BACK TO THE FUTURE IN NEW ZEALAND

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THE NEW ZEALAND DEREGULATION REFORM PROCESS

Bus Services

The New Zealand reform process has been reported on at each of these conferences, except the first in Thredbo (since the process had yet to begin). In particular Ian Wallis in 1995 at Rotorua provided a comprehensive background on those reforms and the outcomes to date. (Wallis, 1995). He, however, restricted his paper to urban bus and consequently neglected the reform of urban rail.

In 1995 Ian Wallis concluded that in New Zealand the main reforms of the urban bus sector had reached some broad equilibrium. Improvements in productive efficiency had achieved savings of 25-30%. The potential benefits from improvements in allocative efficiency were more difficult to assess but Wallis suggested that they could be equally as large. Those improvements have been the result of competition in the market (deregulation) and for the market (competitive tendering).

Rail Services - The Business

This paper will concentrate on urban rail. The reform process for urban rail in New Zealand appears to have not been the topic of any papers to any of these previous conferences though I am sure that the workshop sessions in Rotorua in particular, when the British experience in rail reform were being aired, would have had substantial input from New Zealand rail enthusiasts.

New Zealand rail reform has of course been reported on widely at numerous other conferences (eg. Murray King, 1996). For the purposes of an introduction to this paper some of that history will be summarised here.

In the early years of Rail in New Zealand the pattern was similar to most other countries. A state owned monopoly from 1908, New Zealand Rail was used as a social and national economic engineering tool. Some commodities were even transported for free as politicians pandered to various interest groups.

Various administrative reforms were tried over the years but they failed to get on top of the strong staff capture. However in 1982 the New Zealand Railways Corporation was established. This in itself was not a vast change because the government reserved the right to make the major decisions. However, a board of private sector people was established which was to prove a significant start.

In 1982 the new Corporation had 21,608 staff, now there are 4,600. In 1982 there were 26,400 wagons, now there are 7,100. There were 3,800 houses owned by the company. The company had its own printing works and its work practices ensured that innovation never replaced manual systems.

By late 1990 the Corporation became a new business. New Zealand Rail Limited was established as a wholly government owned company. Whilst this structure could have meant that the commercial goals of the company would be compromised by non-economic government requirements this never happened. This threat however remained, especially as governments do change. The new company was suddenly able to make giant steps towards internal reform without the hindrance of government.

Government soon acknowledged that it had no rationale to remain as the owner of the business, it had already sold its other transport interests (eg. Air New Zealand). New Zealand Rail Limited was therefore sold on 20 July 1993 to a consortium of Winconsin Central, and US and New Zealand investment entities. What was not sold was the land. This has been leased to the new company for 80 years for a nominal annual sum. There may be some Treaty of Waitangi claims over parts of the land.

The new company has since been renamed as Tranz Rail and as a last reform step the company has been publicly listed on the US and New Zealand share markets.

Rail Services - The Urban Services

Though the business reforms of rail to a public company are interesting it is the urban services operated by that company that are of particular concern to the Wellington Regional Council. The 1991 deregulation of passenger transport reforms included both bus and rail services. At that time the rail organisation had just been restructured as New Zealand Rail Limited, a government owned company. Deregulation had been heralded as leading to reduce public purse contributions whilst increasing service quality and passenger numbers. The new company wanted to be a profitable business, the Regional Council wanted to reduce its funding of rail services. Some conflict was inevitable.

The new 1991 structures had envisaged that there would be direct competition between bus and rail services. This was quickly turned around when it was agreed that if the service the community wanted was a rail service it could have it as long as it was competitively priced. Similarly, you could have a ferry service or any other specialist public transport service as long as the principle of competition was maintained. Of course it is somewhat difficult to have competition for rail when there is only one rail company in the whole country. These difficulties were overcome by having a sole supply competitive pricing process for rail services. The relationship between Tranz Rail (and its predecessor) and the Wellington Regional Council is now one of provider and funder with the price arrived at after negotiation.

It is this relationship and how it is changing that is the topic of this paper. But first it is necessary to outline the transport planning and funding system currently in use in New Zealand.

CURRENT PLANNING AND FUNDING STRUCTURES

The process and organisational structures related to planning and funding have also evolved through a changed process from about 1991 onwards. The current planning and funding structures are the result of legislation, the Land Transport Act the Transit New Zealand Act and the Resource Management Act (RMA) along with their various amendments. Those acts provide the framework set out in figures one and two.

