THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

AUSTRALIAN NATIONAL RAILWAYS COMMISSION

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON EXPENDITURE

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1, 3. Chairman of the Joint Committee of Public Accounts, who, in accordance with Clause (2) of the Resolution of Appointment, is a member of the Expenditure Committee.
2. Replaced Mr Lloyd, M.P. (resigned) on 10 October 1978
4. Replaced Mr Stewart, M.P. (deceased) on 10 May 1979.
5. Replaced Mr Dawkins, M.P. (resigned) on 24 May 1978.
6. Replaced Dr Klugman, M.P. (resigned) on 19 September 1979.

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Report Theme

The Australian National Railways Commission (referred to as Australian National or AN) has incurred large annual operating losses which are expected to total over $500m. by 1987-88. The main reason for the Committee's inquiry was concern at the large annual appropriations made by Parliament to cover these losses.

AN's interactions with the government and the market are extremely complex, and are further compounded by the pervasive effects of the terms and conditions embodied in the Transfer Agreements covering the Commonwealth acquisition of the State railways of South Australia and Tasmania. The Committee's inquiry has resulted in its formulation of the major theme of this Report, which is the key in unlocking this relationship:

> AN's commercial objective must predominate and therefore the scale and range of operations of AN should be determined by customer preferences for its services subject only to explicit government directives in the form of public service obligations (PSOs), including the obligations embodied in the Transfer Agreements.

The following recommendations should be interpreted with this theme in mind, as it is central to the Report.

Recommendations Requiring Legislative Changes

The Committee recommends that:

1. AN's management be given decision-making freedom to operate as a commercial organisation and pursue the profitability objective subject to PSOs and the Transfer Agreements. Section 57C (2) of the Act should be amended to give effect to this recommendation. (Paragraph 109)
2. The Minister for Transport institutes a review of the Act and re-examines his role in relation to the obligations placed on him by the Act as identified in the review and this Report. (Paragraph 156)
3. AN's management be left to decide on the extent to which it should publish rates and fares. (Paragraph 143)
4. Prior Ministerial approval of AN's rates and ares be no longer required and Section 29 of the Act be appropriately amended. At the same time, the Minister for Transport should establish a mechanism by which public complaints of overcharging and undercharging by AN can be resolved. AN should also provide the Minister with principal details of all major new contracts entered into in the previous twelve months. (Paragraph 146)
5. A new Section 34 of the Act be introduced to read as follows: Notwithstanding anything in this Act or any other Act or any rule of law, the Commission is not a common carrier, but is still subject to public service obligations. (Paragraph 130)
6. Section 46 (2), which deals with Public Service Board involvement, be deleted and Sections 46 (5), 46 (6) and 46 (7) be amended or repealed as appropriate. (Paragraph 138)
7. With respect to leasing arrangements referred to in Sections 21(1) and 21 (3) of the Act, the Minister determines a figure below which AN does not need to seek Ministerial approval. (Paragraph 151)

8. The value of contracts requiring Ministerial approval, under Section 23 of the Act, be raised to $2m or such other amount as the Minister determines. (Paragraph 152)

9. Section 33, which requires Ministerial consent for the carriage of passengers and goods on a railway before it is open to traffic, be repealed. (Paragraph 153)

10. As Ministerial approval for AN to carry out special repairs, alterations, renewals and extensions is not required, Section 37 of the Act should be repealed. (Paragraph 154)

11. Section 46 (3) which requires Ministerial approval for salaries above a prescribed level, be repealed. (Paragraph 155)

Public Service Obligations

The Committee recommends that:

12. With respect to Public Service Obligations (PSOs):
    (a) When the Minister agrees to the continued operation of a PSO, AN should receive a revenue supplement and all such supplements should be identified collectively and separately in either Appropriation Bill No. 1 or 2, as well as in AN's Annual Report;
    (b) AN should include in its Annual Reports, details of cases where its applications for PSOs have been rejected or varied by the Minister; and
    (c) From time to time the Government should engage either consultants or the Auditor-General to examine the efficiency with which PSO activities are conducted; and these reports should be tabled in Parliament. (Paragraph 113)

13. AN does not delay PSO applications to the Minister until it has introduced its Cost Management Information System (CMIS) but proceeds immediately with a systematic identification of likely PSOs and then requests explicit funding through Section 44 of the Act for the continuation of these services where warranted. (Paragraph 110)

Accountability

The Committee recommends that:

14. The Minister for Finance institutes a review of the appropriate form of AN's accounts, giving particular consideration to the role of AN as a commercial undertaking with certain public service obligations which must be clearly identified. The findings of this study should be reported to Parliament. (Paragraph 158)

15. AN's capital value be adjusted to a level for which AN is to be held accountable and on which it should be required to earn a rate of return. Capital provided by government for non-viable projects should be identified as such and remain separate in AN's accounts. Where possible, these projects should be accounted for as separate activities. (Paragraph 123)

16. Following a commercial adjustment of asset values, the Minister directs AN to earn a rate of return at such rate to be determined by him from time to time. (Paragraph 124)

17. AN provides a detailed flow of funds statement in its annual reports, sufficient to identify all categories of government funds and 'off-budget' borrowings. (Paragraph 159)

Corporate Planning

The Committee recommends that:

18. AN scraps its Corporate Cost Model as detailed in its Corporate Plans and obtains expert advice to produce a meaningful Corporate Plan document which is market-oriented. AN should also consider the transfer of its planning personnel from under the control of technically oriented engineers to either the marketing division or into a position whereby this group interacts directly with the General-Manager and the Commission. (Paragraph 108)

19. AN critically reviews its corporate planning assumptions and methodology. AN should improve its forecasting techniques, particularly with respect to the inter-relationships between freight rates and levels of service demanded. (Paragraph 86)

20. AN discontinues the practice of using the consumer price index both in its corporate planning processes and as a proxy for cost increases in its contracts. AN should develop a more appropriate index and undertake regular rate reviews. (Paragraph 84)

21. (a) AN undertakes a probabilistic evaluation of its forecast results and that such an evaluation becomes an integral part of its forecasting and therefore its Corporate Plan documents; and

(b) The Minister directs the Bureau of Transport Economics to assist AN in improving its forecasting techniques, including the introduction of the probabilistic approach. (Paragraph 95)

22. AN's management gives top priority to the establishment of its Cost Management Information System (CMIS) as this system is critical to AN's corporate planning process, its accountability to the Executive and Parliament and also its ability to show what the costs of PSOs really are. (Paragraph 99)

23. AN integrates its corporate planning process with the budget process as soon as possible, and presents the financial projections and other broad details of its Corporate Plans in its annual reports. (Paragraph 163)

Miscellaneous

The Committee recommends that:

24. AN establishes and maintains an effective Commercial Division which would primarily analyse the costs and qualities of its main competitors. In other words, this Division would analyse 'what the traffic will bear' and should not be directly responsible or in any way subserviant to another group in AN as may well be the case at present. Also the Commercial Division should continually work towards meeting new consumer demands, to enable AN to compete vigorously and expand where there are profitable rail opportunities. (Paragraph 148)

25. With respect to superannuation,

(a) AN explores the possibility of introducing alternative superannuation schemes involving provisions for lump-sum payments on retirement. There should be full discussions between employees and management before any new schemes are introduced;

(b) In the event of a successful conclusion to such discussions, consideration should be given to permitting AN to cease to be an approved authority under the Commonwealth Superannuation Scheme and operates in the same way as TAA by setting up a fund in its accounts to pay pensions or benefits as they arise and for which existing employees are entitled; and

(c) Until such time as AN's management has introduced an alternative scheme in consultation with its employees the Government accepts that AN's superannuation costs above those operated by private firms are funded through a specific revenue supplement as a PSO. (Paragraph 135)

26. When tendering against private firms, AN does so on a commercial basis. (Paragraph 118)

27. The government makes provision for South Australia, Tasmania and the Northern Territory to make a contribution toward the cost of any service provided by AN if they so desire. (Paragraph 111)

28. (a) The Minister for Transport, in assessing AN's financial performance, takes into account the constraints inherent in present intersystem arrangements;

(b) The Minister for Transport institutes an inquiry into the alternatives available to improve intersystem railway operational and marketing practices. Such an inquiry should include both passenger and freight operations and be asked to identify the relative benefits and costs associated with any changes to the current institutional arrangements; and

(c) AN take a firm stand in all intersystem negotiations and refuse to carry traffic which it does not consider to be profitable, even though some traffic may be lost as a result. (Paragraph 129)

29. The Department of Transport reassesses staffing required to handle AN matters. (Paragraph 164)

30. In 1985, or such other date as is convenient, the Minister institutes a review of AN's operations to assess its performance to that date in the light of the findings and recommendations made in this Report and the continuing impact of the Transfer Agreements on AN's financial results. (Paragraph 165)

Chapter I: Introduction

Inquiry Objectives

1. The main reason for the Committee inquiry into the Australian National Railways Commission (subsequently referred to as Australian National or AN) was concern at the large sums of money voted annually by the Parliament to offset AN's operating losses. These losses totalled $274m. for the four years ending 30 June 1981.[1] Even if AN's goal to eliminate these losses by 1987-88 is achieved, the organisation will by that time have accumulated losses of over $500m. since 1977-78.[2]

2. The objectives of this Report are to address three interrelated questions on the deficit:

- the specific causes of these deficits;
- AN's response to the reduction and elimination of these deficits and an evaluation of this work; and flowing from this
- what else needs to be done to improve the performance and accountability of AN.

3. These Report objectives have to be placed in a particular framework. AN is a public authority business undertaking. These undertakings are usually established to perform certain functions and to achieve objectives which are thought, at the time of establishment, to be more effectively and efficiently done by a publicly owned rather than a privately owned business.

4. One important function of modern public business authorities is to achieve explicit or implicit government objectives with as little explicit cost to governments as possible. This is done by establishing the undertaking as a monopoly by appropriate legislation and by using the higher rates of return in some areas of monopoly to cross-subsidise goods or services in other areas. The use of internal cross-subsidy to achieve government objectives without direct and explicit cost is obviously very attractive. Its use in transport is well-known and in the period before 1950 was reasonably successful. It is clear that absence of any significant monopoly power in a market means that internal cross-subsidy is no longer feasible, at least to the same extent.

5. Monopoly power was, many years ago, a feature of railway transport. It has progressively been eroded by the development of the transport abilities of motor vehicles and, to a lesser extent, aeroplanes. Coupled with this erosion in Australia was the inability of the railway systems, largely as a result of Section 92 of the Constitution, to maintain their monopoly by legislation.

6. Railways in general, including AN, are still required to meet public interest objectives, but no longer have sufficient monopoly power to do so only by cross-subsidy. Unlike some other public authority business undertakings AN competes directly with the private sector and there are few barriers to the entry of competitors, particularly in road transport. Road, sea and air transport are alternative modes for the carriage of passengers and freight in many AN markets. But unlike most of its competitors, whose performance is monitored by the market, AN is a wholly owned public undertaking which, while operating in a market environment, is responsible to the Minister and answerable to Parliament. AN is subject to government policy objectives, including the commercial (profitability) criterion which AN interprets as its basic corporate objective. In order to assess AN's efficiency and effectiveness as well as the costs and benefits of implementing government policy through the organisation, AN must be accountable to Parliament.

Theme of Report

7. The Report theme is the key to unlocking AN's interrelationship with the government and the market. The Committee considers that AN should ursue the profitability objective unless specifically instructed by government to do otherwise.

8. Governments may attempt to achieve two main objectives through the pricing of the transport facilities and services they provide: economic efficiency and distributional or public interest goals. Economic efficiency is concerned with the best (optimal) use of resources, meaning the use of resources in producing those outputs which consumers will value most. In an economy in which resources are allocated efficiently, the relative prices of outputs would reflect their relative resource costs, especially for outputs which are good substitutes for one another. In relation to the total resource costs of providing each mode, consideration should also be given to the environmental and social costs of *providing each mode.*

9. Application of this principle to the transport industries requires that, in the absence of particular reasons to the contrary, a policy of deficit elimination for AN should not be applied in isolation from any attempt to apply equivalent cost recovery principles to long distance road transport. If this happened then AN, however internally efficient, may operate in an environment which causes its operations to contradict rather than reinforce resource allocation efficiency. While it is arguable whether long distance road transport does or does not cover its full costs, it is clear that AN recovers a much smaller proportion of its total costs than long distance road transport. AN, unlike long distance road transport, does not even cover its operating cost.

10. The successful pursuit of the profitability objective in the Act would eliminate the deficit and enable the government to achieve full cost recovery. The drain on budget resources would then be limited to the explicit funding of public service obligations (PSOs) which may be regarded as obligations which AN, if considering its own commercial interests, would not assume to the same extent or under the same conditions. (see paragraph 38)

11. The government would then be accountable for its subsidies which are made explicit. At the same time, AN's efficiency and its performance would be more easily monitored by Parliament.

12. AN's interactions with the government and the market are complex and are further compounded by the pervasive effects of the terms and conditions embodied in the Transfer Agreements covering the Commonwealth acquisition of the State railways of South Australia and Tasmania. The Committee's inquiry has resulted in its formulation of the major theme of this Report:

> AN's commercial objective must predominate and therefore the scale and range of operations of AN should be determined by customer preferences for its services subject only to explicit government directives in the form of public service obligations (PSOs), including the obligations embodied in the Transfer Agreements.[3]

Overview of Report

13. Reconciliation of competitive pressures and government directives to AN is possible only if the profitability objective is made to override all others, and government policy directions, together with obligations embodied in the Transfer Agreements, which impinge on AN's profitability are identified and explicitly funded as public service obligations (PSOs).

CAUSES OF AN's DEFICIT

14. The Committee has collected evidence which indicates that services which may be classified as potential PSOs contribute between 33% and 43% of AN's annual operating loss. On this basis, of the 1979-80 loss of $64.8m. likely PSOs would account for somewhere between $21m. and $28m. Most of the remaining deficit would then be attributable to past and present bad business decisions. Any attempt to identify the elements that make up this deficit is made difficult by AN's lack of action in applying for PSO funding under Section 44 of the *Australian National Railways Act* 1917 (subsequently referred to as 'the Act').

AN's ATTEMPT TO ELIMINATE THE DEFICIT

15. AN's attempt to eliminate the deficit by 1987-88 is embodied in its annual Corporate Plans which are basically projections of AN's operations. The quality of AN's planning is critical to any assessment of whether the goal of eliminating the deficit by 1987-88 will be achieved. In two of the last three years the results have been worse than projected in the plans. If AN fails to achieve its yearly targets then the question to be asked is whether the plans are realistic. If they are not realistic then management decisions taken in the context of following these planning documents will be badly based and may even be detrimental to deficit elimination.

16. While recognising AN's acceptance and adoption of corporate planning processes, the Committee has noted certain deficiencies in AN's plans. It is clear to the Committee that certain causes of the deficit are not being remedied by AN's management. The long lead time involved in the establishment of the Cost Management Information System (CMIS) and the reluctance of AN to pursue PSO applications with the Minister are two of the more serious management related problems. Recommendations dealing with these issues have been made.

17. An analysis of planning documents issued to date by AN and its actual performance leads the Committee to have serious doubts about whether AN will realise its stated corporate goal of deficit elimination by 1987-88 if it attempts to follow the course of action detailed in its plans. The principal reasons for this doubt are the Committee's belief that:

- the assumptions and presumptions on which the plans rest are unrealistic; and
- the plans fail to consider explicitly the interaction of key variables such as freight rates and traffic growth.

For these reasons, departures from projections are likely, particularly with regard to labour costs and traffic volumes.

18. Notwithstanding these problems with the Corporate Plans AN's management must still attempt to achieve its objective of deficit elimination by 1987-88. This will mean acquiring the necessary expertise to completely revamp its plans and modifying proposed courses of action accordingly. Appropriate recommendations have been made by the Committee.

IMPROVING AN'S PERFORMANCE

19. The recommendations of our Report attempt to overcome constraints which inhibit the decision-making ability of AN's management. Some of these constraints such as planning deficiencies are internal to AN and should be remedied by its management. Others, such as operational, legislative and financial constraints require changes which AN alone cannot induce: these include difficulties with intersystem arrangements and numerous legislative restraints which inhibit AN's performance. The Committee believes it should be the catalyst in overcoming some of these restraints and has recommended appropriate changes to the Act.

IMPROVING AN'S ACCOUNTABILITY

20. The Committee has cautioned against an assessment of management performance on the basis of existing operating losses as presently defined in AN's annual accounts. It has recommended alterations to the treatment of AN's capital in its accounts which, together with the explicit funding of PSOs and their identification as such in the annual accounts, will improve the usefulness of the financial accounts as a measure of management's performance.

21. The major interests of government should be to set objectives, to monitor the differences between promise and performance by AN and to decide on the extent of funding of PSOs. Although the Committee has identified a number of impediments to the attainment of the corporate goal of deficit elimination by 1987-88, it is confident that implementation of its recommendations will substantially assist AN to this end, reduce the drain on government expenditure and improve AN's accountability to the Parliament.

22. For Parliament to perform its scrutiny role, annual reports should contain relevant information on projections (the corporate plans), performance (financial results which can be interpreted in a meaningful way) and PSOs (in both the capital and current accounts). Therefore the Committee has recommended a number of changes to AN's reporting process which will improve its accountability to Parliament.

