a uniform basis for all rail service providers.
9. The policy changes for rail are interesting in more ways than one. Victoria appears to have rejected the national model for rail's development put forward by the Industry Commission (1991) and endorsed by the Commonwealth government. The national scheme continues to argue that rail services are a natural monopoly, with only minor opportunities for competition. The Victorian approach, on the other hand, accepts only that the rail track and its associated infrastructure holds any element of public advantage through monopolistic control - and even that is subject to reconsideration. Of course, there is some confusion here, for Victoria's proposed solutions fall in line with the Hilmer Report (1994)

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\* Victoria's road freight industry is now effectively free of competitive restraint.

on national competition policy, leaving the Commonwealth and the National Rail Corporation to argue the merits of public monopolies.

10. The changes so far to Victoria's railways illustrate how the government has pursued its policy objectives. First, with conventional theory, it has launched a major attack on industry productivity. Services across the entire rail system urban and non-urban, have been reviewed with significant reductions made to the metropolitan timetable and to some regional operations (especially in the east of the state). A labour redundancy program has been underway since the early 1980s but accelerated in 1993-94. In fact, the PTC shed one-fifth of its workforce across the board, with the largest impact falling on V/Line where one-in-four jobs were displaced. For the first time, there were large scale redundancies in workshops and maintenance services (close to 30%) which had previously enjoyed a degree of political protection. Having achieved in a single exercise, a staff outcome much closer to the level justified by existing services, further attrition seems unlikely without major cuts to operations.
11. The real gain in productivity, however, has come from "contracting out" for maintenance services. In a sense, this is not a new approach to management, for the PTCs staff had climbed the learning curve under the previous government, but they now routinely design and implement appropriate contracts with high efficiency gains. These are most obvious with track and infrastructure repair and with locomotive and rollingstock maintenance, which were once the black holes of unaccountable railway expenditures. Indeed, the process of contracting out has spawned a new industry in Victoria, as those contractors who have flourished under the new competitive arrangements are now best positioned to tender to other interstate rail operators who are just beginning to pursue similar strategies.
12. The symbolically important changes, however, have been those seeking to create a new operating environment. If nothing else, there is now a sense of competitive ability and enhanced performance that is acknowledged by the electorate, the rail staff and managers and by rail's customers. While this all serves to bolster rail's image, it is more than illusion. The Victorian Department of Transport now has formal track sharing and corridor management agreements with the National Rail Corporation (for interstate freight) and with the neighbouring state railways (AN and SRA). Country passenger services have visibly changed with two routes now operated by private companies (West Coast Railways, on the Melbourne-Warmambool line, and Hoys Roadlines, on the Melbourne-Cobram line), albeit under special contracts. There are also a number of community-based tourist railway operation and, more importantly, there is also clear scope for private freight services to commence.

## CHANGES TO THE FINANCIAL COST OF SERVICES

13. In any overall review, there still remains a need to establish some understanding of the actual financial costs to government of the provision of services. It is a prerequisite for further comment, and it provides a means to demonstrate the relative significance of the issues at hand. Here, of course, the interest is in establishing the change in magnitude and direction of the total level of public involvement in rail transport in Victoria. The agenda is obvious; if there are services provided by government which clearly fail to recover costs, then, for whatever reason, they may be considered to distort competition between competing operators or competing modes.

### The Objectives for a Financial Appraisal

14. Back in 1983, Prof. Ogden prepared an appraisal of the research needs for an evaluation of transport policy for the Victorian Ministry of Transport. He observed that, amongst other things, there was a need for accurate financial information to assist in the further and incremental development of policy, but noted:

"Now that a comprehensive infrastructure exists, any contribution to State development through its enhancement can only be marginal, and as a result cause-effect relationships are difficult to trace."

K.W. Ogden (1983): Freight Benchmark Review, p.57.

15. In these circumstances, the need for cost and financial information, as a measure of performance, and as a guide to future policy development, might appear to be self-evident but, as Prof. Ogden documented, such information simply did not exist (and it is still extraordinary difficult to locate). For example, just to determine the economic significance of freight transport to the Victorian economy, he identified nine major categories of information need, but found little or no data available in eight of those categories and that original research would be required to satisfy each (Ogden 1983:64). In fact, much of his report was devoted to identifying what cost data was or was not available, and what purposes could or could not be served by what was to hand; hence, his conclusion that most research must be on a "case-by-case" basis to minimise data collection costs. Little has changed.
16. These sorts of data difficulties are not confined to Australia, of course, and are probably endemic to most transport analyses. It is not so much that there is a paucity of data, in fact the opposite is true for the public sector, but rather there is little consistency in what is available, even between branches of the same state departments in Australia. For an analysis of government's transport functions,

however, there is a critical need for verifiable financial information. But, here, it must be realised that the public financial data which are available are not produced for economic analysis but rather to meet the requirements for public scrutiny of the financial management of each individual government department or agency. The purpose of such information is to demonstrate that proper care has been taken of the expenditure and receipt of public funds, and insofar as this objective is reasonably met, usually by verification through some governmental auditing process, there is little to be gained by arguing that it is in fact inadequate for some other purpose. The great difficulty is that for administrative ease, governments divide their departments, agencies and public enterprises into separable accounting units with more or less autonomous financial reporting status. Thus, each administrative unit becomes an accounting unit which seeks to present its financial information in a form most relevant to its own functional arrangements and tasks.