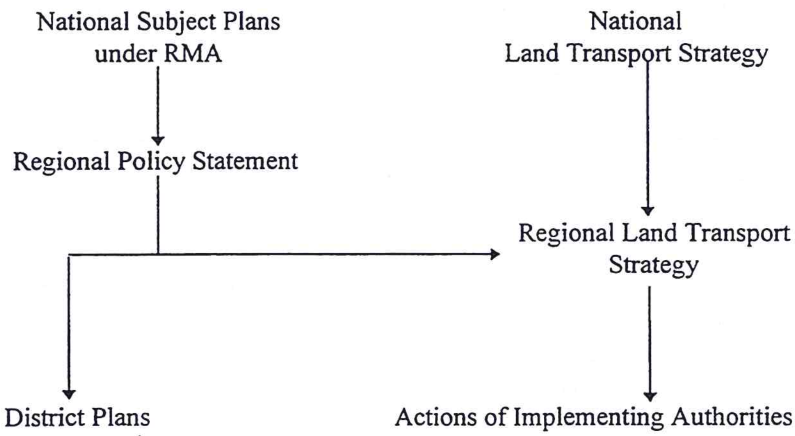

Figure 1 : The New Zealand Transport Planning Structure

The relationship between each plan is that any lower one is not to be inconsistent with any immediately above. For example the Regional Land Transport Strategy cannot be inconsistent with the Regional Policy Statement and the National Land Transport Strategy. At this point there are no National Plans or Strategies.

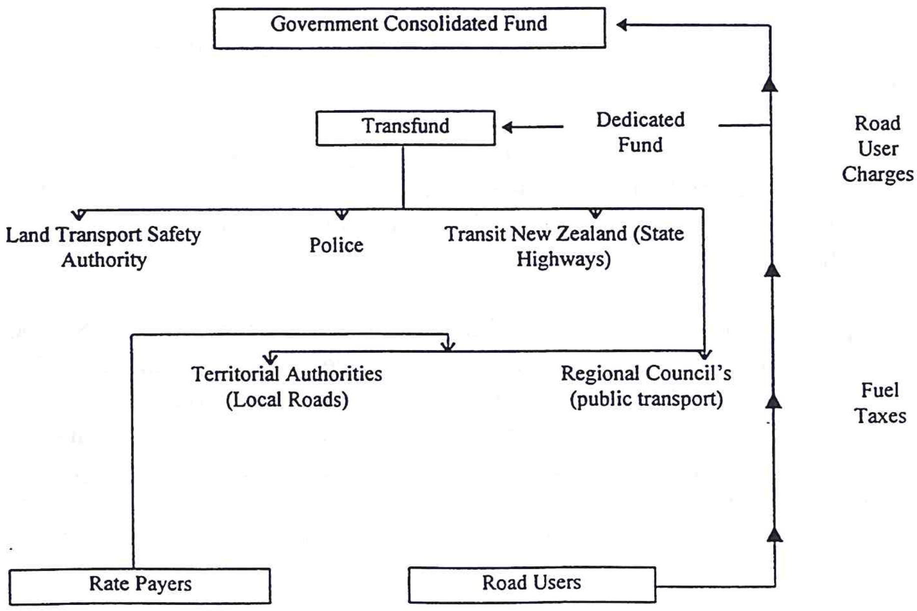

Figure 2 : The New Zealand Transport Funding Structure

Money going to Transfund can be varied by Government by altering the proportion of fuel taxes. Once the money reaches Transfund it is dedicated to transport and can be spent.

The method used for allocating Transfund monies is the project evaluation process of benefit cost. The primary benefits accounted for explicitly being road user time savings, fuel cost savings and accident savings. Other benefits are usually accounted for as externalities. Transfund will therefore be allocating national funds on a nationally ranked project by project benefit cost system.

The planning and funding structures described earlier appear logical in themselves but lack one fundamental element. They are not linked except that all organisations involved with transport activities have to act in a way that is not inconsistent with any National or Regional Land Transport Strategy. The concept of planning before funding is therefore often paid lip service with plans often being used as a basis for a veto on specific projects but rarely used to promote key projects. This difficulty has prompted at least the two largest regions to seek an alternative approach.

Their concerns have been given more credence by two consultants reports, both released in 1996. Symonds Travers Morgan working for the Wellington Regional Council and Transit New Zealand on a joint study considering the method for evaluating strategic roading projects (Symonds Travers Morgan, 1996) concluded that:

- There are strategic factors that the Transit New Zealand project evaluation procedures do not include.

- The Wellington Regional Council's Land Transport Committee should be tasked with the job of evaluating these other factors using a transparent process based on objective criteria.

- Transit New Zealand project evaluation procedures are not in general compatible with soundly based Regional Land Transport Strategies.

- Transfund needs to review the procedures for evaluating projects and setting priorities to reflect regional values.

A study undertaken for the Wellington Regional Council by the consultants Berl to examine the funding structures (Berl, 1996) also concluded that the traditional national ranking project evaluation system used by Transit New Zealand was incompatible with the concept of the implementation of transport strategies.