Chapter II: Description of Australian National

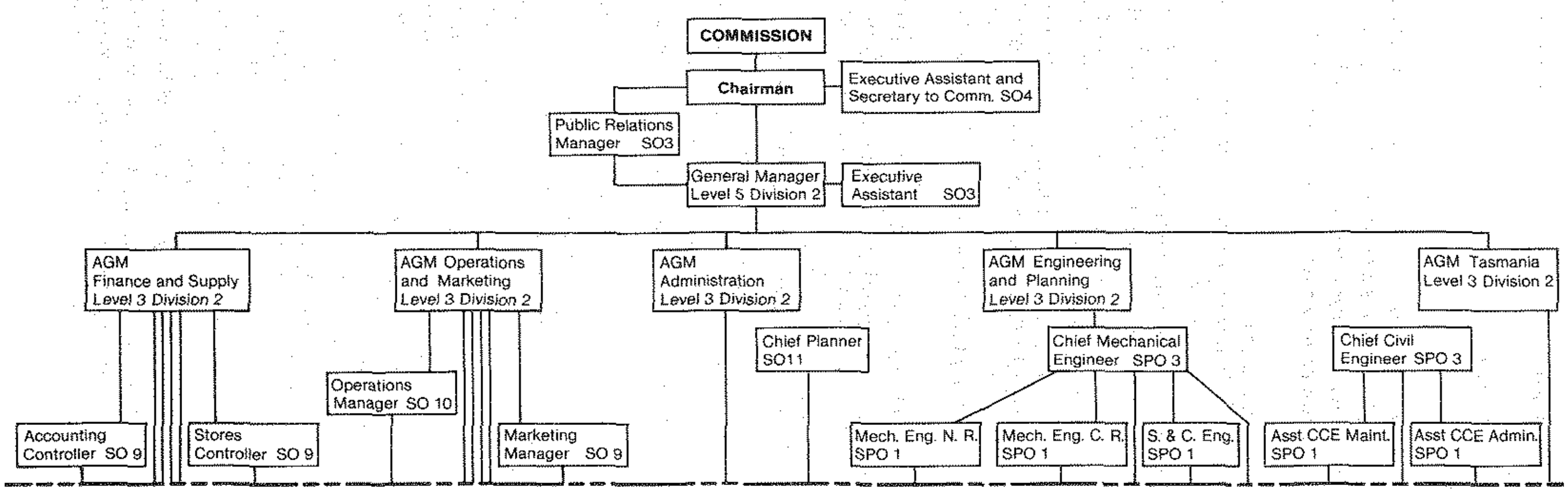
Establishment and Structure

23. AN was established on 1 July 1975 to take over the duties and functions of the former Commonwealth Railways Commissioner and to ultimately assume control of the former Tasmanian Government Railways and the non-urban sector of the former South Australian Government Railways. The latter required the signing of Transfer Agreements between the Commonwealth and the States of Tasmania and South Australia respectively.

24. Because of the need to develop common conditions of employment in the three hitherto separate systems and the requirement to transfer assets to AN, and the difficulties associated with such tasks, it was not until 1 March 1978[1], almost three years after the Act was proclaimed, that AN took over full responsibility for running the former State systems.

25. The management structure and organisation of AN has evolved progressively since amalgamation. The structure as at 1 August 1981 is presented in Figure 1. The Act provides for the appointment of a full-time Chairman and six part-time Commissioners. However, only five part-time Commissioners have ever been appointed. Commissioners are appointed by the Governor-General for a term not exceeding five years, but they are eligible for re-appointment. As at 19 August 1981, four part-time Commissioners were appointed for five years. All current appointments expire on 13 October 1985. The Chairman's appointment is for a period of five years which terminates on 15 March 1986. The Chairman receives a salary of $56,500 plus an allowance of $3,075 while the Commissioners receive a fee of $6,800.[2] The General-Manager as the chief executive officer of AN, is appointed by the Commission, but the appointment is subject to the approval of the Minister.

Figure 1 **Top management structure of Australian National Railways Commission, August 1981**



Operations

26. AN has interpreted its functions as:

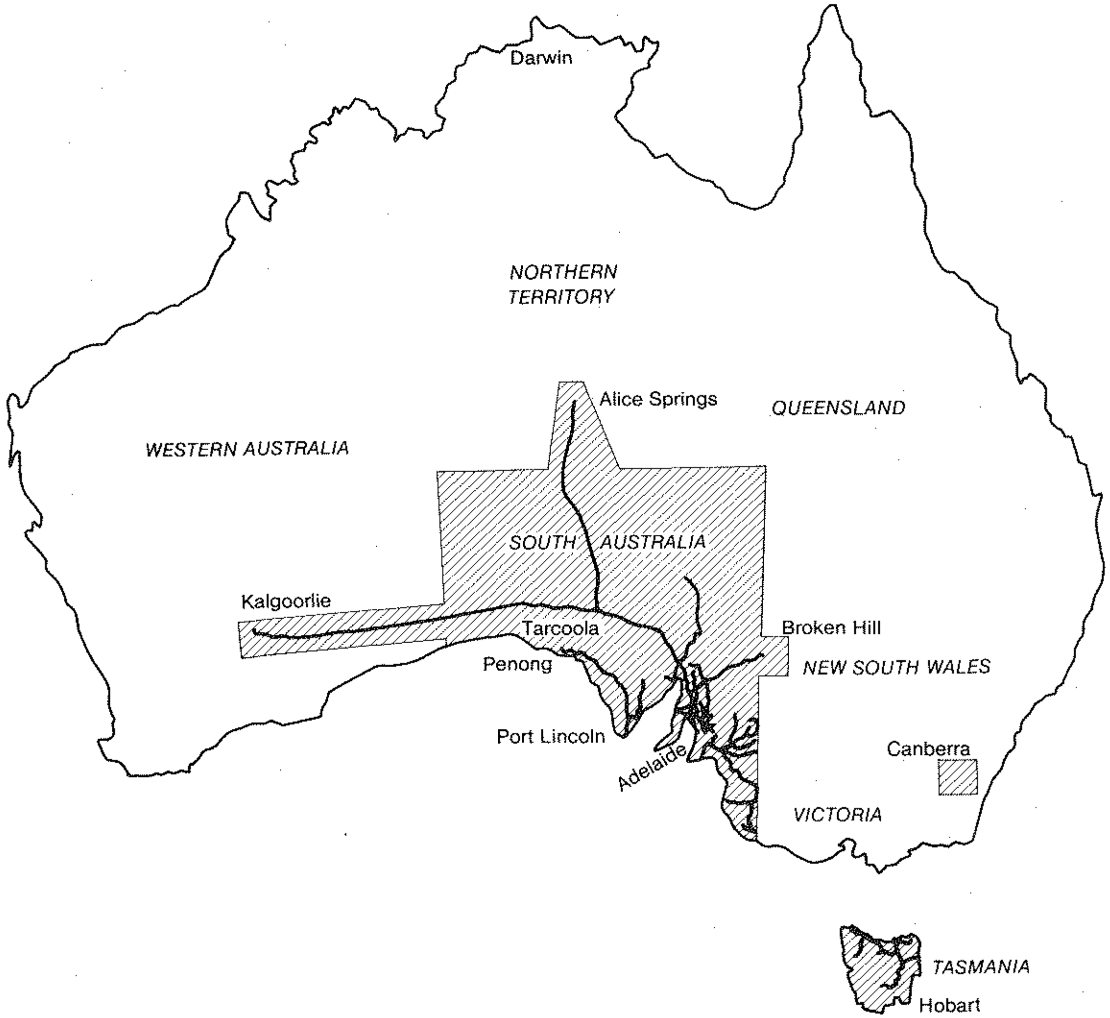
'– to operate rail services over those railways built or otherwise vested in it.
- to operate such other services as are authorised by the Act.
- to construct railways pursuant to the provisions of the Act.
- to provide technical advice and assistance at the request of the Commonwealth.
- to do anything incidental or conducive to these functions, including cooperation with State railways and other transport undertakings.'[3]

These functions are embodied throughout its Act, particularly in Sections 29 (1), 31 and 65 (1) (see Appendix 2 for extracts from the Act). In performing its functions, AN is required to pursue a policy directed towards reaching a profitable situation.[4]

27. While AN provides both passenger and freight services, it is freight services which dominate. In 1980-81 revenue from passenger operations totalled $17.7m. compared with freight revenue of $150.2m.[5] AN carried 12.7 million tonnes of freight in 1979-80, with an average length of haul of 442 kilometres per net tonne.[6]

28. Geographically AN's operations are illustrated in Figure 2 and comprise: the Tasmanian region; the Central region (basically the South Australian country network); and the Northern region (extending from Broken Hill across to Kalgoorlie and north to Alice Springs, plus the Australian Capital Territory line).

Figure 2 **Location of AN's operations**



29. AN provides intrastate services for clients over which it maintains full control from origin to destination. However, AN also operates over two major interstate routes which require cooperation with State railway authorities. In general the rate negotiations with the client are carried out by the authority which originates the traffic, in consultation with the other railway authorities involved. Furthermore, once traffic originated by AN is transferred to the State railway systems at the borders, the courses of action open to AN to satisfy customer requirements are limited. Therefore AN's management is constrained by the extent of its intersystem activities from both an operational and rate-setting viewpoint. In 1977-78, revenue from intersystem traffic totalled \$55.6m,[7] while total revenue for the year was \$122.0m[8] Intersystem revenue thus accounted for nearly half of total AN earnings in 1977-78.

30. Two rating structures apply to the movement of intersystem freight traffic. The movement of smaller consignments between systems generally incur the Railways of Australia 'book' rates, while intersystem special rates apply to more significant intersystem traffics, the details of which are not published.[9] Local AN traffic is carried under either classified or special rates.[10] These classified rates are published and apply to such major commodities as grain, fertilisers, petroleum products and livestock. Special rates are not published and cover such commodities as Leigh Creek coal, Broken Hill concentrates, gypsum and local traffics where AN feels that it is necessary to quote special charges to secure loading.[11]

Relationship With Government

31. Besides maintaining considerable interaction with state rail systems because of the nature of its traffic task, AN, as a wholly government-owned authority, must be continually involved with the Minister for Transport and therefore his Department. The Act requires AN to submit to its Minister (and therefore the Department of Transport) quarterly and annual reports and such further reports as the Minister requires.[12] These reports are to include details of special rates made by AN and the Minister must approve all tolls, fares and charges.[13] In addition, the Minister may direct AN to make alterations to its undertakings, but provision is made for reimbursement to AN where these directions adversely affect the railway accounts.[14]

32. The Department of Finance has an ongoing involvement with AN since the Minister for Finance, on behalf of the Commonwealth, is required to rovide funds to AN through the Budget. Broadly speaking, there are three categories of government funds —capital works and services, an operating loss subsidy and the reimbursement of concessions. In addition, AN has the ability to go 'off-budget' and raise funds at semi-government rates, subject to the approval of the Treasurer. This power was granted only recently[15] and involves a guarantee of repayment by the Commonwealth.

33. The Government has given a direction to the Commission to pursue a policy directed towards making profits in each financial year. These profits are to be sufficient to earn a return on capital. Although required to make profits, the amalgamated system immediately faced a loss of approximately \$1.70m per week when it effectively commenced operations in 1977-78.[16] AN's immediate concern, and its main corporate objective,[17] is elimination of its annual operating deficit. This target has been set at 1987-88. However, the Committee notes that the governments of South Australia, Tasmania and the Northern Territory may wish to contribute towards the costs of providing particular services. An appropriate recommendation to facilitate such payments has been made.

Chapter III: Causes of Australian National's Deficit

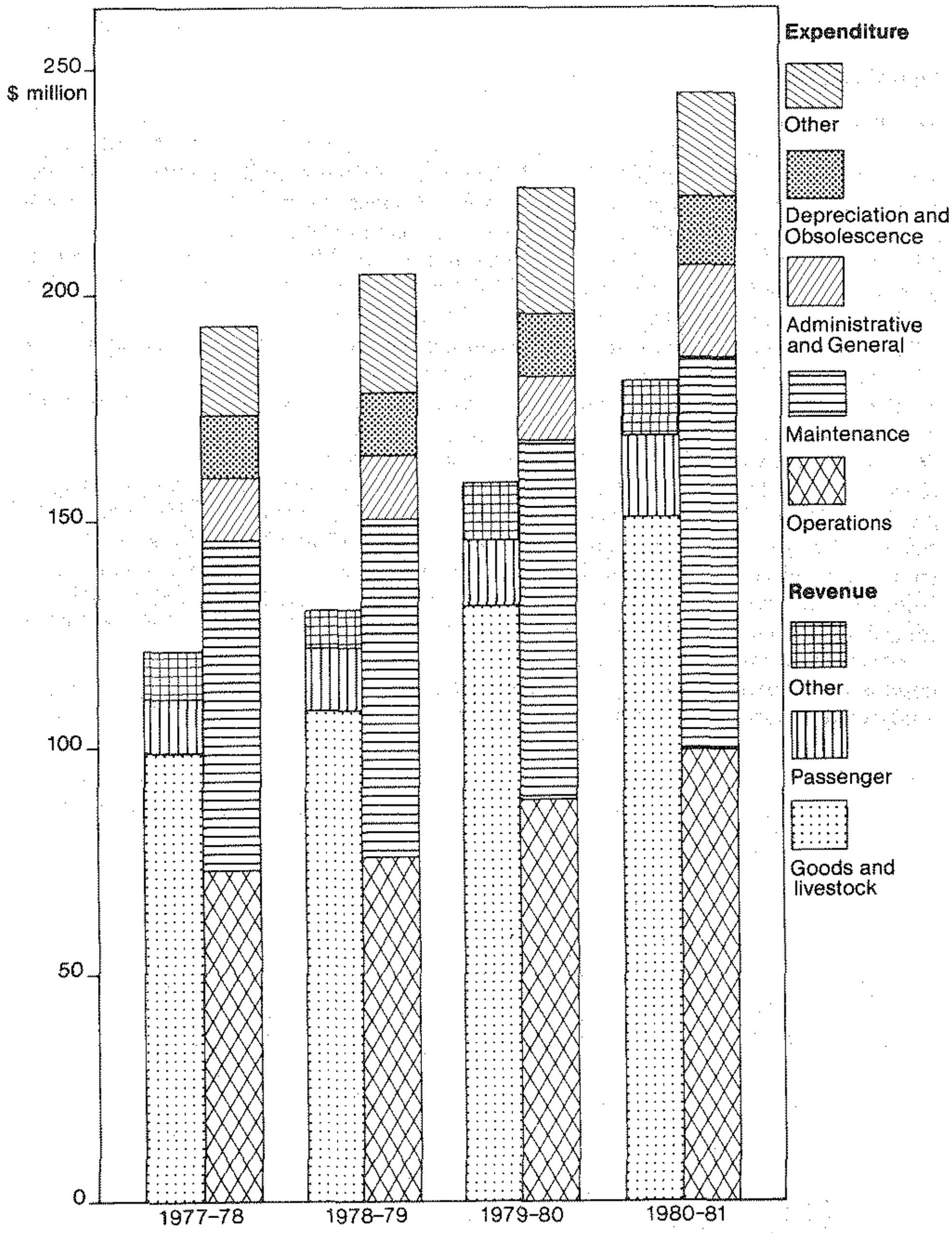
Annual Deficits

34. The starting point of our analysis is an examination of the causes of AN's deficits. An attempt is made in this chapter to itemise major factors which contribute to the deficit. Estimates of the magnitudes of these items are drawn from a number of sources, including published reports, speeches, written responses by AN to Expenditure Committee questions and other evidence taken in the course of this inquiry.

35. Details of AN's annual revenue and expenditure are illustrated in Figure 3. A copy of AN's profit and loss statements for 1979-80 and 1980-81 are provided in Appendix 3. Both revenue and expenditure have climbed steadily over the four year period ending 1980-81. The annual operating loss (excluding abnormal items) has declined from \$73.8m in 1977-78 to \$62.7m in 1980-81, although there have been changes in the treatment of certain items in the accounts which makes a straightforward comparison misleading.

36. Any service which does not even cover the direct cost associated with its provision obviously contributes to the deficit. This direct cost is defined as the cost saved if the particular service was not provided. However, even if all services performed by AN covered their direct cost, AN could still make an overall loss because insufficient revenue, above direct cost, was earned to cover indirect costs. Thus the amount earned from a service over and above direct costs should be as high as market conditions permit, so that a contribution to indirect costs can be earned. It follows from this point that to concentrate management's attention solely on services which do not cover direct costs is inadequate, although it is a good starting point. Other traffic should also be analysed to ensure that an appropriate revenue contribution is being earned.[1]

Figure 3 **AN's revenues and expenditures, 1977-78 to 1980-81**



Source: AN's *Annual Reports* 1978-79, 1979-80 and *Financial Statements* 1980-81

37. The size of the deficit can be used to give some indication of managerial performance. If this is done it is a more meaningful guide if PSOs are separately accounted for. The deficit will then give some indication of the extent of bad business decisions rather than PSOs.

Public Service Obligations

38. As a public authority business undertaking AN has certain PSOs, which are defined as obligations which AN, if considering its own commercial interests, would not assume either at all or to the same extent or under the same conditions. Two necessary conditions must both be met, before an obligation can be treated as a PSO. The obligation must be accepted by government as fulfilling an undertaking incurred by government either:

(a) because, in the current Government's opinion, it is in the public interest to do so; or
(b) because it is a consequence of previous government obligations (eg. the Transfer Agreements) and the costs of its provision will exceed its revenues when the service is provided as efficiently as possible.

In both cases, in the provision of services, the maximum revenue consistent with the government's obligations must be obtained and the relevant costs associated with the service must be minimised. It should be noted that PSOs are not mentioned as such in the Act. However, the mechanisms for funding them are embodied in Section 44 of the Act which provides for funds to be paid to AN through the Annual Appropriation Act to the extent certified by the Auditor-General.

39. AN has identified the losses associated with non-viable lines and services which might be classified as potential PSOs. These losses totalled $31.4m in 1978-79 and were not separately funded through Section 44.[2] As the operating loss reported by AN for 1978-79 was $72.9m[3] before abnormal items, this evidence suggests that potential PSO losses accounted for approximately 43% of the deficit. AN has also estimated that probable PSOs 'represent about one-third of our deficit of about $60m'.[4] The Committee thus has some evidence that potential PSOs represent between 33% and 43% of AN's annual loss. On this basis, of the 1979-80 loss of $64.8m, likely PSOs would account for somewhere between $21m and $28m.

40. The Committee has identified that the following items may be expected to be the main PSO candidates (all or in part) and the subject of future approaches to the government by AN for specific reimbursement:

(a) passenger services;
(b) less than container load (LCL) and parcels traffic because of the common carrier obligation;
(c) branch lines;
(d) Tasmanian region;
(e) superannuation costs above commercial rates; and
(f) obligations imposed by the Transfer Agreements.

41. The most recent estimate of annual passenger related losses was provided by AN as $13m in 1979-80 although it should be emphasised that this figure is an interim estimate only.[5] This compares with evidence which suggests that country passenger operations in the Central Region incurred losses of approximately $9m, and intersystem passenger

operations losses of approximately $4m, in the 1976-77 deficit of the former Rail Division of the South Australian State Transport Authority.[6] AN stated in response to a Committee question in regard to the existence of break-even capacities on passenger services, particularly the Indian Pacific:

> 'The short answer is that there is not one based on current manning levels.'[7]

42. LCL and parcels traffic is estimated by AN (in 1978-79) to cost the system $11.5m to undertake and generated gross revenue of $3.5m, leaving an $8m loss which is also estimated (on an interim basis) to be that pertaining to 1979-80.[8] It is not possible to determine from AN's financial statements annual revenue generated by this class of traffic as LCL freight revenue, other than that from parcels and mails, is included in total goods revenue.