17. In the 1980s, the Labour government, in Victoria, took steps to modify and change the public accounting process, putting them at the forefront of such developments in Australia. The shift to 'program budgeting' and 'management by objectives' created a new uniformity in accounting records across the range of government activities. Nevertheless, the process of change was slow, not because of any perceived obstructionism but because it affected the whole concept of financial data collection and the procedures of each accounting (administrative) unit (Dept. of Management & Budget 1986). Consequently, there still remain inconsistencies and overlaps brought about by the differing objectives between various government agencies. Devil theorists might suggest that this is an artfully contrived mechanism for bureaucrats to hide their decision-making powers from political scrutiny; or, worse, that it is a ploy to avoid comparisons with other more efficient organisations. Whilst the empirical researcher is often tempted to agree, such arguments fail to recognise not only the purpose of the accounting process, but also the historical nature of the development of the financial data collection.
18. These problems are acute when trying to make financial comparisons over time for the transport enterprises of the Victorian government. The larger enterprises, such as the major ports and the railways, perform a variety of functions which are often divided internally into separate accounting units; for maintenance, operations, marketing, etc.. Within these enterprises, then, the problems of transferring costs and revenues across 'joint' and 'marginal' activities is such that true allocations are difficult to recognise and have been subject to numerous changes over the last decade. As a result, performance must often be judged on an 'estimated' basis.
19. The lack of appropriate financial data, may well have encouraged one-dimensional research to answer specific policy questions, whilst discouraging

attempts to develop serious macro overviews and performance comparisons over time. In truth, however, the demand for accuracy may be more than a little overstated, serving to shield the transport sector from a broad appreciation of its overall performance, and causing policy analysis to be piecemeal without any perspective of the inter-relationships that may actually be involved. In conditions such as these, where the data are not optimal, there is nothing intellectually wrong with resorting to second-best alternatives to establish a broad position, so long as the limitations of that position are fully understood. Here, the task is to establish an **order of magnitude** estimate of the cost of the State's involvement in rail transport. That the nature of the data sources prevents that estimate from being 'accurate', in the sense that every revenue and expenditure item can be precisely defined and found to parallel the accounts of every other government agency, should not mean that a second-best estimate (in the form of aggregates of revenue and expenditure) is not of considerable value in determining the overall pattern of performance and the direction of change.

20. In this paper, then, the objective for reviewing public transport budgets is simply to determine the extent of change in their financial liability to the Victorian government. While this may oversimplify the issues involved, the purpose is solely to establish a broad comprehension of the extent and nature of government involvement ... to attempt to do more would justify the criticisms of second-best approaches, but to do less would leave many of the key issues unexposed. In short, the task at hand is:
  - (i) to provide a financial measure of the scale of current government participation in the provision of services;
  - (ii) to provide one means of identifying current levels of cost-recovery; and
  - (iii) to quantify the prima facie cost of subsidies from the taxpayer.
  
21. Table 1 compares the extent of government participation in public land transport in Victoria between 1986/7 and 1993/4. It does this by quantifying the changes in financial expenditures of the Victorian government agencies which had a direct responsibility for both urban and non-urban rail transport, by comparing the results at either end of the 8 year period. The year 1986/87 was chosen for its relative stability under the old regime and the absence of abnormal commercial trading aspects or government expenditures. As such, it serves as a useful benchmark. 1993/94 data constitutes the latest publicly available and incorporates the initial impacts of the new decision-makers.
  
22. For this exercise, then, the desired information is:

TABLE 1 A FINANCIAL SUMMARY OF VICTORIAN GOVERNMENT\*  
EXPENDITURES ON PUBLIC TRANSPORT : 1986/7 TO 1993/4  
(Constant A\$ - 1994)

(\$ Million)

YEAR	Government Payments				Earnings			Summaries				
	(1) Total Expenditure	(2) Commonwealth Payments	(3) State Payments	(4) Sub-total (4=2+3)	(5) Direct Earnings	(6) Govt. Reimburse- ment	(7) Unattributed Earnings	(8) Sub-Total Earnings (8=5+6+7)	(9) Surplus/ Deficiency (9=1-8)	(10) Operating Cost Recovery %	(11) Net Govt. Payments (11=1-5+7)	(12) Total Govt. Contribution %
1986/7	938.17	7.64	636.39	644.03	294.13	22.71	22.66	339.50	598.66	36.2%	621.38	66.2%
1993/4	1,136.87	-	585.92	585.92	389.59	60.93	110.30	560.82	576.05	49.3%	636.98	56.1%

SOURCES: Victoria (1987) *Budget Summary and Program Budget Expenditures 1987-88*, Budget Paper No. 5, Melbourne, Govt. Printer.