In an early paper presented to the Transit New Zealand hosted National Roading Symposium (Watson, 1994) it was argued that the use of the ranking benefit cost procedures to allocated limited national resources was wrong in theory. That argument was founded on the belief that all projects with an agreed benefit cost of greater than one were worth doing at some stage. That this was the role of benefit cost evaluation to determine whether a project was economically viable. But that the benefit cost approach was not a recognised process for rationing money and that indeed to do so was to screw the scrum.

A Better Approach

The introduction of the requirement to produce Land Transport Strategies has confirmed the need for a comprehensive integrated transport planning and funding system. A project by project based funding system is no longer valid. A transport forum run by the Regional Council debated that issue and concluded that:

- Soundly based transport strategies should be implemented

- Comprehensive integrated and fully costed transport packages should be developed by Regional Land Transport Committees that reflected the strategy.

- Funding for these packages should come in part from Transfund as a bulk allocation (with the level of funding reflecting at least the historic level of funding previously provided by Transit New Zealand).

- Regions should be able to supplement Transfund's contribution by local collected transport related income sources including rates, car parking charges, road tolls and petrol taxes if the local community were prepared to accept such local charges.

- Local communities should be left to make local decisions (Watson, 1997)

A Timely Reminder

An article in Town and Country Planning (Enoch, 1996) reviewing ten years of deregulation of bus services in the UK is a timely reminder that complex objectives are not necessarily achieved by simple solutions. The conclusion of the article is that the real issues facing those with the power to change the bus industry are:

- What do we want from our transport system?

- How can the bus best contribute to that?

- How do we organise things so that the bus can contribute in this way?

These questions should have been set and answered ten years ago, they were relevant then and they remain relevant now. However, the changed objectives of 1985 were to reduce public funding and realistically nothing else. This has been achieved but at a cost to the overall transport system.
In New Zealand we have the answer to those questions with respect to all modes of land transport. The answers are set down in the planning documents, particularly the Regional Land Transport Strategy. The problem is to convince those with the money to invest in these answers.

BACK TO THE FUTURE WITH TRANZ RAIL

Urban rail services are an important part of the Wellington Region's Land Transport Strategy. The paper will now concentrate on how the Region's strategic goals can be linked into Tranz Rail's commercial goals to achieve a win-win at reasonable cost. It is assumed that all the other problems and issues set out earlier are solved and there is little or no impediment to block any rationale approach.

The Wellington Regional Council since about 1981 has contracted in some form with the national railway provider. Those early days were particularly interesting because the government department mentality of the early 1980's meant that the Regional Council had to in effect assist the rail organisation establish basic accounting principles to allow it to separate out the cost of the Wellington services from the rest of the business. Much debate took place then about allocation of head office costs, the allocation between freight and urban rail of the track costs, power costs, maintenance costs and so on. A lot was learnt. The payment for a year's worth of services was originally NZ$33 million in 1981 dollars. The fact that a better quality and more frequent service costs $14.75 million today begs a lot of questions, none of which will be answered here.

The Various Contractual Relationships since 1981

The relationship between the Regional Council and the New Zealand Railways Corporation from 1981 to the financial year 1990/91 was an annual negotiated contract price for a specific number of seats at peak time into the central Wellington Station. The negotiation was based on the full knowledge of the reported costs of providing the service determined by an independent cost accountant consultant. Competition for the rail corridor from bus operators was not available because of legislation that denied it. In those days the Regional Council had only just embarked on comprehensive public transport planning and so was endeavouring to keep what it had. A history of political interference meant that the cost recovery ratio of fares to cost was minimal. Some fares charged were less than the cost of producing the ticket. By 1990/91 fares were up to the equivalent prevailing bus fare and costs had been driven down to more reasonable levels. The company was still however, making about 11% on capital.

Annual contracts continued for the first three years of deregulation. Initially some level of competition for the marginal services was allowed. Those were the weekend and evening services. All were retained by rail because with their peak requirements funded these additional services were marginally priced. Though the annual price was negotiated the Regional Council no longer had access to any accounts or other information. Rail had become a state owned company with new business objectives. The negotiations remained friendly but also more prolonged using the ping pong approach of batting a series of total offers backwards and forwards toward some inconclusive compromise with both sides no doubt sure they had been done by the other.

Competition, the driving force of the 1991 reforms was dead and buried a year into the new ball game. To try and stimulate a change the concept of a sole supplier for rail services and a long term contract (up to ten years) was spawned. After all urban rail assets have very long lives so if any infrastructure investment was to be made by the operator there needed to be sufficient time in the contract to recoup that amount at a rate acceptable to the funder.