43. The carriage of LCL and parcels traffic has been included by the Committee as a likely PSO, because of the common carrier constraint on AN. This common carrier obligation is contained in Section 34 of the Act. Being a common carrier means having certain responsibilities for providing transport services to the public, including the requirement that the carrier must undertake to serve all users who apply to use its services without discrimination. There are limits on these responsibilities, and a common carrier can limit its services in some degree by refusing to carry certain types of goods, so long as it does so for all users.

44. The common carrier obligation thus makes it difficult to withdraw from certain types of business. It is likely, furthermore, that the responsibilities which a common carrier is deemed to have will induce it to retain some loss making traffics. This was one of the reasons for relieving British Rail of its common carrier obligations in 1962. The Victorian Railways have also recently had their common carrier status removed.[9]

45. Another likely PSO is the operation of branch lines. Branch line losses in 1979-80 total $4m.[10] This figure refers almost entirely to lines located in the country area of the former South Australian Railways (Central Region).

46. The entire Tasmanian network contributed $13m to the deficit in 1979-80. [11] No passengers have been carried in Tasmania since 1978-79 and hence the entire deficit is attributable to freight operations. It is worthwhile noting that the report entitled *Tasmanian Railways*, which became known as the 'Joy Report' commented on the Tasmanian system as follows:

> 'Tasmanian Railways will never make a profit [12] and 'If in the future the Tasmanian Government should wish to have a higher level of service, or lower freight rates than can economically be justified, we recommend that the cost of these should be specifically determined and reimbursed to the Australian National Railways Commission, as provided in para. 7 of the Transfer Agreement.'[13]

47. AN's accounts include an annual charge for superannuation which until 1980-81 was based on 25% of the salary and wages of its employees who contribute to superannuation. AN's liability as an employer has been in the form of regular cash payments to the government's Consolidated Revenue Fund (15%) while the remainder (10%) was a provision to meet payments (the exact extent of which is yet to be determined) which relate to post retirement superannuation pension increases. At 30 June 1980, AN's employees totalled 11,756 of whom approximately 5,600 (48%) contributed to superannuation.[14]

48. It appears that superannuation provisions, to the extent that they are provided by private firms, cost them approximately 8% of the employee's salary.[15] If AN could operate a scheme at similar cost, then their superannuation charge would have been $5m. instead of $14m. in 1979-80. On this basis, annual superannuation costs for 1979-80 may be said to be $9m. higher than for private firms, although attention must be paid to superannuation schemes operating in State rail systems. The Committee regards this amount of $9m. as the PSO element. It should be noted, however, that in general AN's competitors such as freight forwarders and road transport firms do not provide any superannuation benefits to the majority of their employees. The superannuation issue is further discussed in paragraph 135.

49. Other PSOs, which have an effect across the entire spectrum of the AN organisation and its services, are embodied in the Transfer Agreements which specified certain terms and conditions as the consequence of the takeover of the State systems. Three major categories of obligations under the Transfer Agreements are:

(a) those relating to passenger fares, freight rates and other charges;

(b) those relating to line closures or reductions in levels of service; and

(c) those relating to transferred staff.[16]

50. Procedures do exist for AN to vary any of the above. In fact, arbitration is possible where agreement cannot be reached with the State Minister for Transport. Arbitration has been used once, resulting in the cessation of Tasmanian passenger services. Reductions in levels of service have been preferred by AN to outright line closures.

51. The Committee notes that Section 44 has only been used once to provide funds to AN. Perhaps a major reason for this has been the inability of AN to accurately estimate the costs associated with various traffics, lines and services. By awaiting the introduction of its computerised costing system (CMIS), AN can be more confident that any costs it places before the Minister with respect to PSOs will be accurate. However, this appears to be an extremely conservative stance to adopt, as application for cessation of activities, or alternatively, revenue supplements, will have been delayed by at least five years (1978 until 1983). Manual extraction of the necessary data is possible and has been done by AN, at least in part, in providing evidence to this Committee.

52. In summary, the Committee has identified the following PSOs, as contributors to AN's 1979-80 loss:

(a) passenger services—($13m)

(b) LCL and parcels—($8m)

(c) branch lines—($4m)

(d) Tasmanian Region—($13m)

(e) excess superannuation costs—($9m)

(f) Transfer Agreements (not quantifiable).

53. The above classification is not mutually exclusive. For instance, some losses incurred because of the Transfer Agreements or the losses calculated for an area or line will contain elements of costs included in other PSOs e.g. passenger services and LCL and parcels traffic. Therefore, any attempt to add losses identified in the above list will certainly result in double counting. However, classification of PSOs purely by activity, e.g. passenger services plus LCL and parcels, gives an estimate of $21m., which is the lower limit of the Committee's PSO estimate of between $21m. and $28m. (paragraph 39).

54. A difficulty with quantifying potential PSOs is that AN may not be either providing these services at minimum cost or maximising the revenue received from them. Even if the level of service is determined by government and is beyond AN's control, AN should still be able to minimise costs and maximise revenue. It is therefore possible that the dollar estimates of activity losses detailed above can be reduced but it is extremely unlikely that they will ever be eliminated unless these activites are terminated. On this basis the Committee has classified these activities as potential PSOs.

Bad Business Decisions

55. The annual operating loss ($65m in 1979-80) which cannot be assigned to PSOs, must be the result of bad business decisions. Between $34m and $44m of the deficit can be attributed to management. The difficulty inherent in this point is that these bad business decisions are the result of both past and present management of the railways and cannot be attributed to present management alone. Furthermore, it should be recognised that there has been a change in the market environment in which railways operate, and in the view taken of the proper functions to be performed by a public authority railway undertaking.

56. The Committee has isolated the following six factors as contributors to the bad business decisions inherent in the deficit:

(a) failure to set correct initial rates for services;
(b) inadequate escalation of rates to cover increases in costs;
(c) failure to offer the appropriate quality of service to customers;
(d) underutilisation of equipment;
(e) underutilisation of labour; and
(f) the inability of management and unions to agree on variations to established working arrangements.

57. Evidence was given by the National Freight Forwarders Association that some AN services were underpriced.[17] The submission from the South Australian Branch of the Australian Workers Union also made the same observation:

> '(I)t is a submission of this Union that substantial increases in revenue would be available to the ANR if it were to charge what the market could bear in relation to freight rates generally'.[18]

Furthermore, the contracts for special (unpublished) rates which were available to the Committee did not suggest that AN had undertaken any significant market research in order to establish a maximum rate based on what the traffic would bear.

58. The structure of the rate escalation clauses in contracts is also tangible evidence to the Committee that inadequate market research has been undertaken to establish rates and furthermore that AN has not determined what the actual cost increases are in particular cases. It is to be expected that weakness in demand may have an adverse impact on the ability to pursue some rate increases, even in times of inflation. The actual form taken by escalation clauses are partly due to the inheritance by AN of the Tasmanian and South Australian systems. Contracts written in these systems often provided for rate increases of about 50% of the consumer price index (CPI). Later contracts written by AN provide for escalation clauses in the range 70% to 100% of the CPI. The Committee estimated the following distribution of contracts across this range from a sample of contracts whose total value was $39.3m. in 1979-80:

- 17.3% with 60% CPI
- 9.8% with 70% CPI
- 55.8% with ROA Conference escalation (ie. not less than 70% CPI)
- 13.8% with approximately 90% CPI
- 3.2% with approximately 100% CPI.[19]

59. While it may be difficult to determine the cost increases of particular traffics, the question to be asked is whether the CPI is an appropriate index. Using a formula with weights of 80%, 15% and 5% for labour, fuel and steel rail costs respectively, a study undertaken by Westrail[20] yielded the conclusion that costs so defined had increased at a much faster rate than the CPI in the period 1952-74, and at about the same rate as the CPI in the period 1975-79. At no stage did costs increase at a rate significantly slower

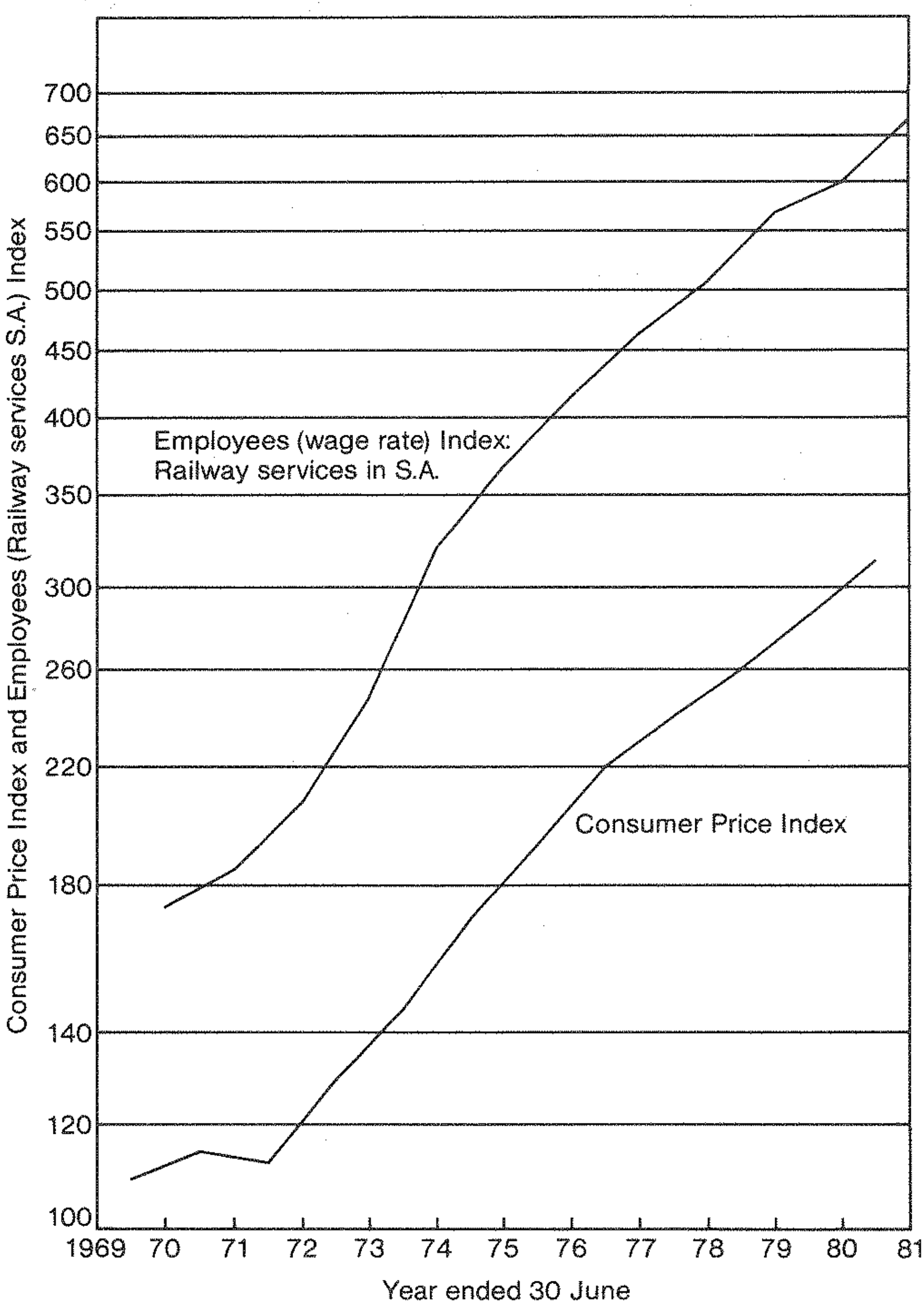
than the increase in CPI. Although the Westrail study has many deficiencies, it raises serious doubts as to the use of the CPI as an index to increase rail rates.

60. These doubts are confirmed by an examination of relative movements in the CPI and rail wages. The rail wage index used in this Report is the Employees (Railways Services—South Australia) Index, as compiled by the Australian Bureau of Statistics. This index does not include over-award payments.

61. Relative movements in these two indices are plotted in Figure 4. This graph is not arithmetic but semi-logarithmic because the Committee is interested not in absolute changes in each index but in a comparison of the percentage rates of growth in the two index numbers. For the railway wage to move in line with the CPI these two lines in Figure 4 must be parallel. This is not always the case. Over the ten year period 1970 to 1980, the CPI has risen 287%, while the railway wage index for South Australia increased by 384%. It must be noted that any over-award payments are not included in this index. While there will be productivity increases, it is doubtful whether they will always be sufficiently large to outweigh the increase in wages relative to the increase in the CPI. Care must be taken in interpreting Figure 4, because labour productivity increases must be allowed for when attempting to derive information about labour cost changes from a railway wage index.

62. A large proportion of traffic on AN is intersystem in nature. In 1977-78 AN revenue from intersystem traffic totalled 45.6% of their total revenue.[21] The intersystem special rates (under which the bulk of intersystem traffic moves) are usually negotiated by the system in which the traffic originates, in consultation with the other systems involved. Therefore the rating and cost recovery policies followed by other systems have a strong effect on feasible policies to be pursued by AN. AN's only choice may be to refuse carriage below a certain rate.

Figure 4 **Consumer Price Index and Employees (Railways Services—South Australia) Index 1969-81 (Semi-logarithmic scale)**



63. AN has said that intersystem wagon load rates 'generally cover the direct cost of the traffic concerned and make a reasonable contribution to other costs'.[22] This may be an indication that traffic moving under intersystem special rates is covering associated direct costs and is therefore not a cause of the operating deficit. As noted earlier (paragraph 36) intersystem traffic should not be overlooked in AN's attempt to pursue profitability, simply because the rates may not be pitched at a level which generates the maximum possible revenue, not just 'a reasonable contribution to other costs', although AN may be restricted in this by the Transfer Agreements.

64. Evidence has been given before the Committee that for some traffic tasks a higher freight rate associated with better quality of service (reliability, time in transit, frequency, etc.) would be more acceptable to the user than lower quality services at lower rates.[23] A whole range of price/quality combinations are offered by AN's competitors. Quality of service may be improved while relative prices are constant, the expected result being a modal shift of traffic. An example of this shift may be the upsurge in rail traffic predicted by AN to result from completion of the Adelaide-Crystal Brook standard gauge link. Bogie exchange of wagons at Port Pirie will be eliminated, reducing transit times. Partial standard gauge services are intended to commence by mid to late 1982, with completion of the line scheduled for the end of 1984.[24]

65. AN has estimated that if service quality was improved the freight forwarders' traffic could be increased by 15 to 20%.[25] It is not clear what additional costs would be incurred to gain this traffic, nor is it clear whether this traffic gain would eventuate if rates were increased at the same time. In the absence of a detailed market analysis by AN no estimate can be made of the contribution to the deficit of inappropriate levels of service. Service quality can be improved either through more efficient operations at the same price, or by incurring increased costs to provide a better service (and, in the process increasing the freight rate which results in revenue increases greater than cost increases).

66. The Committee has not concentrated its efforts on a detailed analysis of the technical efficiency of AN's operations. However, under-utilisation of equipment may be an important cause behind the operating losses of AN. For instance, the Bureau of Transport Economics (BTE) has estimated that for South Australia there existed a potential for cost reductions of $7m per annum (at June 1977 prices) if the utilisation of wagons was improved.[26] The majority of these potential savings were associated with the general freight traffics, where the provision of general freight services to a large number of small stations was the main cause of under-utilisation. However, as rationalisation of services has taken place since 1977, the extent to which the underutilisation of wagons now contributes to the deficit is unknown.

67. Another operational saving can be achieved by the through running of locomotives on main intersystem links, thus avoiding time delays at intersystem borders.[27] No estimate has been made by the Committee of possible cost reductions flowing from this course of action or other possible operational and maintenance savings (such as centralised wagon control). However, AN has estimated in the initial evaluation of Western Australian through running (ie. if AN's locomotives ran to Perth and Westrail's ran across AN's system), that eight locomotives could be eliminated out of the 29 which operated the service.[28] As the current price of locomotives is approximately $1.1m, potential savings in capital replacement costs in the order of $8.8m may be able to be realised. Also the BTE estimated that the operational cost of the bogie exchange in Port Pirie was $23.89 per wagon or $1.35 per net tonne.[29]

68. Besides the under-utilisation of equipment, under-utilisation of labour as a result of overmanning is an important cause of the deficit. Confidential evidence available to the Committee has clearly indicated that the labour force is at present underutilised. AN's

corporate planning relies on large staff reductions, achieved by natural wastage, to achieve breakeven. Although the precise estimate of staff levels in 1987-88 varies according to the projections of variables such as growth of traffic, AN is aiming for a staff of around 8,000 by that year. The average number of employees in 1979-80 was 11,939.[30] Hence a reduction of approximately 4,000 employees is planned. The basis for this staff reduction is service and cost-cutting, rather than revenue maximisation and efforts to gain additional work, as a means towards profitability. This latter alternative policy of extensions into profitable areas should also be seriously considered.

69. Large reductions in AN's workforce are thus projected, coupled with traffic growth (AN assumes in most cases a traffic growth of 3% per year). Labour productivity is to be improved over the period to 1987-88 either through the non-replacement of staff who at present contribute little to real output, or plant and equipment is to be substituted for labour. These two processes are coupled with traffic growth in AN's projections. It is therefore not possible to extract from the plans an assessment of surplus labour and its total financial cost to AN in 1979-80. The Committee does not know the extent to which the attrition of staff over time is to be made possible by the replacement of men with machines or simply the elimination of jobs which produce no useful ouput.

70. The general conclusion is that the Committee has identified a number of deficit causes. Some of these may be considered as likely PSOs, others more rightly as bad business decisions with the important caution that the Transfer Agreements constrain management's actions.

Chapter IV
Australian National's Attempt to Eliminate the Deficit

Description of the Corporate Plans

71. AN's response to the requirement that its annual operating deficit be eliminated is embodied in its Corporate Plans. Once the amalgamation of the South Australian and Tasmanian railways with AN was finalised on March 1, 1978, a plan covering future operations of the enlarged system was necessary. The long term aim of this plan was for AN to break-even in ten years. AN's management has adopted this aim as its basic corporate goal.

72. Following the formal issue of Corporate Plan No. 1 in August 1978, AN has produced a new plan annually: Plan No. 2 (September 1979); Plan No. 3 (November 1980) and Plan No. 4 (at draft stage in August 1981). Basically the Corporate Plan is a financial analysis of AN over the next ten years taking account of general economic trends, expected traffic task, staff attrition, capital investment and improvements in operational, marketing and management methods.

73. AN's management considers that each Corporate Plan is made up of a family of plans comprising the:

- Market Plan;
- Operations Plan; and
- Resources Plan.