Victoria Transport (1987) : *Ministry of Transport Annual Report, 1986-87*, Melbourne, Govt. Printer.  
Public Transport Corporation (1994): *Annual Report 1994, Melbourne*.

\*Expenditure by the PTC and its predecessors



- (i) the **total expenditure** by Victorian public transport agencies involved in the administration or the provision of services or infrastructure to the transport sector;
- (ii) the total of **government payments** for transport administration, infrastructure and services;
- (iii) the total of **direct earnings/receipts** by governments or their agencies from the sale of transport services;
- (iv) the total of **indirect or unattributed earnings** by governments or their agencies from various user charges associated directly with rail transport;
- (v) the **net cost** to government (i.e. the taxpayer) of government participation in the provision of state rail services; and
- (vi) a measure of **cost recovery** for government activity, based on the net cost to government of these activities.

22. In order to produce an aggregation like Table 1, it has been necessary to process each set of accounts individually, wherever possible by making assumptions about differences in expenditure terminology according to the stated intentions of the reporting agency. Some of these assumptions are necessarily intuitive, but it is believed that on balance a **reasonable** overall result has been achieved. Information for government departments is, in most cases, readily derived from Budget Papers and the more authoritative Auditor-General's reports, but balanced against the reports of the Government Business Enterprises when they are separately reported. The examination of some accounts has identified areas of double-counting, and revealed further transfers from 'non-transport' government agencies, necessitating further rounds of financial investigation. (Clearly, this is an iterative process which could be further refined, given greater resources.)

23. Summarising the financial results for Victoria proved difficult for 1986-87 as the state's accounts were in transition from the traditional budgetary presentation to a system based on program budgeting. As might be expected with such a reorganisation of accounting practices, there were a number of inconsistencies and gaps, not the least being the failure to identify all earnings by government agencies, the failure to identify Commonwealth funds and other government transfers and an incompatibility of performance indicators between agencies (see Victoria 1987, and Victoria Transport 1987). Regrettably, this also implies that the subsequent financial information for 1993/94 is not compatible with the earlier data releases. The 1993/94 financial appraisal, whilst the latest available, is clearly based on abnormal circumstances. Not only has the PTC, and its various operating arms, been subject to massive restructuring which has imposed

large scale one-off costs for service closures and staff terminations (redundancies, alone, make up 8.3% of expenditure), the Victorian government also restructured its future liabilities, particularly in the case of unfunded superannuation liability. It may well take a year or two to clear the smoke from these accounting movements; implying that the 1993/4 outcomes are indicative at best.

24. One result of this process is that it identifies the change in magnitude of government subsidy practices, although not of cross-subsidies. It is apparent that the growth in public transport expenditure has been curtailed, with total 1993/94 expenditure having fallen by 12% in real terms from 1992/93 and with similar outcomes forecast for this financial year. More importantly, the proportion of expenditure supported by taxpayers rather than by consumers, has begun to fall: total public contributions amounted to 56.1%, significantly less than the 66.2% required in 1986/7. Operating cost recovery is also improving, up from 36.2% to 49.3%. These changes are even more dramatic in the rail sector, where cost recovery was around 43% in 1986/7 but is expected to be around 70% this year. Given the extent of restructuring, and hence the inevitability of incurring losses through closures and termination payments, the real outcome for V/Line should be a potential to fully recover costs by 1996/7.

## OBSERVATIONS

25. In many cases, there may well be strong and substantial arguments for the provision of some government services at less than cost-recovery levels, particularly when the full implications of externalities are considered, or when equity considerations (politically determined value judgements) are translated into economic targets. Table 1, however, remains concerned solely with establishing and quantifying the extent and direction of government involvement within the sector.
26. What is apparent from this review is that the extent of restructuring in such a short time-period in Victorian transport is virtually unprecedented in any other modern western state (with parallels only to be found in New Zealand). Simultaneously the state has sought to bring about a revolution in approach and strategy by fully endorsing the competitive model, and reorganizing its service provision to reshape its unit costs. The restructure now means that the Marginal Cost of many services (especially non-metropolitan rail services) now bears some semblance to Marginal Revenues, making it possible to manage services in a commercial framework. The implication, of course, is that rail managers (at least) can now pursue new business opportunities wherever they arise, rather than being constrained by deficit-holding policies. For the first-time in 20 years, growth is now an option.

27. Judgements, of course, ought not to be made too quickly. Whether the new approach will be sustainable will be determined by the capacity of the railways (and the PTC) to cope with the new competitive environment. The financial results for this year (1994/95) and next (1995/96) will provide indicators that should prove of significant interest to all analysts of change.

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