This proved even more difficult to deal with than the year by year approach. The Regional Council became very concerned about the level of profit taking, the lack of certainty that capital would be spent were indicated rather than going straight to the bottom line to boost profits and because the business was sold to a private consortium whether the previous knowledge of asset costs remained realistic. Quality issues, performance criteria, infrastructure maintenance and other matters were all drawn into the negotiation.

The Regional Council came under direct political threat from the highest levels when it attempted to solve the problem by withdrawing its funding support entirely. It was apparently argued that the sale price that the taxpayer received relied on the ongoing funding support of the Regional Council. In effect some of the taxpayers sale income would eventually be paid for by the ratepayers of the Wellington Region.

After two years of negotiation a three year fixed price contract with performance incentives was signed. Major capital investments, particularly in replacement of rolling stock, were left unresolved to be considered in the negotiation of the next contract.

Matching Business Objectives with Overall Transport System Goals

There are always going to be separate and often conflicting goals between being an efficient business and achieving specific environmental and social outcomes. Even when the transport system is totally controlled by one organisation, as it was in parts of New Zealand only a decade ago, one set of goals tended to override the other. With political ownership the social and environmental goals were paramount, hence the quickly growing levels ongoing government support that followed and the under investment in infrastructure.

The privatisation of operation and the deregulation of the market has tipped the balance in the other direction. How far this change has gone differs throughout the world, major differences can even be seen between areas of a country. In New Zealand there have been cases of operators entering the market as profiters whilst others, the larger operators with an expectation of still being around in ten years time have recognised the need to be a responsible member of the local community. Probably they do this to ensure that politicians are not tempted to reintroduce regulation, so they self regulate. The New Zealand resource management legislation does impose constraints making it just as hard as previously to change land uses when the proposal would have resource use implications.

It is interesting to note that in the UK there have been some agreements reached between operators and communities on how they will work towards common outcomes. The agreements are informal partnerships unlike the customer charters that the UK government imposed on railway services.

In an environment where longer term contracting is being encouraged, operators are growing larger by acquisition and funding support from the community is being squeezed some new arrangements other than tendering of services may be necessary to ensure all outcomes are being met.

The Joint Venture Option

The Regional Council employed consultants to consider mechanisms to link the objectives of the two organisations. One such mechanism was to establish a Joint Venture company for

services in Wellington. Clearly such a company if established on a 50:50 basis would in effect be a reversion to public ownership but with equally balanced commercial and social/environmental objectives. As long as the Regional Council restricted its direct role to appointing directors (non political hopefully) and the drawing up of a statement of corporate intent then the company should be able to perform efficiently and effectively.
The funding arrangements rely upon the Regional Council purchasing a half share of the company thereby generating a cash injection sufficient to pay for necessary capital expenditure needed to make the business more competitive. By virtue of sharing the bottom line the financial outcome for the parties has been assessed at a net present value of $70m in subsidy reduction over a 20 year period for the Council and net present value of $11m of improved profit to Tranz Rail over the same period. Clearly a joint venture company has appeal to both parties. Unfortunately it is currently unlawful in New Zealand.

Other Relationships

Joint ventures are the middle road of two opposite relationships, merger and open market. Moving towards merger would be completely contrary to national political dogma. The next level toward open market would constitute formal or informal co-operative ventures. It is these latter possible relationships that are now being pursued.

Tranz Rail and the Regional Council have formally exchanged their objectives for the business. Tranz Rail wish to grow the business through infrastructure improvements and marketing strategies to ultimately become operationally independent as a fully commercial operation. The Regional Council clearly wishes to reduce or restrain car commuting and to maintain fixed rail as a core service, grow patronage and get out of the business of providing financial support on an ongoing basis.

Consideration of the growth objectives has led to determination of resource requirements in rolling stock, stations, routes and service levels. Funding mechanisms to match the resource requirements are being considered as a series of scenarios. Concepts such as capital investments by the Regional Council using our lower loan interest rates with reduced operational support. Share swaps between Tranz Rail and the Council owned Port of Wellington to strengthen both businesses. Incentive payment schemes. You name it we are looking at it, as long as it is legal. Once a preferred scenario is selected then a formal co-operative agreement will be drafted incorporating the preferred funding scenario together with service performance criteria.

The ongoing performance of urban rail will ultimately depend on the ability of the Regional Council to achieve delivery of its other land transport policies, particularly road traffic restraint. Hence the ongoing concern that funding must follow planning and local communities can make local decisions. Without this ability the formal co-operative agreement between the two organisations will fail. This must not be allowed to happen. These negotiations are occurring now and should have reached a conclusion before this paper is presented. The result of these efforts will therefore be reported, hot off the press, to this conference.

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