AN explains that its Market Plan defines its task, its Operations Plan defines the level of service required to meet this task and its Resources Plan defines the level of human, material and financial resources required to provide this service.[1]

74. The mechanisms suggested by AN's management to link these plans are the Cost Management Information System (CMIS), for controlling and assessing performance and the Corporate Cost Model, for projecting into the future. The CMIS is a computer based system and is a critical link in AN's attempt to become profitable. It is designed to meet accounting and audit requirements, plus provide freight cost information to assist management in rate setting.

Planning Assumptions and Methodology

75. Since the plans are projections they are dependent on basic assumptions, particularly those relating to the general economy. Assumptions relating to the CPI, fuel price escalation and business growth have varied from plan to plan as the environment in which AN operates constantly alters. The following key assumptions (Table 1) relate to Corporate Plan No. 4.

Table 1: Key Assumptions In Corporate Plan 4

Item	*Projection to 1990-91*
Real Gross Domestic Product	4.5% per annum (p.a.) rise in 1981-82, thereafter 3% p.a.
Traffic Task (tonnes)	static 1981-82, thereafter 3% p.a. plus 'standardisation surge'
CPI	11% p.a. rise in 1981-82, declining steadily to 8% p.a. rise in 1990-91
Average Railway Wage (ARW)	Assumed moves in line with CPI
Fuel	15% p.a. rise in 1981-82, declining steadily to 8% p.a. rise in 1990-91
Materials and Incidentals	Rise in line with (CPI-2)% p.a.
Staff Attrition	3.7% p.a. average

Source: Exhibit number 26.

76. The short-term outlook for 1981-82 as projected by AN can be compared with projections in the Budget Statements. Briefly, the government expects growth in real gross domestic product (GDP) of more than 3.5% per annum (p.a.), a rise of 10.75% p.a. in the CPI and an increase in average weekly earnings of around 13.5% p.a.[2] In general, AN's 1981-82 projections are very similar, except that the Budget Statements illustrate that growth in average weekly earnings cannot be assumed to move in line with the CPI.

77. The Committee believes that the projections for the remainder of the planning period to 1990-91 are open to criticism. AN has attempted to marry its 1981-82 outlook to its longer term projections. The result is a hybrid plan which may well be inconsistent. In the longer term the traffic task is assumed to move in line with real GDP at 3% p.a., except for additional growth because of the new standard gauge link between Adelaide and Crystal Brook. To test the validity of this assumption, knowledge is required of the GDP elasticity of demand, which is defined as the ratio of the rate of growth of demand to the rate of growth of GDP at constant prices. As an example the GDP elasticity of demand has been estimated at 0.6 for non-bulk rail freight.[3] This means that a 3% rise in real GDP can be expected to increase non-bulk rail freight demand by 1.8%. However, this assumes that the distribution of non-bulk freight between *the competing modes will be unchanged and therefore implies that nothing else changes* so far as the relative costs of the various competing modes are concerned. This is unlikely and further study is necessary to determine how the distribution of traffic between the competing modes is effected by such changes.

78. The other significant point concerning the interrelationship between real GDP and traffic growth is the 1981-82 outlook. AN expects a 4.5% rise in real GDP but zero traffic growth. The Committee believes this to be a strong indication that the plan is unrealistic, the immediate 1981-82 outlook being incompatible with a basic planning assumption.

79. The Committee also believes that the longer term projections are over-optimistic. In particular, no arguments were produced to support the contention that both annual CPI and fuel price increases will steadily decline to 8% p.a. by 1990-91. The Department of National Development and Energy has projected a 2% real increase in the price of crude oil.[4] AN's fuel price rises could be expected to be at least this great, as Australian crude is very light and is more suitable for the production of petrol than distillate.

80. An unrealistic assumption in AN's Plans is that the average railway wage (ARW) will move in line with the CPI. As AN's planning projections are basically the extrapolation of past trends, it is appropriate to examine previous relative movements in the CPI and the ARW index. This has been done in Chapter III (paragraphs 60-61) where it was illustrated in Figure 4 that historically the railway wage has not moved in line with increases in the CPI. If it is believed that labour productivity will increase sufficiently to offset wage increases in excess of CPI increases, this would have to be separately argued and supported by evidence.

81. There are other assumptions implicit in the planning process which are open to question. No allowance is made for decreases in profitability as a result of above average industrial disputes or the introduction of a shorter working week.

82. A major problem with AN's planning process is the failure to recognise the relationship between output (traffic task) and price (freight rates). AN has been calculating the necessary annual rate increases (as the result of its financial projections) required to breakeven by 1987-88 assuming certain movements in its costs and traffic growth.

83. In Corporate Plan No. 1, AN projected expenditure and traffic growth and then calculated necessary freight rate increases to achieve breakeven in ten years. From this analysis came the result that this breakeven would be possible if rates were increased on average by 60% of the CPI. Successive deficits in excess of those forecast have meant upward revisions of necessary rate increases. Corporate Plan No. 4 proposes an initial annual rate increase of 80% of CPI, with annual progressive increments until the rates move in line with the CPI in later years.[5] Furthermore AN has foreshadowed a need to escalate at a higher rate in the near future, due to current wage pushes in the industry. Thus AN has been using rate increases as a 'balancing item'.

84. The use of the CPI in the planning process is confusing, as it clouds the price/quantity linkages. As discussed in Chapter III (paragraphs 59-61) the use of the CPI as a proxy for increases in railway costs in contract escalation clauses should also be questioned. The Committee therefore recommends that:

> *AN discontinue the practice of using the consumer price index both in its corporate planning processes and as a proxy for cost increases in its contracts. AN should develop a more appropriate index and undertake regular rate reviews.*

85. A point of concern is that average rate increases of less than the level of inflation imply real rate reductions. The Committee finds this tactic difficult to marry with AN's profitability objective, unless real rate reductions increase traffic carried to such an extent that this increase in quantity more than compensates for the decrease in income due to the lower real price. Because AN's management has not concentrated on real movements in costs and revenues in its corporate planning, it is impossible to determine whether the projected revenues increase because of traffic growth (a quantum increase) or because real rates are increased.

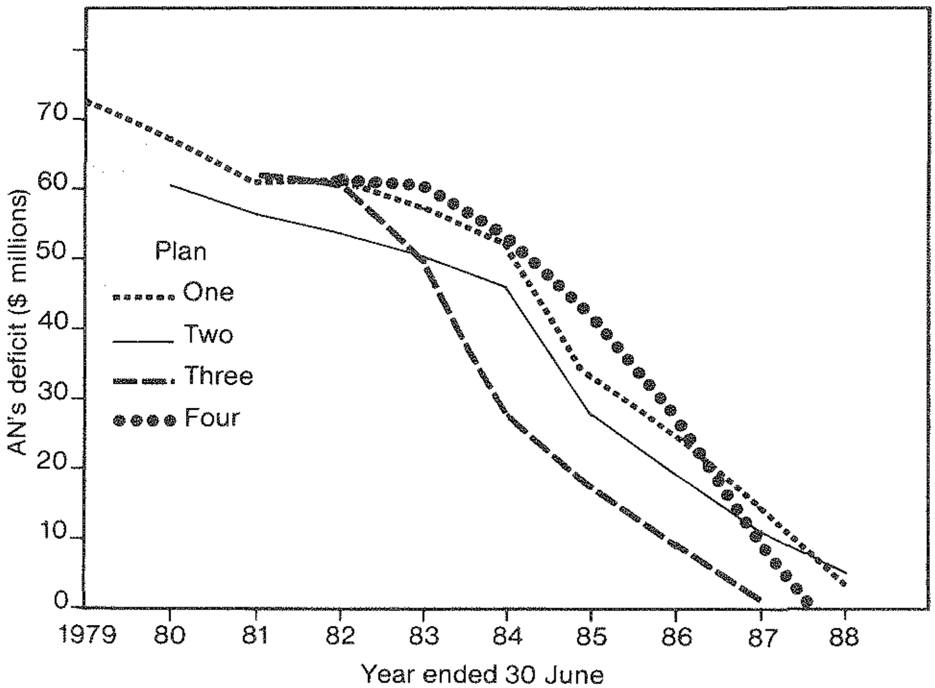
86. AN has not specified the demand and supply interactions in its plans to date. Yet the inverse relationship between price and quantity will mean that it will be impossible to pursue, in existing markets, real rate increases together with traffic growth. It may well be that the profitability objective dictates that AN becomes a smaller, not larger, enterprise. Alternately, vigorous attempts to fulfill new areas of customer needs in pursuit of profitability together with specific government objectives through PSOs, may dictate a larger AN. The Committee recommends that:

> *AN critically reviews its corporate planning assumptions and methodology. AN should improve its forecasting techniques, particularly with respect to the interrelationships between freight rates and levels of service demanded.*

Promise and Performance

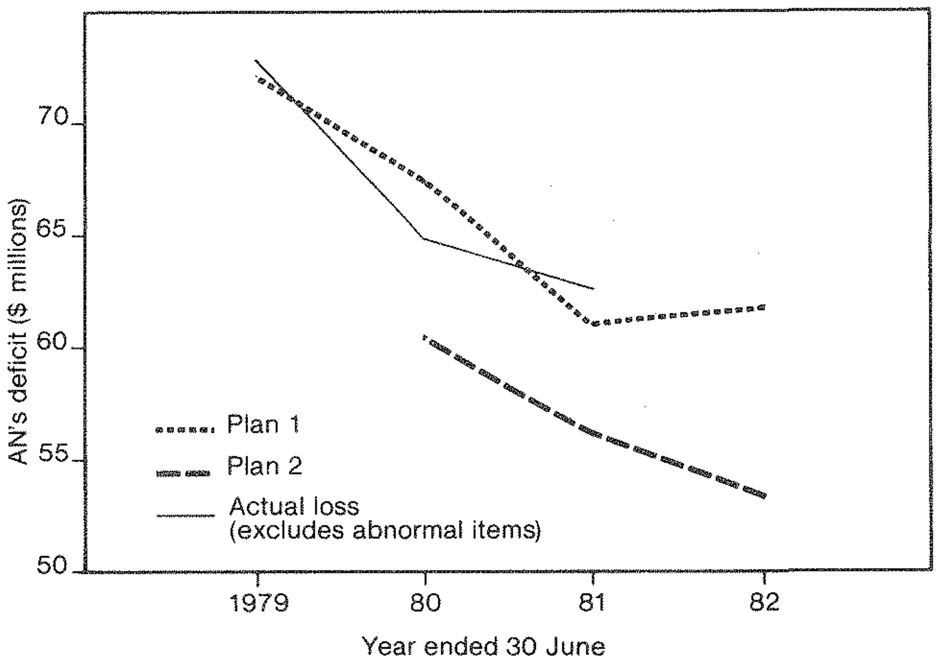
87. The Committee believes that AN's response to deficit elimination as embodied in its Corporate Plans has been shown to be unrealistic. It is necessary to consider AN's broad projections of financial results made over the planning period, together with its actual performance so far. Projections and performance to date are illustrated in Figures 5 and 6. Differences in the forecasts reflect the fact that successive plans have the previous year's results available as feedback into the planning process. They also reflect changes in the major economic variables affecting AN, such as expected CPI increases, fuel price escalation and business growth.

Figure 5 **AN's corporate plan projections 1978-79 to 1987-88**



Source: Exhibit number 26

Figure 6 **AN's performance and projections 1978-79 to 1981-82**



Source: Exhibit number 26

88. With the exception of one result in 1979-80 (when grain revenue doubled that of the previous year) the actual deficit has been greater than that projected in all of the plans. In other words performance is, with one exception, falling short of that projected by AN. In the financial statements for 1980-81 changes have been made to the treatment of provisions for insurance ($1.6m. less provided in 1980–81 compared with 1979-80) and post retirement superannuation pension increases ($2.8m. less provided in 1980-81 compared with 1979-80). Had these accounting changes not been made, the 1980-81 result would have been worse, not better, than that recorded in 1979-80.

89. Two comments relating to such aggregate comparisons are warranted. Firstly, as AN as now constituted is such a young organisation, it is impossible to undertake a trend analysis since results can be compared with projections for only three years. A second difficulty with this approach is the large seasonal variations brought about by fluctuations in the grain haulage task. These two factors mean that such a broad analysis of AN's operations to date is of little value in attempting to predict future results. However the projected annual percentage increases for revenue and expenditure do provide a guide to AN's strategy. This information is presented in Table 2 and illustrates that AN's strategy is to increase total revenue at a rate in excess of CPI movements while at the same time holding expenditure increases below the CPI increases. In real terms, increases in revenue are coupled with decreases in expenditure.

Table 2: AN Projected Revenue and Expenditure.

Year	*1982-83*	*1983-84*	*1984-85*	*1985-86*	*1986-87*	*1987-88*
Revenue (% increase)	16	18	13	13	12	12
Expenditure (% increase)	12	9	8	7	6	7

Source: Exhibit number 26.

Likelihood of Deficit Elimination

90. AN considers that its long-term goal of the elimination of operating losses by 1987-88 is still attainable. In fact, a sensitivity analysis of the financial results to alternative assumptions has been undertaken by AN in Corporate Plan No. 4. The test indicates that the financial results, with the exception of traffic growth, are insensitive to different planning assumptions. Generally, breakeven is still attainable in 1987-88, if the pessimistic projection for each variable is realised individually, all other variables realising their predicted values.

91. From this analysis it would be tempting to assume that, given expected traffic growth, AN would have little difficulty in equating revenue and working expenses by 1987-88. Even if business growth was pessimistic, the breakeven would be delayed only until 1990-91. Unfortunately, the Committee believes that prospects for AN are simply not this rosy.

92. The method of sensitivity analysis undertaken by AN is open to question on a number of grounds. Although the forecast breakeven appears insensitive (apart from business growth) to the realisation of the pessimistic assumption for each variable—all other variables achieving their predicted result—the question arises as to the effect on results if a combination of two or more of these variables realised their pessimistic values together.

93. As an example, AN does not consider what would happen if the pessimistic results for CPI, fuel expenses, materials and incidentals expenses and traffic growth were all realised together. Adopting AN's own estimates,[6] pessimistic results would reduce profitability in 1987-88 by approximately:

- $1.1m for the CPI;
- $3.2m. for fuel;
- $1.1m. for materials and incidentals; and
- $29.8m. for business growth.

In total, the operating deficit for 1987–88 would be increased by $35.2m., delaying breakeven by several years.

94. A final point concerning sensitivity analysis relates to the treatment of an uncertain future. Uncertainty pervades every aspect of the AN planning process—yet it is rarely considered explicitly. When assessing the likelihood of deficit elimination, the shortcomings associated with AN's presentation of single estimates are apparent. The Committee and quite possibly AN's management does not know the degree of confidence surrounding each estimate. Yet one comparatively simple way to take into account these uncertainties is through the use of probabilistic techniques.

95. Technical exposition of this statistical technique is unnecessary in this Report.[7] While it is true that a sensitivity test as undertaken by AN identifies how sensitive the result is to changes in particular variables, there is no way from such a test that it is possible to gauge the likelihood of the occurrence of alternative values of a given variable or of combinations of alternative values of several key variables. Therefore AN's management should undertake a probabilistic evaluation of its projected results. From such a study, both AN and government would be in a better position to assess the likelihood of success or failure to eliminate the operating deficit by 1987-88. The Committee therefore recommends that:

(a) *AN undertakes a probabilistic evaluation of its forecast results and that such an evaluation becomes an integral part of its forecasting and therefore its Corporate Plan documents; and*

(b) *The Minister directs the Bureau of Transport Economics to assist AN in improving its forecasting techniques, including the introduction of the probabilistic approach.*

AN's Actions

96. The Committee has reviewed AN's Corporate Plans and compared AN's performance to date with these Plans. Apart from the planning process itself, the extent to which AN proposes to tackle the major deficit causes from an operational viewpoint is presented in Table 3.

97. Table 3 illustrates that AN is taking action to eliminate its deficit on a broad front. However, the following areas are still of concern to the Committee; and relate to factors not explicitly included in AN's Corporate Plans:

- action with regard to likely PSOs is not detailed; and
- intersystem difficulties are not adequately tackled.

98. Because actions which relate to PSO candidates are not detailed, it is not clear whether likely PSOs will be continued with (or without) a specific revenue supplement, or whether such operations will be ceased. This aspect is critical not only to the predicted size of AN's operations, but also to its flow of funds. As no detailed flow of funds statement is provided, this aspect cannot be pursued further, except to say that a staff attrition of approximately 4,000 over ten years most likely implies curtailment of labour-intensive operations: branch lines and perhaps passenger services.

Table 3: Deficit Causes and AN's Actions

Item	*AN's Response In Plans*
Passenger Services	Reduce frequencies, increase fares. Ceased Tasmanian passenger operations. Computerise intersystem passenger booking system
LCL and Parcels	Increase Rates
Branch Lines	Reduce levels of service. Limited closures
Tasmanian Region	Ceased passenger services. Upgrading system
Superannuation	Will develop alternative schemes
Transfer Agreements	No explicit action
Underpricing	CMIS to be introduced, escalation clauses as % CPI increased
Intersystem Difficulties	No explicit action on rating issues. Some through running of locomotives. Computerise passenger booking system
Inadequate Service	Standard gauge line Adelaide to Crystal Brook
Surplus Labour	Attrition of staff
Underutilisation of Equipment	Computerised Wagon Control System. Intersystem through running of locomotives
Payment for PSOs	Limited revenue from government. But PSO applications may result in cessation of some services—implicit in staff attrition

99. A major constraint on AN's performance is the lack of a computer based costing system. AN's Cost Management Information System (CMIS) should meet this requirement, although it is currently not fully established. Identification of the direct costs associated with a particular service or traffic, is crucial to AN as management decisions follow sequentially from this first step. Although cost is only one input relevant to a pricing decision, the direct cost still sets the lowest limit to price. It remains the sole criterion for the lowest acceptable price within a given time period. The Committee agrees with the Auditor-General who commented:

> 'The need for a consistent realistic costing system is pervasive; in the absence of such a system, management developments of the type currently being tackled by ANR could be ineffective. Not only would such a shortcoming seriously inhibit the Commission's capacity to meet the terms of its legislation in its commercial activities but it would also compromise its accountability for whatever loss-making public service obligations it may be committed to, the costs of which should be clearly identifiable'.[8]

Although the Auditor-General's remarks are now two years old, the statement still remains valid. The CMIS is not expected to be fully operational until 1983, although certain functions will be provided prior to this date. The Committee recommends that:

> *AN's management gives top priority to the establishment of its Cost Management Information System (CMIS) as this system is critical to AN's corporate planning process, its accountability to the Executive and Parliament and also its ability to show what the costs of PSOs really are.*

100. One reason for the long lead-time involved in CMIS implementation may be the debate surrounding costing methodology. There are two conflicting approaches to the costing and pricing of services. One approach, the 'marginal' or 'avoidable' cost approach, is to consider as relevant only those costs directly associated with serving the traffic. The second approach to pricing is a method based on accounting principles known as the 'fully distributed' cost approach. The distinction between these approaches is discussed in Appendix 4 and is relevant to two important issues —an assessment of the costs which AN is expected to recover and the estimation of costs associated with operations where viability is in question, leading to requests for PSO funding to AN. Appendix 4 also covers the method of PSO assessment.

101. AN's management is not in a position to alone induce changes to intersystem rating and operational practices. This constraint is highlighted by the evidence collected by the Committee with respect to intersystem passenger operations. The most critical of these problems is the passenger booking system which is manually operated with block allocations of tickets to the various state systems and travel agents. The allocation of tickets in blocks created situations whereby potential customers were told that no seats were available on particular journeys. Subsequently, other sellers would return unsold tickets on these journeys, the result being that the train travelled with empty seats, even though some potential customers were told otherwise.

102. When questioned by the Committee on the shortcomings of the passenger booking system, AN accepted the criticisms.[9] Computerisation of passenger booking facilities with terminals located nationally could dramatically overcome the problems and alleviate the frustrations of potential travellers. AN should be able to convince the other rail systems that this change is desirable even though the objectives of State railways may be different from AN.

103. Another important initiative by AN is the introduction of the haulage of express freight trailers attached to the Trans-Australia service from South Australia to Western Australia. The movement of such freight at premium rates (transit time being reduced by almost 24 hours) attached to express passenger trains may well create a situation where the train is profitable. This concept of mixed passenger and freight services on one train is, in itself, fairly novel. In addition, more 'sit-up' rather than sleeping accommodation is being provided on this service. Current indications are that this initiative has been extremely well patronised and should markedly assist the profitability of the train, as the extra costs associated with this service are very small.

104. AN has also introduced seasonal pricing to its passenger operations, but it is too early to judge whether this move has improved profitability. From a management viewpoint, AN has established a 'Passenger Services Manager'. The management of passenger services will now be much less fragmented than previously and these services will be under more effective management control.

105. Unfortunately, the issue of staff levels on the Indian-Pacific train has yet to be resolved. This train appears to be prone to both industrial relations and intersystem difficulties. The Committee is left in no doubt that the marketing and operation of the Indian-Pacific passenger service could be substantially improved, thereby increasing its profitability. Evidence from AN indicated that the Indian-Pacific service was not viable and that AN in 1979 lost approximately $30 for every passenger carried.[10] This issue is further considered in the following chapter.

Conclusions

106. In summary, the Committee believes that although AN is to be commended for the introduction of corporate planning, its planning documents to date are unrealistic. The financial projections are based on assumptions which do not stand up to a critical review. Furthermore, the methodology is incompatible with operations in a market environment. One of the reasons for this may be the location of the planning group within AN's organisation. Rates charged for services should not be the balancing figure of such an analysis but an input in projecting the profitability of the organisation.

107. The Committee seriously doubts whether AN will attain its stated goal of deficit elimination by 1987-88 if it attempts to follow its Corporate Plans. The principal reasons for this doubt are that:

- (a) AN is unlikely to be successful in restraining the growth of labour costs to the extent forecast; and
- (b) AN will be unable to pursue increases in traffic growth to the extent projected at the same time as it increases its freight rates.

108. Notwithstanding these planning criticisms we believe that if AN could successfully approach these problems then there would still be time for it to make its planning realistic and modify its actions where appropriate to achieve its goal of breakeven in 1987-88. At present the Committee believes that neither AN nor the public service in general has the necessary expertise in corporate planning. AN may achieve breakeven in 1987-88 but this result would be due to management efforts, rather than as a result of the plans as now formulated. The Committee therefore recommends that:

> *AN scraps its Corporate Cost Model as detailed in its Corporate Plans and obtains expert advice to produce a meaningful Corporate Plan document which is market-oriented. AN should also consider the transfer of its planning personnel from under the control of technically oriented engineers to either the marketing division or into a position whereby this group interacts directly with the General-Manager and the Commission.*

Chapter V
Improving Australian National's Performance

Profitability

109. It is important that AN operates with a clear corporate objective. A clear objective provided by government will improve AN's performance. AN says that its basic corporate objective is profitability as required by section 57C (2) of the Act. However, the relative importance attached to profitability is an interpretation by AN. The Committee believes that such a matter should not be left to the interpretations of a particular management at a particular point of time, but should be made explicit in the Act. In short, the considerations in Section 57C (2) should generally override those considerations stated in Section 31A or other parts of the Act. The Committee formed a similar view with respect to the *Australian Industry Development Corporation Act* 1970.[1] The Committee therefore recommends that:

> *AN's management be given decision-making freedom to operate as a commercial organisation and pursue the profitability objective subject to PSOs and the Transfer Agreements. Section 57C (2) of the Act should be amended to give effect to this recommendation.*

Public Service Obligations

110. The facility which enables AN to seek re-imbursement for PSOs is embodied in Section 44 of the Act, which contains two mechanisms. Firstly, the Minister may direct alterations to AN's practices. Secondly, and as a consequence of such Ministerial action, AN can apply to have the amount of any loss incurred by this direction reimbursed, provided Parliament includes in the Annual Appropriation Act an item to cover such losses. These losses are to be certified by the Auditor-General. As mentioned in Chapter III, (paragraph 51) it is not clear to the Committee why AN has not approached the Minister more often with alterations to operations and rates which, if not agreed to by the Minister, would constitute PSOs for which explicit revenue would be provided to AN by government. Although the CMIS will make management's job easier with respect to PSO costing, a delay of eight years from AN's inception (1975 to 1983) is unfortunate. Manual extraction of the necessary data is possible. The Committee believes that AN's management should be criticised for this lack of action and recommends that:

> *AN does not delay PSO applications to the Minister until it has introduced its Cost Management Information System (CMIS) but proceeds immediately with a systematic identification of likely PSOs and then requests funding through Section 44 of the Act for the continuation of these services where warranted.*

111. The Committee recognises that it is not only the Federal Government which may wish AN to act in a non-commercial manner. The governments of South Australia, Tasmania and the Northern Territory may wish to contribute towards the costs of providing particular services beyond the terms of the Transfer Agreements. The Committee therefore recommends that:

> *The government make provision to allow South Australia, Tasmania and the Northern Territory to make a contribution toward the cost of any service provided by AN if they so desire.*

112. The identification and treatment of PSOs has been considered earlier in this Report (paragraphs 38-54). It is paramount in the pursuit of efficient government expenditure that AN invokes this Section of the Act wherever possible. To date it has not done so because it does not have an adequate costing system established and perhaps also because AN's management is concerned that it is not providing many of the PSOs as efficiently as possible.

113. The Committee recommends that:

With respect to Public Service Obligations (PSOs):

(a) *When the Minister agrees to the continued operation of a PSO, AN should receive a revenue supplement and all such supplements should be identified collectively and separately in either Appropriation Bill No. 1 or No. 2, as well as in AN's Annual Report. The number and type of beneficiaries should also be explicitly identified in each case in AN's Annual Report;*

(b) *AN should include in its Annual Reports, details of cases where its applications for PSOs have been rejected or varied by the Minister; and*

(c) *From time to time the Government should engage either consultants or the Auditor-General to examine the efficiency with which PSO activities are conducted and these reports should be tabled in Parliament.*

Tendering

114. An issue which requires clarification is AN's role when competing for tender against private companies. The Australian Federation of Construction Contractors asserted that there are advantages so far as costs are concerned which are available only to AN and which therefore place the private construction firms at an unfair disadvantage. Such advantages to AN include non-liability for pay-roll and some other taxes, as well as the existence of in-house facilities and equipment for which the appropriate costs are said not to be included adequately in the tender price. However, AN also suffers disabilities in that it can only tender for work within its own area of operations, whereas the private sector can tender over the whole area of construction work.

115. A great deal of confusion has arisen because of the failure to appreciate that the tendering process requires AN to make judgements concerning the alternative uses to which plant and labour can be put at any one time. To place AN on an equal footing with its competitors is thus not simply a matter of requiring them to use similar rules about the costs of each category of input.

116. If labour and equipment would otherwise be temporarily unemployed, it would not be sensible to enter costs into a tender at their accounting price. Rather the opportunity cost of these resources should be assessed, which is defined as the value of alternative outputs in which those inputs could be used. From AN's point of view, the existence of surplus labour in its organisation may mean that the value of labour costs in a tender should be very low. On the other hand, it would not be economically efficient to employ AN's resources simply because a cost advantage existed which was due solely to AN's status which exempted it from some costs, notably taxes.

117. Any direction to AN by government with respect to the tendering process should make the policy objective clear. Given the profitability objective, AN should be concerned only with the direct financial impact on its own accounts which results from any course of action. Concerned with deficit elimination, the most acceptable tender under this policy is that which has the lowest financial cost to AN.

118. Evidence collected on the contracting process has highlighted to the Committee the difficulties involved when a public authority operates in a competitive market. A requirement that AN pursues the profitability objective automatically precludes that its management be concerned with any other government objective, including any allowances for market distortions which may impede an efficient use of resources unless Ministerial direction allows AN to seek compensation by way of Section 44. If the government wishes AN to pursue any objective other than profitability, it can do so through the mechanisms of PSO funding if such a direction increases AN's deficit. Therefore the Committee recommends that:

When tendering against private firms, AN does so on a commercial basis.

Treatment of Capital

119. Part IV of the Act relates to finance. Two issues concerning AN's finances are of importance. The first is the value of assets on which AN is to be required to earn interest. The second is the determination of the actual rate of interest to be applied.

120. Problems exist with the valuation of both AN's existing and new capital assets. Under its legislation, AN is to pursue a policy directed towards making profits. Revenues at present do not even cover operating expenditure and are not expected to do so at least until 1987-88. Therefore it is understandable that issues such as an adjustment of asset values are not accorded a high priority. However, if AN is to operate as a commercial body, it should be required to earn a rate of return on its assets.

121. A private firm with a profit making goal has its capital assets valued by the market, primarily on the basis of current and expected net revenue earning capacity. A lower limit of this valuation is the value of the capital assets in their best (most profitable) alternative use. The historical costs of AN's assets are irrelevant, since the passage of time has ensured that much of what is now included as AN's capital stock is obsolete, of the wrong type, or in the wrong place, given today's market for transport services. It is not clear whether a revaluation would result in an increase or decrease in asset value. Assets with little alternative use would be written down in value, but certain real estate, particularly urban goods yards, etc., would have profitable alternative uses. These assets should be valued by the market and AN should be expected to earn a return on this value. At present, AN does not pay State or local government rates and the opportunity cost of this land is not reflected in AN's financial accounts.

122. In terms of book values, capital on establishment date (1.7.75) was $320.5m, as determined by the Minister for Finance under Section 55(1) of the Act.[2] However, Sections 56 (1) and 56 (2) respectively state:

> 'Interest is not payable to the Commonwealth on the capital of the Commission but the Commission shall pay to the Commonwealth, out of the profits of the Commission for a financial year . . . such amount as the Minister determines'; and
>
> 'The capital of the Commission is repayable to the Commonwealth at such times and in such amounts as the Minister determines'.

123. If AN is to be required to act on a commercial basis its capital assets need to be valued with that in mind. It is the capital value on which AN can be expected to earn a rate of return that is important if AN is to be placed on a competitive basis. Considerable investment activity has occurred since AN was formed, much of which creates assets on which it is extremely unlikely that a commercial return will ever be earned. An example is the Tarcoola-Alice Springs line and later, the extension of this line to Darwin. The Tarcoola-Alice Springs line, for instance, involved capital expenditure of some $145m. The Committee recommends that:

AN's capital value be adjusted to a level for which AN is to be held accountable and on which it should be required to earn a rate of return. Capital provided by *government for non-viable projects should be identified as such and remain separate in AN's accounts. Where possible, these projects should be accounted for as separate activities.*

124. The second issue concerning the treatment of AN's capital is the determination of the actual rate of return payable by AN. Sub-section 57C (1) (a) states that the Minister:

> '(S)hall, before the commencement of each financial year, determine the percentage of the capital of the Commission that would represent a reasonable return to the Commonwealth from the operations of the Commission in that financial year . . .'.

Sub-section 57C (1) (b) also gives the Minister power to amend such a determination. The Committee is concerned at the appropriateness of the annual determination and the Minister's power to amend that determination since this creates a degree of unnecessary uncertainty for AN's management. The Committee therefore recommends that:

> *Following a commercial adjustment of asset values, the Minister directs AN to earn a rate of return at such rate to be determined by him from time to time.*

Intersystem Problems

125. One of the most important external constraints on AN's management is the degree of interdependence with other railway systems. As previously mentioned (paragraph 29) intersystem traffic accounts for nearly half of total AN earnings. Two types of intersystem freight rates apply. Railways of Australia published rates are a common set of book rates which apply on all systems for intersystem consignments. They generally apply for the movement of smaller consignments between systems.

126. The second type of intersystem charges are intersystem special rates. These rates apply to all significant intersystem traffics and are not published. Intersystem special rates have been quoted for most major intersystem traffics. As with passenger fares, intersystem book rates are reviewed in conjunction with State systems at six-monthly intervals. Automatic escalation clauses apply to some intersystem special rates, the rest being reviewed twice a year, the same as book rates.

127. Besides rate setting, operational interaction can also create problems. Historically, this is manifested in the infamous three gauge Australian network. Unfortunately for AN, they operate with all three gauges hindering not only the flow of passengers and freight but also reducing the mobility of resources such as locomotives and rollingstock. Even where no break of gauge is involved, delays or bottlenecks in other systems affect wagon utilisation and the level of service AN can deliver to its clients. Although centralised wagon control may have improved the situation, operational difficulties such as crew and locomotive changes at intersystem borders still occur.

128. Intersystem difficulties are also evident in passenger operations, particularly the Indian-Pacific service. Although AN itself has undertaken a number of improvements to the operation and marketing of passenger services, continual protracted negotiations with other systems will remain a fact of life unless there are institutional changes.

129. There does not appear to be any overall short term solution to this problem although solutions of some value, such as increasing the demurrage charges on wagons consigned interstate, have some effect. Certainly AN in its Corporate Plans has not addressed this issue. It is difficult for AN's management to pursue its commercial objective when it only has direct control over half of its revenue. The longer term solution may be the creation of a single marketing and operating authority for intersystem freight and passenger traffic. The Committee recommends that:

(a) *The Minister for Transport, in assessing AN's financial performance, takes into account the constraints inherent in present intersystem arrangements;*

(b) *The Minister for Transport institutes an inquiry into the alternatives available to improve intersystem railway operational and marketing practices. Such an inquiry should include both passenger and freight operations and be asked to identify the relative benefits and costs associated with any changes to the current institutional arrangements; and*

(c) *AN take a firm stand in all intersystem negotiations and refuse to carry traffic which it does not consider to be profitable, even though some traffic may be lost as a result.*

Legislative Constraints

130. The Committee noted earlier in its Report (Chapter III, paragraphs 42-44) that the common carrier obligations contained in Section 34 inhibit withdrawal from certain types of business, particularly LCL and parcels traffic. Presumably, this traffic could be carried by either Australia Post or the private sector. AN may still be retained by these organisations to perform the line haul of LCL and parcels traffic in a consolidated form. As this traffic is estimated to be contributing $8m. per year to AN's deficit, removal of common carrier status could improve AN's performance. Therefore the Committee recommends that:

A new Section 34 of the Act be introduced to read as follows: Notwithstanding anything in this Act or any other Act or any rule of law, the Commission is not a common carrier, but is still subject to public service obligations.

131. One of the conditions of employment in AN is entitlement to superannuation benefits under the *Commonwealth Superannuation Act* 1976 (subject to eligibility). As mentioned in Chapter III (paragraph 47) AN's liability as an employer has, until the 1980-81 financial year, been in the form of regular cash payments of 15% of employee's salary to the Consolidated Revenue Fund, plus 10% of employee's salary as a provision to meet post retirement superannuation pension increases.

132. AN's management has made the point to the Committee that it is not involved in the calculation of retirement benefits or in actual payments of superannuation benefits to retired employees.[3] Furthermore, AN does not consider that it should be faced with superannuation charges far beyond alternative commercial schemes, especially if its performance is to be judged by the size of its operating deficit.[4] It should be noted that major AN competitors, such as freight forwarders and road transport operators, do not in general operate superannuation schemes at all, or if they do so, the schemes are only available to individuals with senior status in the organisation.

133. However, AN's competitors point out that AN does enjoy certain taxation concessions, such as non-payment of State payroll tax. Thus, while AN's status as a public authority business undertaking confers some financial benefits to the organisation, it is clearly at a disadvantage compared with its competitors with regard to superannuation costs.

134. The Review of Commonwealth Functions stated that AN could develop alternative superannuation schemes 'if appropriate'.[5] The Expenditure Committee concurs but recognises that such an action initially will have a minor impact on AN's accounts if only applied to new staff. AN's management is also constrained by the protection of superannuation entitlements of staff transferred from the former State systems.

135. In 1980-81 the provision for post retirement superannuation pension increases was altered from 10% to 5% of the salary for superannuation purposes. This improved AN's financial performance by approximately $3m. Such a reduction would have no effect on employee entitlements, because AN's superannuation payments are paid into the Consolidated Revenue Fund, and employee entitlements are paid by the government as they arise. Thus the actual costs of AN's superannuation scheme are difficult to assess. Therefore the Committee recommends that:

With respect to superannuation,

(a) *AN explores the possibility of introducing alternative superannuation schemes involving provisions for lump-sum payments on retirement. There should be full discussions between employees and management before any new schemes are introduced;*

(b) *In the event of a successful conclusion to such discussions, consideration should be given to permitting AN to cease to be an approved authority under the Commonwealth Superannuation Scheme and operates in the same way as TAA by setting up a fund in its accounts to pay pensions or benefits as they arise and for which existing employees are entitled; and*

(c) *Until such time as AN's management has introduced an alternative scheme in consultation with its employees the Government accepts that AN's superannuation costs above those operated by private firms are funded through a specific revenue supplement as a PSO.*

136. Section 46 (2) of the Act provides that:

> '(T)he terms and conditions of service or employment . . . are determined by the Commission with the approval of the Public Service Board'.

The question arises as to whether the Public Service Board (PSB) provides a useful input to AN's management. The PSB performs the function of ensuring that government policies, such as staff ceilings, are observed. AN's management has, in fact, set its own staff policy and the PSB has not found it necessary to disagree with AN's decisions on this matter in recent years.[6] Furthermore, government policy in relation to staff ceilings and other staff matters can be and has been applied to Telecom and Australia Post, although neither is subject to the general oversight of the PSB.

137. It is clear from the evidence that the PSB performs a purely nominal function so far as AN is concerned. AN's management decisions are designed to achieve its goal: deficit elimination by 1987-88. Its actions with respect to staff levels and conditions of employment are dictated by commercial necessity, subject to restraints inherent in the Transfer Agreements. The PSB does not have the expertise to provide AN with a useful input in such circumstances.

138. The Review of Commonwealth Functions stated that AN's staffing level is:

> —'(T)o be determined as a commercial judgement without reference to the Public Service Board'.[7]

The Expenditure Committee concurs but notes that an amendment to the Act is necessary to remove an anomoly and therefore recommends that:

Section 46 (2), which deals with Public Service Board involvement, be deleted and Sections 46 (5), 46 (6) and 46 (7) be amended or repealed as appropriate.

139. AN's ability to set freight rates and passenger fares is constrained by competition, intersystem rating practices and legislative constraints embodied in its Act. Intersystem rating difficulties have been discussed earlier (paragraphs 125-126).

140. For some traffics competition sets the effective limit on what AN can charge if it is to obtain or retain traffic. AN is no longer in the strong monopoly position in freight transport which was a characteristic of railways before the advent of effective competition from road transport. The prices and qualities of competitors' services, particularly road transport, set effective limits on what AN can charge for these competitive traffics. Road and rail have been estimated to compete for about 30% (by weight) of the rail freight.[8] In other cases, overpricing by AN could prohibit movement of commodities.

141. The legislative constraints on AN's rate setting practices are embodied in its Act in Sections 29, 30, 30A and 40 (c). (See Appendix 2). Section 29 makes it clear that AN may demand 'tolls, fares and charges' but they are subject to approval by the Minister. This Section of the Act also attempts to ensure that there are no discriminatory practices by AN. But while Ministerial approval of rates is required, AN has the power to strike special rates and contracts by virtue of Sections 30 and 30A of its Act. There is clearly a problem with the Act with respect to contract rates as Sections 30 and 30A enable AN to circumvent Ministerial approval of all rates.

142. Finally, Section 40 (c) requires AN to furnish to the Minister in the first month of each quarter 'the special rates (if any) which have been made and the reasons for making them'. Yet the Department of Transport stated in evidence:

> 'The private contract rates are something of a mystery to us'.[9]

143. Section 29 (4) refers to any such publication of rates and fares (printed by the Government Printer) as evidence that these book rates, etc., have been approved by the Minister. This Committee finds that there need be no requirement to publish AN's rates and fares. The Committee recommends that:

> *AN's management be left to decide on the extent to which it should publish rates and fares.*

144. An important issue is the extent to which Ministerial involvement is required in the freight rate and passenger fare setting processes. At present Sections 30 and 30A of the Act enable AN to circumvent prior Ministerial approval. Prior Ministerial approval results in unnecessary rigidity of rate and fare structures and thereby lessens AN's ability to respond to market pressures.

145. Ministerial approval of rates and fares may have been required in the past to limit exploitation of the public through the abuse of monopoly powers. Although competition has removed much of the grounds for this fear, there is certainly room for disagreement as to the extent of this competition. For this reason the Committee believes that the removal of prior Ministerial agreement of AN's rates and fares should also involve the establishment of an appropriate appeals procedure to assess claims of exploitation.

146. But one of the main problems identified by this Committee has been the exact opposite of this point —the extent to which AN undercharges for some of its services. The Committee emphasises that pursuit of the profitability objective requires that priority be given to the elimination of undercharging. This underpricing results in exploitation not of the customer but of the taxpayer. The Committee therefore recommends that:

> *Prior Ministerial approval of AN's rates and fares be no longer required and Section 29 of the Act be appropriately amended. At the same time, the Minister for Transport should establish a mechanism by which public complaints of overcharging and undercharging by AN can be resolved. AN should also provide the Minister with principal details of all major new contracts entered into in the previous twelve months.*

147. Skilled negotiators employed by large companies can be expected to win contracts from AN on favourable terms unless AN is an equally hard bargainer. The top management structure illustrated in Figure 1 shows that the marketing section of AN is not dominant in the organisation.

148. The Committee fears that the dominance of technical positions in AN may result in technical considerations overriding commercial objectives. Concern with maximising traffic volume could swamp the objective of maximising revenue, resulting in underpricing for fear of losing traffic. To overcome this problem the Committee recommends that:

AN establishes and maintains an effective Commercial Division which would primarily analyse the costs and qualities of its main competitors. In other words, this Division would analyse 'what the traffic will bear' and should not be directly responsible or in any way subservient to another group in AN as may well be the case at present. Also the Commercial Division should continually work towards meeting new consumer demands, to enable AN to compete vigorously and expand where there are profitable rail opportunities.

149. One of the Committee's more difficult problems was to untangle the impact of the Transfer Agreements on AN (paragraph 49). The Transfer Agreements have an influence not only on the inputs that would normally be determined by management (e.g. levels of staff and equipment) but also on the services provided to customers (eg. rates charged and lines open for traffic). Under the Transfer Agreements, for changes to fares and rates, line closures and reductions in services and levels of employment, agreement with the relevant State Minister for Transport is required. If this agreement is not forthcoming, provisions exist for arbitration. For example, Clause 8 of the Schedule to the *Railways Agreement (South Australia) Act* 1975 states:

> 8. (1) The Commission will ensure that, in general, fares, freight rates and other charges in respect of the non-metropolitan railways and services shall be maintained, on and after the commencement date, at levels not less favourable to users than those levels generally applying on the railways of States other than South Australia and where, in general, fares, freight rates and other charges at the commencement date have established a relative advantage to the users, that advantage shall not be diminished.
>
> (2) Passenger concessions that exist in respect of the non-metropolitan railways at the date of this agreement shall continue after the declared date so far as they lawfully may do so.
>
> (3) The State will reimburse the Commission the reasonable cost to the Commission as agreed between the parties, of the passenger concessions continued pursuant to sub-clause (2).
>
> (4) Failing agreement on any matter to which this clause relates it shall be determined by arbitration.

150. There are a number of other Sections in the Act not previously mentioned which deal with the Minister's involvement in AN's management decisions of a minor nature. In total the Minister for Transport (and therefore his Department) is specifically involved in the decision-making process of AN through approximately 30 Sections in the Act.[10] While many of these Sections may never have been used their possible future use cuts across an aim of this Report which is directed towards maximum decision-making freedom by AN's management to enable it to operate as a commercial enterprise.

151. Section 21 (1) gives AN the power to let land or buildings not required by AN on lease, but subject to approval by the Minister. Section 21 (3) is also concerned with the leasing of premises for the provision of travellers' requisites, tenement (other than for trading purposes), or site for storage, etc. The term stipulated in this sub-section is not to exceed five years. The Committee recommends that:

With respect to leasing arrangements referred to in Sections 21 (1) and 21 (3) of the Act, the Minister determines a figure below which AN does not need to seek Ministerial approval.

152. Section 23 provides for the Minister to approve any contracts in which the Commission is to pay an amount exceeding that prescribed. The amount at present prescribed is $500,000. The Review of Commonwealth Functions (RCF) stated that the:

'Value of contracts requiring Ministerial approval . . . be raised to $2m or such other amount the Minister determines'.[11]

While the actual limit may be arbitrary the RCF's recommendation is in agreement with the Report's aim and therefore, to remove an anomaly, the Committee recommends that:

The value of contracts requiring Ministerial approval, under Section 23 of the Act, be raised to $2m or such other amount as the Minister determines.

153. Consent of the Minister is required to enable the carriage of passengers and goods on a railway before it has been declared open for traffic. The Committee finds that as this necessity for consent serves no apparently useful purpose, it is no longer required. The provisions in Section 33 transferring risk to passengers and owners of goods should also be repealed, as traffic carried in these circumstances should be carried under the same terms and conditions as apply to the remainder of AN's network. Therefore the Committee recommends that:

Section 33, which requires Ministerial consent for the carriage of passengers and goods on a railway before it is open to traffic, be repealed.

154. The inspection, maintenance and repair of railways may also be authorised by the Minister under Section 37. The Committee believes that AN's management should be free to decide whether any special repairs, etc., are warranted on a normal commercial basis. Where the government requires infrastructure changes because of developmental or defence reasons, this would require explicit PSO funding to AN if the project would not have been undertaken by AN on normal commercial criteria. Therefore the Committee recommends that:

As Ministerial approval for AN to carry out special repairs, alterations, renewals and extensions is not required, Section 37 of the Act should be repealed.

155. Section 46 (3) provides for the Minister to approve the determination of a salary where the rate exceeds a prescribed amount which is an amount equivalent to the maximum of the Class 11 rate in the Third Division of the Australian Public Service. The RCF stated that AN is to determine salary levels below that of General Manager.[12] This Committee concurs and notes that to remove an anomaly requires amendment to the Act and therefore recommends that:

Section 46 (3) which requires Ministerial approval for salaries above a prescribed level, be repealed.

156. The Committee believes that the legislative constraints embodied in the Act unnecessarily hamper AN's attempts to improve its performance. We therefore recommend that:

The Minister for Transport institutes a review of the Act and re-examines his role in relation to the obligations placed on him by the Act as identified in the review and this Report.

Chapter VI
Improving Australian National's Accountability

157. The Committee finds that for AN to operate as a commercial enterprise, its management should be given the maximum decision-making freedom possible. Management would then be responsible to the Minister and answerable to the Parliament for the elimination of the deficit. The Committee is of the opinion that the major interests of government should be to set objectives, monitor any differences between AN's projections and its actual performance and to decide on the funding of PSOs. For Parliament to perform its scrutiny role, annual reports should contain relevant information on such matters.

158. Section 41 (1) of the Act provides for the Minister for Finance to determine the form of the Commission's accounts. At present, the accounting framework and the description of AN's funding arrangements do not assist the Executive and Parliament in judgements as to the efficiency and effectiveness of government funding of AN. In particular the Committee finds that separate activity accounts would be appropriate for large operations. An example of this would be the new line from Alice Springs to Darwin. The Committee therefore recommends that:

> *The Minister for Finance institutes a review of the appropriate form of AN's accounts, giving particular consideration to the role of AN as a commercial undertaking with certain public service obligations which must be clearly identified. The findings of this study should be reported to Parliament.*

159. Another aspect of AN's finances which is not explicit in its annual reports is the funding arrangements. As stated in Chapter II (paragraph 32), AN obtains three categories of government funds (capital works and services, an operating loss subsidy and the reimbursement of concessions) plus borrowings 'off-budget'. At present this is not made clear in the annual reports. Thus a detailed flow of funds statement would greatly enhance AN's accountability. The Committee therefore recommends that:

> *AN provides a detailed flow of funds statement in its annual reports, sufficient to identify all categories of government funds and 'off–budget' borrowings.*

160. Once PSO activities have been financially identified, the remaining deficit will provide an indicator of AN's management performance. The question arises as to the appropriateness of such an indicator and its possible deficiencies. At present, the exclusion of large amounts of capital from the requirement to pay interest means that the deficit or operating loss as presented by AN will understate the opportunity cost of the capital tied up in AN's operations. Therefore, the deficit as measured at present is not a good indicator of the value of resources embodied in AN's operations. Conversely, use of the historical cost of assets, the opportunity cost for a large proportion of which may well be zero, would mean overstatement of the value of resources tied up in AN. These two points are covered in the Committee recommendations regarding the treatment of capital. (Recommendations 15 and 16)

161. The appropriate indicator of AN's performance is the financial result of AN, including its cost of capital and specific payments by the government for PSO activities. The Minister and the Parliament will then be in a far better position to judge the managerial performance of AN.

162. Recommendations made by the Committee in this Report are designed to improve the accountability of AN, while at the same time improving its performance by limiting Ministerial (and therefore bureaucratic) intervention in normal management processes. However, Section 42 of the Act still gives the Minister power to require the

Commission to supply all relevant information that the Minister requires. The retention of Section 42 in the Act will enable the Minister to seek information on an 'as required' basis.

163. Involvement by the Minister and his Department in minute detail is a costly operation, both to AN and government. While the Committee has recommended that maximum decision-making freedom be accorded to AN's management, it is concerned that adequate accountability exists and has made appropriate recommendations. For Parliament to effectively monitor AN's performance, we believe that integration of the corporate planning and budget processes is essential and that broad details of AN's Corporate Plans should be published in its annual reports. Therefore the Committee recommends that:

AN integrates its corporate planning process with the budget process as soon as possible, and presents the financial projections and other broad details of its Corporate Plans in its annual reports.

164. Evidence provided to the Committee[1] suggested that the equivalent of about ten staff in the Department of Transport are involved full-time on AN matters. To date, this section of the Department has only been of limited value in ensuring that the requirements of the Act (particularly AN's accountability) have been met (paragraph 142). Once this Committee's recommendations have been implemented, the major remaining important function will be advising the Minister on any PSO application by AN, including an estimation of the value of the benefits inherent in these services. Only by comparing benefits and costs will the Minister be in a position to decide on the merits of a PSO payment. Apart from this function, little day-to-day involvement with AN will be required and therefore the Committee recommends that:

The Department of Transport reassesses staffing required to handle AN matters.

165. Finally, the Committee believes that unless continual pressure is applied to AN's management, it will not pursue the profitability objective as vigorously as possible. Hard decisions may be deferred indefinitely, resulting in poor utilisation of resources and continual government subsidies. The Committee has recommended that PSO activities be investigated from time to time to ensure that they are provided as efficiently as possible. In addition, the Committee would like to see a review of AN at a later date to see if the problems identified in this Inquiry have been remedied. Therefore the Committee recommends that:

In 1985, or such other date as is convenient, the Minister institutes a review of AN's operations to assess its performance to that date in the light of the findings and recommendations made in this Report and the continuing impact of the Transfer Agreements on AN's financial results.

166. Notwithstanding the problems identified in this Inquiry, the Committee believes that AN is in a far better position to tackle these problems and achieve its corporate goal than it ever was in the past. The Committee notes that AN has already responded to this Inquiry in a number of constructive ways. The Committee is confident that implementation of its recommendations will substantially assist AN to this end, thereby reducing the drain on government expenditure, while at the same time improving AN's accountability to the Parliament and the public.

4 February 1982

STEPHEN LUSHER
Chairman

Appendix 1
Conduct of Inquiry

(a) Hearings

On 28 March 1979, the Committee decided to inquire into the operations of the Australian National Railways Commission. The inquiry was conducted by the full Committee with Professor H. M. Kolsen appointed as Specialist Adviser.

In the first phase of the inquiry the Committee obtained submissions from private and public sector organisations and held public hearings on 10 September 1979, 29 October 1979, 29 February 1980 and 7 March 1980. In addition, an *in-camera* hearing was held on 11 September 1979.

By 14 April 1980 a number of 'emerging conclusions' had been formulated. The second phase of the inquiry involved testing these at a series of hearings with witnesses. These hearings were held on 19 and 20 June 1980, 21 August 1980 (all *in-camera*) and 3 February 1981. This process reflects the attitude of the Committee to reach conclusions and base recommendations after consultation rather than the development of adversary positions of the Committee and other organisations.

The third and final stage of the inquiry was consideration of all the evidence as well as preparation and presentation of this Report to the House.

(b) List of Witnesses

	Dates of appearance before Committee
AUSTRALIAN FEDERATION OF CONSTRUCTION CONTRACTORS	
Mr Gordon Gregory Mathams, Executive Director, Sydney	29.2.80 3.2.81
Mr John Malcolm Muir, Executive Councillor, Sydney	29.2.80 3.2.81
AUSTRALIAN NATIONAL RAILWAYS COMMISSION	
Mr John Desmond Harris, Sales Manager, Adelaide	19.6.80
Mr Mervin Lawrence Nayda, Chief Planner, Adelaide	10.9.79 11.9.79
Mr Nelson Bruce Walkom, Finance and Supply Manager, Adelaide	10.9.79 11.9.79
Dr Donald Gatherer Williams, General Manager, Adelaide	10.9.79 11.9.79 19.6.80 3.2.81
DEPARTMENT OF FINANCE	
Mr Patrick Joseph Barrett, First Assistant Secretary, Transport and Industry Division, Canberra	21.8.80
Mrs Sandra Elizabeth Fenwick, Chief Finance Officer, Retirement Benefits Branch, Social Security Division, Canberra	21.8.80
Mr Leonard David Russell Osmond, Assistant Secretary, Transport and Communications Branch, Canberra	21.8.80
Mr Jeffrey Regan Rae, Chief Finance Officer, Transport and Communications Branch, Canberra	21.8.80

	Dates of appearance before Committee
DEPARTMENT OF TRANSPORT	
Mr Ian Ramsay Grigor, Assistant Secretary, Rail Branch, Canberra	29.10.79 20.6.80
Mr David Thomas Armitage Langford, Director, Rail Branch, Canberra	29.10.79 20.6.80
NATIONAL FREIGHT FORWARDERS ASSOCIATION	
Mr Edward Walter Ayling Butcher, Chairman, Sydney	29.2.80
Mr Owen Phillip Davies, Member, Sydney	29.2.80 19.6.80
Mr Peter Rochfort, Executive Director, Sydney	19.6.80
Mr John Arthur Wise, Member, Sydney	29.2.80
PUBLIC SERVICE BOARD	
Mr Graham Gordon Glenn, Deputy Commissioner, Canberra	20.6.80
Mr Patrick Dennis Gourley, Senior Inspector, Legislation and Parliamentary Branch, Canberra	7.3.80 20.6.80
Dr Allan Douglas Hawke, Director, Canberra	20.6.80
Mr Brian Rex Lowe, Director, Pay and Conditions Division, Canberra	7.3.80
Mr Ronald Neville McLeod, Secretary, Canberra	7.3.80

(c) Index of Exhibits

Exhibit No.

1. Submission from the General Manager, Australian National Railways Commission, of non-confidential replies to Committee Questionnaire, received 6 August 1979.
2. Submission from the General Manager, Australian National Railways Commission, of replies to Committee Questionnaire, received 6 August 1979 (in confidence).
3. Submission from the General Manager, Australian National Railways Commission of Corporate Plan Number One, received 6 August 1979 (in confidence).
4. Submission from the Executive Secretary, Tasmanian Road Transport Association dated 17 July 1979.
5. Submission from the Executive Director, Australian Chamber of Shipping dated 30 July 1979 including a report entitled 'Areas of concern affecting the Australian Shipping Industry'.
6. Submission from the National Secretary, Australian Transport Officers' Federation dated 16 August 1979.
7. Submission from the Western Australian Centre of The Institute of Road Transport Engineers dated 23 August 1979.
8. Submission from The Honourable J. Bjelke-Petersen, M.L.A., Premier of Queensland dated 8 October 1979.
9. Submission from the General Manager, Australian National Railways Commission dated 5 November 1979 and attachments (in confidence).
10. Submission from the General Manager, Australian National Railways Commission dated 14 November 1979 of a special edition of 'Ausrail' magazine (November 1979).
11. Submission from the General Manager, Australian National Railways Commission dated 3 December 1979 and attachments (in confidence).
12. Submission from The Honourable P.A.E. Everingham, M.L.A., Chief Minister of the Northern Territory dated 13 December 1979.
13. Submission from the Executive Director, Australian Federation of Construction Contractors dated 27 February 1980 and attachments.

14. Submission from the Assistant Secretary, Rail Branch, Department of Transport dated 3 March 1980 and attachments (attachments 1, 2, 3 and 6 in confidence).
15. Submission from the Executive Director, Australian Federation of Construction Contractors dated 8 April 1980 and attachments.
16. Submission from the Acting Secretary, Public Service Board dated 20 June 1980 and attachment.
17. Submission from the General Manager, Australian National Railways Commission dated 11 July 1980 and an attachment of a copy of a paper delivered by the General Manager, Dr. D.G. Williams entitled 'Railways Some Views Of The Current Position And Future Prospects' presented to the Institute of Transport on 8 July 1980 (in confidence).
18. Submission from the General Manager, Australian National Railways Commission dated 23 July 1980 and attachments (in confidence).
19. Submission from the General Manager, Australian National Railways Commission dated 15 August 1980 and attachments (in confidence).
20. Submission from the Acting Commissioner, Public Service Board dated 29 August 1980.
21. Submission from the Acting First Assistant Secretary, Land Transport Policy Division, Department of Transport dated 16 September 1980 and attachment.
22. Submission from the General Manager, Australian National Railways Commission dated 4 December 1980.
23. Submission from the National Director, Australian Federation of Construction Contractors dated 12 February 1981.
24. Submission from the Branch Secretary, Australian Workers Union, South Australian Branch dated 13 February 1981.
25. Submission from the General Manager, Australian National Railways Commission dated 20 February 1981 and attachments (in confidence).
26. Submission from the General Manager, Australian National Railways Commission dated 25 August 1981 and attachments including a copy of a paper delivered by the General Manager, Dr. D.G. Williams entitled 'The Role of Rail' presented to the Institute of Directors, Adelaide on 17 February 1981 and a copy of Corporate Plan Number Four (in confidence).
27. Submission from the General Manager, Australian National Railways Commission dated 8 December 1981 (in confidence).
28. Submission from Senator the Hon. P. Durack, Q.C., Attorney-General, Parliament House dated 23 December 1981.

Appendix 2
Extracts from the Australian National Railways Act 1917

25. The Commission shall annually, and at such other times as the Minister directs, prepare and submit to him a statement showing full details of contracts entered into by the Commission, and statements in such form as the Minister requires of all purchases made by it which are not covered by contracts, and shall, if so directed by the Minister in any particular case or in general, arrange for future purchases to be covered by contracts.

26. The Commission may compound and agree with any person who has entered into any contract in pursuance of or under the authority of this Act, or against whom any action or suit is brought for any penalty contained in the contract, or in any bond or other security for the performance thereof, or for or on account of any breach or non-performance of the contract, bond or security, for such sum of money or other consideration as the Commission thinks proper.

27. (1) No person shall be entitled to carry, or to require the Commission to carry, upon any railway or on a vehicle of the Commission any goods whatsoever which, in the judgment of the Commission or its employees, are of a dangerous nature.

(2) The Commission may refuse to take any parcel which it suspects to contain goods of a dangerous nature, or may require any parcel to be opened so that the nature of the contents may be ascertained.

28. The Commission may refuse to accept for conveyance upon the railways or on a vehicle of the Commission any goods which from their excessive weight or bulk would be inconvenient to transport, or it may, if it is agreeable to the acceptance of the goods for conveyance, fix special rates and conditions for their transport.

29. (1) The Commission may carry and convey upon the railways all such passengers and goods as are offered for that purpose, and may demand such tolls, fares and charges and impose such conditions in respect thereof as are, upon the recommendation of the Commission, approved by the Minister.

(2) Subject to the provisions of this Act and of the Railway Agreements, all such tolls, fares and charges shall at all times be charged equally to all persons, and after the same rate, whether per ton, per mile, or otherwise, in respect of all passengers and of all goods of the same description, and conveyed or propelled by a like carriage or engine passing over the same portion of the line of railway and under the same circumstances; and no reduction or advance in any such tolls, fares or charges shall be made, either directly or indirectly, in favour of or against any particular company or person travelling upon or using the railway.

(3) All such tolls, fares and charges shall be paid to such persons, and at such places upon or near to the railways, and in such manner, and under such regulations, as the Commission appoints.

(4) Any publication purporting to contain a list of the tolls, fares, charges and conditions recommended by the Commission and approved by the Minister, which is printed by the Government Printer, shall be *prima facie* evidence that the tolls, fares, charges and conditions contained therein were so recommended and approved, and, until the contrary is proved, that they are still in force.

(5) In this section, 'Railway Agreements' means the agreement approved by the *Railways Agreement (South Australia) Act* 1975 and the agreement approved by the *Railways (Tasmania) Act* 1975.

30. Notwithstanding anything in this Act contained, the Commission may fix a special toll or charge for the conveyance of any special article or parcel of goods provided that the same toll or charge shall apply alike to all persons using the railways under the same conditions.

30A. Notwithstanding anything in this Act contained, the Commission may, with a view of preventing decrease of income by reason of loss of traffic on the railway, enter into a contract with any person for the conveyance, during such period as is provided in the contract, of such proportion of the goods of that person as is stated in the contract at a special rate or charge fixed in the contract or subject to a rebate or concession specified in the contract.

31. The Commission may enter into any agreement or contract with the Australian Postal Commission for the performance of any service for the Australian Postal Commission.

31A. The Commission may provide to the Commonwealth and authorities of the Commonwealth, for reward, land transport and engineering services and such other services as can conveniently be provided by the use of the resources of the Commission.

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34. For the purposes of this Act the Commission shall be deemed to be a common carrier, and (except as by this Act otherwise provided) shall be subject to the obligations and entitled to the privileges of common carriers.

35. For the purposes and subject to the provisions of this Act, the Commission may do all that is necessary or convenient for making, maintaining, altering or repairing and using the railways.

36. The Commission shall maintain the railways and all works in connexion therewith in a state of efficiency, and shall carry persons and goods without negligence or delay.

37. The Commission shall at all times cause to be made a careful inspection of the condition of the railways, and it shall be responsible for carrying out such ordinary maintenance and repairs as may from time to time be necessary, and for carrying out such special repairs, alterations, renewals and extensions as may be authorized by the Minister.

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39. Before the Commission authorizes or incurs any expenditure for any works or services which are not chargeable against ordinary working expenses or maintenance, it shall submit to the Minister a statement of the proposed works or services, together with an estimate of the cost thereof.

40. In the first month in each quarter of the year the Commission shall furnish to the Minister a written report setting out—

(a) the approximate expenditure and receipts during the past quarter;

(b) the general condition of the lines and accommodation for the traffic;

(c) the special rates (if any) which have been made and the reasons for making them; and

(d) the appointments and removals of employees holding permanent office.

41. (1) The Commission shall, as soon as practicable after each 30 June, prepare and furnish to the Minister a report of the operations of the Commission during that year, together with financial statements in respect of that year in such form as the Minister for Finance approves.

(2) Before furnishing financial statements to the Minister, the Commission shall submit them to the Auditor-General, who shall report to the Minister—

(a) whether the statements are based on proper accounts and records;
(b) whether the statements are in agreement with the accounts and records and show fairly the financial operations and the state of affairs of the Commission;
(c) whether the receipt, expenditure and investment of moneys, and the acquisition and disposal of assets, by the Commission during the year have been in accordance with this Act; and
(d) as to such other matters arising out of the statements as the Auditor-General considers should be reported to the Minister.

(3) The Minister shall cause copies of the report and financial statements of the Commission, together with a copy of the report of the Auditor-General, to be laid before each House of the Parliament within 15 sitting days of that House after their receipt by the Minister.

42. The Commission shall furnish all such reports, documents, and information relating to the railways and the railway service as the Minister requires.

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44. The Minister may direct the Commission to make any alteration in any existing practice or carry out any system or matter of policy, but where any such direction adversely affects the accounts of the railways, the Commission shall notify the Minister thereof from time to time, and the amount of any loss occasioned by the direction shall, if certified by the Auditor-General, be provided by Parliament in the Annual Appropriation Act and paid to the Commission.

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55. (1) The capital of the Commission at any time is the sum of—
(a) the value, at the date of commencement of this section, of the rights, property and assets (including the amount of any moneys) referred to in section 16A as determined by the Minister for Finance, or so much of that value as is determined by the Minister for Finance;
(b) the value, at the date of becoming vested in the Commission, of the rights, property and assets that become vested in the Commission under section 16 after the commencement of this section as determined by the Minister for Finance, or so much of that value as is determined by the Minister for Finance; and
(c) the amounts paid to the Commission by the Minister for Finance out of moneys appropriated by the Parliament for the purposes of providing further capital for the Commission,

less—
(d) the sum of any amounts paid by the Commission for assets referred to in paragraph (b); and
(e) the sum of any amounts of capital repaid to the Commonwealth by the Commission.

(2) If, by virtue of a determination referred to in paragraph (1) (a) or (b), part of the value of the rights, property and assets referred to in those paragraphs does not constitute capital of the Commission, that part of the value shall be deemed to be a loan by Australia to the Commission on such terms and conditions as to interest and otherwise as is determined by the Minister for Finance.

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56. (1) Interest is not payable to the Commonwealth on the capital of the Commission but the Commission shall pay to the Commonwealth, out of the profits of

the Commission for a financial year commencing after the commencement of this section, such amounts as the Minister determines.

(2) The capital of the Commission is repayable to the Commonwealth at such times and in such amounts as the Minister determines.

(3) In the making of a determination under sub-section (1) or sub-section (2), regard shall be made to any advice that the Commission has furnished to the Minister in relation to the financial affairs of the Commission.

57. The Commission shall prepare estimates, in such form as the Minister directs, of its receipts and expenditure for each financial year and, if so directed by the Minister, for any other period, and shall submit those estimates to the Minister not later than such date as the Minister directs.

57A. (1) Subject to this section, the moneys of the Commission shall be applied only—

(a) in payment or discharge of the expenses, charges, obligations and liabilities incurred or undertaken by the Commission in or in connexion with the performance of its functions, or the exercise of its powers, under this Act or any other Act;

(b) in payment of any remuneration and allowances payable under this Act; and

(c) in making payments to the Commonwealth as provided by this Act.

(2) Moneys of the Commission not immediately required for the purposes of the Commission may be invested—

(a) on deposit with an approved bank;

(b) in securities of the Commonwealth; or

(c) in any other manner approved by the Treasurer.

57B. The Minister for Finance may, on behalf of the Commonwealth, out of moneys appropriated by the Parliament for the purpose, lend moneys to the Commission on such terms and conditions as the Minister for Finance determines.

57BA. (1) The Commission may, with the approval of the Treasurer but not otherwise, from time to time, borrow moneys (otherwise than from the Commonwealth) on such terms and conditions as the Treasurer approves.

(2) Approvals for the purpose of sub-section (1) may be in respect of particular borrowings or in respect of borrowings included within specified classes of borrowings.

(3) The Treasurer may, on behalf of the Commonwealth, guarantee the repayment by the Commission of amounts borrowed under this section and the payment of interest on amounts so borrowed.

57BB. (1) The Commission may, with the approval of the Treasurer but not otherwise, deal with securities.

(2) Where the Commission borrows or otherwise raises moneys by dealing with securities, the Treasurer may determine that the repayment by the Commission of the amount borrowed or raised, and, the payment by the Commission of interest (if any) on those amounts, are, by force of this sub-section, guaranteed by the Commonwealth.

(3) The power of the Treasurer to make a determination for the purposes of sub-section (2) extends to the making of a determination in respect of—

(a) securities included in a specified class, or specified classes, of securities; and

(b) transactions included in a specified class, or specified classes, of transactions.

57BC. The Commission may give security over the whole or any part of its assets—

(a) for the repayment of moneys borrowed under section 57BA and the payment of any moneys that the Commission is otherwise liable to pay in respect of those borrowings; and

(b) for the payment of any moneys that the Commission is liable to pay in respect of dealings with securities in accordance with section 57BB, including, but without limiting the generality of the foregoing, the payment of interests (if any) on moneys borrowed or otherwise raised by the Commission.

57BD. Subject to sub-section 55 (2), the Commission shall not borrow, or otherwise raise, moneys except in accordance with sections 57B, 57BA and 57BB.

57C. (1) The Minister, after consultation with the Commission—

(a) shall, before the commencement of each financial year, determine the percentage of the capital of the Commission that would represent a reasonable return to the Commonwealth from the operations of the Commission in that financial year, and give notice in writing to the Commission of the percentage so determined; and

(b) may, at any time during a financial year, by reason of a change in circumstances, by notice in writing to the Commission, amend a determination under paragraph (a).

(2) The Commission shall pursue a policy directed towards making in each financial year, profits sufficient to enable the Commission to pay to the Commonwealth, out of those profits, an amount equal to the percentage of its capital determined under sub-section (1) in respect of that financial year.

57D. (1) The Commission may open and maintain an account or accounts with an approved bank or approved banks and shall maintain at all times at least one such account.

(2) The Commission shall pay all moneys received by it into an account referred to in this section.

57E. (1) For the purposes of this Act, the profits of the Commission for a financial year are the amount (if any) remaining after deducting from the revenue received or receivable in respect of that financial year the expenditure and provision for expenditure properly chargeable against that revenue.

(2) The profits of the Commission for a financial year shall be applied in the first place in payment of the amount determined under sub-section 56 (1) and the balance (if any) shall be applied in such manner as the Minister determines.

(3) In the making of a determination under sub-section (2) regard shall be had to any advice that the Commission has furnished to the Minister in relation to the financial affairs of the Commission.

57F. The Commission shall cause to be kept proper accounts and records of the transactions and affairs of the Commission in accordance with the accounting principles generally applied in commercial practice and shall do all things necessary to ensure that all payments out of its moneys are correctly made and properly authorized and that adequate control is maintained over the assets of, or in the custody of, the Commission and over the incurring of liabilities by the Commission.

57G. (1) The Auditor-General shall inspect and audit the accounts and records of financial transactions of the Commission and records relating to assets of, or in the custody of, the Commission and shall forthwith draw the attention of the Minister to any irregularity disclosed by the inspection and audit that is, in the opinion of the Auditor-General, of sufficient importance to justify his so doing.

(2) The Auditor-General may, at his discretion, dispense with all or any part of the detailed inspection and audit of any accounts or records referred to in sub-section (1).

(3) The Auditor-General shall, at least once in each financial year report to the Minister the results of the inspection and audit carried out under sub-section (1).

(4) The Auditor-General or a person authorized by him is entitled at all reasonable times to full and free access to all accounts, records, documents and papers of the Commission relating directly or indirectly to the receipt or payment of moneys by the Commission or to the acquisition, receipt, custody or disposal of assets by the Commission.

(5) The Auditor-General or a person authorized by him may make copies of, or take extracts from, any such accounts, records, documents or papers.

(6) The Auditor-General or a person authorized by him may require any person to furnish him with such information in the possession of the person or to which the person has access as the Auditor-General or authorized person considers necessary for the purposes of the functions of the Auditor-General under this Act, and the person shall comply with the requirement.

(7) A person who contravenes sub-section (6) is guilty of an offence punishable, upon conviction, by a fine not exceeding $200.

57H. (1) Subject to sub-section (2), the Commission is not subject to taxation under the laws of the Commonwealth or of a State or Territory.

(1A) Where the Treasurer so determines by notice published in the *Gazette*, stamp duty, or any similar tax, is not payable by the Commission or any other person under a law of the Commonwealth or of a State or Territory in respect of—

(a) a security dealt with by the Commission;

(b) the issue, redemption, transfer, sale, purchase, re-sale, acquisition or discounting of such a security by the Commission or any other person, not including a transaction done without consideration or for an inadequate consideration;

(c) any other transaction done for the purposes of a borrowing or other raising of moneys by the Commission; or

(d) any other document executed by or on behalf of the Commission for the purposes of a borrowing or other raising of moneys by the Commission.

(1B) The power conferred on the Treasurer by sub-section (1A) to make a determination extends to the making of a determination in respect of securities included in a specified class or specified classes of securities and in respect of documents or transactions included in a specified class or specified classes of documents or transactions.

(2) Subject to sub-section (1A), the regulations may provide that sub-section (1) does not apply in relation to a specified law or specified laws.

(3) If the regulations under sub-section (2) provide that sub-section (1) does not apply to Acts imposing income tax, the Commission shall be deemed not to be a public authority for the purposes of paragraph (d) of section 23 of the *Income Tax Assessment Act* 1936-1974.

(4) If the regulations under sub-section (2) provide that sub-section (1) does not apply to Acts imposing sales tax, the Commission shall be deemed not to be a public transport authority for the purposes of item 77 in the First Schedule to the *Sales Tax (Exemptions and Classifications) Act* 1935-1973.

58. (1) The Commission shall, when so directed by the Minister, or as may be required for the purpose of supplying information to the Parliamentary Standing Committee on Public Works, have investigations, inspections, and preliminary surveys made of any proposed railway route.

(2) The Commission shall supply to the Minister, if required, such plans, reports, estimates and information generally in respect of any proposed railway route as the Minister directs, or as will in the opinion of the Commission be of service to the Minister.

(3) The expenditure incurred by the Commission in making investigations, inspections and surveys at the direction of the Minister shall not in any case exceed the sum authorized by the Minister for the purpose.

(4) For the purpose of carrying out its duties under this section, the Commission may exercise any of the powers contained in this Part in relation to the construction of new railways.

59. (1) Where there has been referred to the Parliamentary Standing Committee on Public Works any public work involving the construction of a railway, the Commission shall transmit to the Minister under its official seal the following information, namely:

(a) a plan of the railway and of the lands through which it is to pass;

(b) a book of reference in which shall be set forth the names of the owners of the said lands so far as can with reasonable diligence be ascertained, a description of the said lands showing the bearings of the railway and the nature and quality of cultivation, the state of the enclosures (if any) and the quantity of such land required for the purpose of the railway;

(c) the estimated cost of the railway (including station buildings, signalling, &c.) when completed;

(d) the additional rolling-stock (if any) likely to be required for working the railway, and an estimate of the cost thereof;

(e) the estimated working expenses of the railway, including traffic, locomotive, and maintenance charges;

(f) the probable revenue which would be derived from the traffic on the railway;

(g) any other special advantages which are likely to accrue to the Department generally from the construction of the railway; and

(h) a general statement of the primary and other industries, and the possibilities thereof, of the district served by the proposed railway.

(2) If the public work involves the construction of the railway along over or across any public reserve or road, the plans, sections and books of reference shall also contain particulars of the levels, and specify the several areas required to be taken for the purposes of the railway.

60. If the Minister moves that the House of Representatives declare that it is expedient to carry out the proposed work the information supplied to him in pursuance of the last preceding section shall at the same time be laid before the House of Representatives.

61. (1) Notwithstanding anything contained in the *Public Works Committee Act* 1969-1973 the construction of a railway shall not be authorized by the Parliament except in pursuance of an Act of the Parliament the Bill for which was introduced into the House of Representatives by or on behalf of the Minister.

(2) Any such Bill shall contain provisions relating to the following matters:

(a) A detailed description of the route of the proposed railway;

(b) the limit of deviation; and

(c) the maximum cost of the proposed railway.

62. When the Parliament has by Act authorized the construction of any railway, the Minister may give such orders and directions for the due carrying out and execution of the works, and for the effective control and direction of the Commission and officers and employees of the Commission in carrying out and executing them, as he thinks fit, and the Commission shall have and may exercise all the powers of this Act with respect to the railway and works so authorized.

Appendix 3
Australian National's Profit and Loss Statements: 1979-80 and 1980-81

	1980-81	*1979-80*
	$'000	$'000
REVENUE		
Goods	143 356	126 056
Livestock	6 849	5 458
Passenger	15 249	12 748
Parcels and Mails	2 420	1 769
Other	13 479	11 940
TOTAL REVENUE	181 353	157 971
EXPENDITURE		
Operation of Services	99 343	87 775
Maintenance of Services	86 596	79 744
Administrative and General	19 842	14 315
Depreciation and Obsolescence	14 301	13 464
Interest	4 221	4 233
Insurance	3 001	4 606
Long Service Leave	5 459	5 036
Superannuation	11 280	13 626
TOTAL EXPENDITURE	244 043	222 799
OPERATING LOSS	(62 690)	(64 828)
Extraordinary Items	(9 917)	..
OPERATING LOSS AND EXTRAORDINARY ITEMS	(72 607)	(64 828)
Commonwealth Subsidy to meet Operating Loss	56 000	58 100
NET LOSS	(16 607)	(6 728)
Accumulated Losses brought forward	(36 534)	(29 806)
ACCUMULATED LOSSES	(53 141)	(36 534)

Figures rounded to the nearest thousand dollars.
Source: Australian National Railways Commission, *Financial Statements 1980-81.*

Appendix 4
Railway Costs and Public Service Obligations

Setting Prices[1]

1. Two schools of thought have emerged on railway system pricing. In both schools, rate determination is cost and market oriented, but they differ in the way in which indirect costs are allocated across traffic.

2. In what may be termed the economic approach, prices or rates for any service are based on the principle of 'charging what the traffic will bear' subject to a lower limit set by the direct costs of providing services. In the short run, differential prices are determined by reference to the price elasticity of demand for railway services for each class of traffic carried, subject to the following conditions. In the case where the service is provided for only one good, price is not less than those costs which can be directly assigned to that good. Where the service is provided for the carriage of several goods, the revenue from the service should be not less than the direct costs of the service. In addition, the revenue contributions made by each class of traffic towards expenditures which cannot be unambiguously assigned to the various traffics carried by a train will be determined by reference to the demand elasticities in each case. Consequently, the average financial cost of providing railways services is not specifically the basis of price determination.

3. Fixed or 'sunk' costs relate to past capital expenditure on renewable and non-renewable assets. Expenditure on the latter assets may be a large proportion of initial capital outlays. Where non-renewable assets exist which are also specific, the significant point for price determination is that the sunk capital involved has zero opportunity cost.[2] Then in a situation of underutilised capacity and specific assets the rate of return on the capital sunk in those assets may be ignored when setting the price of the transport service, i.e., total financial outlays associated with providing the service may not necessarily form the basis of railway freight rates.

4. In relation to investment in railway operation Baumol's incremental cost approach to specifying the lower limits to railway freight rates covers both the *ex post* situation just described and also the *ex ante* case where the carriage of additional traffic necessitates further capital investment.[3] Incremental costs are defined as 'the increase in total costs resulting from an expansion in the firm's volume of business'.[4] In the *ex ante* case the floor price should cover all costs associated with any extra investment required. However as Baumol points out[5] once the investment commitment is made and excess capacity subsequently develops in the system the additional investment is sunk, and the incremental costs for determining the floor price revert to the *ex post* direct costs of providing the service. The relevant incremental cost for determining the floor price therefore depends on whether excess capacity exists in the system to carry the additional traffic, and if not, the costs associated with the added investment expenditure and then whether the expectations on which the added investment was undertaken are realised. Consequently, there is no simple cost function which will always be uniquely appropriate.

5. The rationale of a pricing policy based on economic principles is two fold. Firstly, existing railway facilities are utilised efficiently and secondly, the policy provides signals for rational replacement decisions.

6. The second method of setting prices may be termed the accounting approach which in setting the floor level to freight rates relies on the fully distributed cost principle.[6] The base price entails adding to direct costs a loading based on an allocation to recoup total overhead costs. The actual freight rate charged may then include an assessment by

management of what the market will bear above the minimum set by fully distributed costs. Hence, total financial outlays underlie the price structure.

7. While a differential pricing policy based on this approach will generate income sufficient to cover total costs when demand for rail services is at least equal to the optimal output of the services, deficits may arise when provision of facilities exceeds that required to meet demand at existing prices. This pricing policy could lead to a situation where capacity is underutilised because traffic, available at a price which covers direct but not fully distributed costs, would be excluded from carriage. The fallacy of this approach is the failure to recognise that when capacity is underutilised additional traffic could be generated at a price lower than fully distributed costs and still make a contribution to overhead costs. In addition, with excess capacity in the system, this pricing policy may not yield an appropriate guide, in terms of the value the community places on scarce resources, to replacement investment decisions.

8. There is evidence however, that one of the main problems, not only with AN but all Australian railway systems, has been the underpricing of rail services.[7] Indeed, to regard any one set of figures as 'the costs' associated with a particular service would be naive. Given that there is no precise relationship between prices and costs, the question to be answered is how should the viability of services be assessed. This issue leads directly to the next point: the basis for the explicit payments to AN for PSOs.

9. The Australian Railways Research and Development Organisation (ARRDO) has done considerable work in this field.[8] They emphasised that different measures of the costs of PSOs are required for different purposes which are:

- 'To measure the impact of public service obligations individually, or in aggregate, on railway finances, a range of cost types are useful. These include *avoidable* costs, *fully distributed* costs, and measures of the *opportunity* costs of revenue foregone where applicable.
- To measure the relative merits of the various rail and non-rail options for achieving wider government objectives, a social cost-benefit analysis is appropriate, based on *resource* costs and *external* costs'.[9]

Government-Rail Contracts

10. ARRDO considers that government-rail contracts may be seen to be serving two main functions, which are the promotion of accountability and efficiency. PSO identification and funding will allow railway accounts to reflect more fully actual performance, through compensatory payments for costs actually incurred in the provision of these services. Both AN and the government would become more accountable within this type of operational framework.

11. The efficiency of the organisation can be stimulated in this framework because AN can aim at a financial objective. The management of AN is placed under greater pressure to perform commercially as the number of possible excuses for what are essentially bad business decisions is diminished as PSOs are made explicit.

12. However, the full compensation for losses incurred in fulfilling PSOs is not without difficulties. Cost related subsidies may not encourage lower operating costs or motivate greater marketing of services which are being sold at less than cost. These problems have been succinctly detailed in a paper by Walker and Murdoch which was presented at the Sixth Australian Transport Research Forum.[10] They found that where difficulties have arisen with subsidy payments, the major contributing factor allowing this situation to arise has been the selection of an inappropriate basis for compensating these services.[11]

13. From the point of view of AN a direct PSO subsidy based on costs may remove from AN's management some of the incentive to improve the efficiency and quality of service. If this happens, the government as subsidy provider obtains an inefficiently operated service which requires a larger subsidy than is really necessary.
14. If the government is sufficiently concerned with this problem, it is free to develop alternative forms of government-rail contracts to overcome any difficulty. For instance, AN could be paid an output related subsidy similar to the type operating for Westrail and advocated by Walker and Murdoch.[12] Payment could be either at a fixed rate per passenger or train kilometre, or a two part payment—one payment designed to cover direct costs, plus a lump sum (to cover indirect costs). Whatever the form of the output-related subsidy its application

> 'offers some reward for reducing costs and raising patronage —as applies to commercial operations not concerned with providing PSOs. This basis for the subsidy payment should also lead directly to reduced subsidies because productivity improvement targets can be incorporated in the annual review and rate negotiation process'.[13]

15. It should be noted that *all* subsidy schemes have some weaknesses. While a cost related subsidy may work against the interests of the government, underwriting AN's deficit each year in a general manner as is presently done is also very unsatisfactory. Firstly, the existing system leaves the Parliament and public (and probably even the Government) in a position where they simply do not know the extent to which services are being subsidised, even if AN does. Secondly, AN may not know the extent to which the Government wishes to subsidise certain services. The 'Catch 22' situation which currently exists leaves everyone 'in the dark', particularly the Parliament and therefore the taxpaying public. On the grounds of accountability then, the PSO scheme is far superior to generally underwriting the total deficit every year.

PSO Funding Through Section 44

16. Section 44 of the Act contains the mechanisms which provide for explicit funding of PSOs. The reasons for the introduction of this Section of the Act and its evolution are detailed below.
17. The *Commonwealth Railways Act* 1917 established the office of the Commonwealth Railways Commissioner and conferred upon the Commissioner certain powers and duties.
18. In relation to the carrying out of matters of policy Section 43 of the Act provided:

(1) The Minister may at any time in writing request the Commissioner to propose in writing a scheme for effecting an increase of income or a decrease of expenditure or for carrying out any matter of general policy specified by the Minister, and the Commissioner shall propose a scheme accordingly.
(2) If the Minister approves of the proposed scheme he may direct the Commissioner to take all necessary steps to carry it out.
(3) *If the Minister does not approve of the proposed scheme he may himself transmit* to the Commissioner any proposition for effecting or carrying out such increase, decrease or matter of policy, and there upon the Commissioner shall take all necessary steps to give effect to the proposition of the Minister.
(4) If any doubt or difference of opinion occurs respecting the provisions of this section the doubt or difference may be finally determined by the Governor-General.

19. In respect of alterations made by direction of the Minister Section 44 of the 1917 Act provided:

The Minister may direct the Commissioner to make any alteration in any existing practice or carry out any system or matter of policy, but where any such direction or any direction or proposition given or transmitted in pursuance of the last preceding section, adversely affects the accounts of the railways, the Commissioner shall notify the Minister thereof from time to time, and the amount of any loss occasioned by the direction or proposition shall, if certified by the Auditor-General, be provided by Parliament in the Annual Appropriation Act and paid to the Commissioner.

20. Whilst the legal position may be complicated, the debate on clauses 44 and 45 of the 1917 Bill (which became Sections 43 and 44 of the Act) shows that it was contemplated that the provisions of clause 45 (Section 44) would apply to a direction by the Minister that the Commissioner not reduce or close an unprofitable service.[14] Also during the second reading debate the Minister for Transport and Railways, Mr Wyatt, advised that the clause referred to any question of policy.[15]

21. The provisions of Sections 43 and 44 remained unchanged from 1917 to 1975 when the *Australian National Railways Act* replaced the office of Commonwealth Railways Commissioner with a corporate body entitled the Australian National Railways Commission. Section 19 of the 1975 Act repealed Section 43 of the Principal Act, and the Schedule to the 1975 Act contained consequential amendments to Section 44 omitting references to a direction or proposition made pursuant to Section 43. The repeal of Section 43 passed without comment in both the House of Representatives and the Senate, presumably on the basis that the expanded powers of the Commission rendered redundant the procedures provided by that Section.

22. As far as it has been possible to ascertain, and definitely since the establishment of the Australian National Railways Commission, there has been only one instance of certification by the Auditor-General pursuant to Section 44 of the Act. During the financial year 1977-78, by direction of the Minister for Transport, the Tasman Limited passenger service between Hobart, Launceston and Wynyard in Tasmania continued to operate at loss and following certification by the Auditor-General an amount of $490,000 was appropriated to the Commission as an additional subsidy pursuant to Section 44.

23. The present Attorney-General has commented:

'In my opinion, therefore, the section has an effective operation both in regard to the Minister's power to direct the Commission and in regard to the Commission's right of recovery out of moneys appropriated in Annual Appropriation Acts. However, a direction by the Minister to the Commission to continue an existing practice where the Commission wished to institute a change in that practice could not be said to be a direction to make an *'alteration'* in an existing practice. Unless, therefore, such a direction amounted to a direction to carry out a 'system or matter of policy', the Minister would have no power to compel the Commission to continue to operate in accordance with the existing practice. If, however, the Commission wished to institute a change in an existing practice the Minister could, under section 44, direct the Commission to initiate some other change in the existing practice. In effect, therefore, by directing the Commission to make relatively minor changes in an existing practice the Minister would be able to direct the Commission substantially to follow the existing practice and hence prevent it from abandoning or substantially changing that practice.'[16]

ENDNOTES

Chapter I

1. Operating losses as defined here exlude abnormal items. The financial statements for 1977-78 were the first to combine the operations, assets and liabilities of the acquired State systems (Tasmanian and non-urban South Australian) with those of the former Commonwealth Railways.
2. This estimate is based on past losses plus AN's financial projections as detailed in their Corporate Plan No. 4.
3. Of particular concern is Clause 8 of the South Australian agreement. The Transfer Agreements between the relevant States and the Commonwealth appear as Schedules to *Railways (Tasmania) Act 1975* (No. 70) and *Railways Agreement (South Australia) Act 1975* (No. 105).

Chapter II

1. It was only after the 'Declared Date' of 1 March 1978 (when the parties had agreed in principle on all outstanding matters such as conditions of employment and ownership of assets) that the task of amalgamating the three railway systems could really begin.
2. Australia, Senate, Debates 1981, Reply to Question No. 959, p. 809.
3. Exhibit number 10, p. 2.
4. *Australian National Railways Act* 1917, Section 57C (2).
5. Australian National Railways Commission, *Financial Statements* 1980-81.
6. Australian National Railways Commission, *Annual Report* 1979-80, p. 8.
7. Exhibit number 2, Response to Committee Question No. 29.
8. Australian National Railways Commission, *Annual Report 1977-78*, p. 43.
9. Exhibit number 2, Response to Committee Question No. 46.
10. Exhibit number 2, Response to Committee Question No. 46.
11. Exhibit number 2, Response to Committee Question No. 46.
12. *Australian National Railways Act* 1917, Sections 40, 41 and 42.
13. *Australian National Railways Act* 1917, Section 29 (1).
14. *Australian National Railways Act* 1917, Section 44.
15. *Australian National Railways Amendment Act* 1980, Section 4.
16. Australian National Railways Commission, *Annual Report* 1977-78, p. 43. This loss includes abnormal items which if excluded from the calculation reduces the weekly operating loss to $1.42m.
17. For public statements which reflect this attitude see Australian National Railways Commission, *Annual Reports* 1978-79, p. 1 and 1979-80, p. 5.

Chapter III

1. For a general discussion on railway rating practices see Australia, Bureau of Transport Economics, *A Study of Intersystem Railway Freight Rating Practices (With Particular Reference To The Riverina Area of New South Wales)*, AGPS, Canberra 1976, pp. 65-68 and pp. 95-105.
2. Exhibit number 18, p. 2. Note that this estimate did not include non-commercial superannuation.
3. Australian National Railways Commission, *Annual Report* 1978-79, p. 36.
4. Evidence, p. 11.
5. Exhibit number, 17, p. 5.
6. South Australia, State Transport Authority, *Annual Report* 1976-77, p. 9.
7. Evidence, p. 645.
8. L. Marks, 'Transport An Indivisible Whole', *Network* (Australian Railways Journal), July 1981, Vol. 18 No. 6, p. 9 and Exhibit number 26, p. 4.
9. Victoria, *Transport (Deregulation) Act* 1980, Section 17.
10. Exhibit number 26, p. 4.
11. Exhibit number 27.
12. S. Joy, S. K. Hicks and K. W. Kershaw, *Tasmanian Railways*, A Report to the Hon. P. J. Nixon M.P., Minister for Transport, AGPS, Canberra 1977, p. v.
13. Joy, p. x.
14. Exhibit number 18, p. 4.
15. Trevor Sykes, 'Our Multi-Million Dollar Men In The Ministry', *The Bulletin*, August 18, 1981, p. 72.
16. *Railways Agreement (South Australia) Act* 1975, Schedule, Clauses 8, 9, 17 and 21; and *Railways (Tasmania) Act* 1975, Schedule, Clauses 6, 7, 8, 12 and 17.
17. Evidence, p. 253 and pp. 255-256.
18. Exhibit number 24, p. 2.
19. Exhibit number 25, p. 2.
20. Western Australia, *Departmental Submissions To The Commonwealth Grants Commission For The Review of State Relativities*, Volume 1, February 1980, Departmental Number 1, Appendix 12, pp. 1-190.

21. Exhibit number 2, Response to Committee Question No. 29.
22. Exhibit number 11, p. 2.
23. Evidence pp. 249, 253, 255, 260.
24. Australia, Senate, Debates 1981, p. 811.
25. Exhibit number 17, p. 13.
26. Australia, Bureau of Transport Economics, *Railway Freight Operations: Survey of Wagon Utilisation*, Occasional Paper 23, AGPS, Canberra 1979, p. 63.
27. This practice has already been partly introduced by AN.
28. Evidence, p. 48.
29. Australia, Bureau of Transport Economics, *A Study of the Port Pirie Bogie Exchange*, AGPS, Canberra 1977, p. vii.
30. Australian National Railways Commission, *Annual Report* 1979-80, p. 9.

Chapter IV

1. Exhibit number 10, p. 4.
2. Australia, Parliament, *Budget Statements 1981-82, Budget Paper No. 1*, AGPS, Canberra 1981, pp. 54-55.
3. Australia, Bureau of Transport Economics, *Transport Outlook Conference 1978, Papers and Proceedings Volume 2*, AGPS, Canberra 1980, p. 120.
4. Australian Department of National Development and Energy, *Forecasts of Energy Demand and Supply—Primary and Secondary Fuels Australia 1980-81 to 1989-90*, AGPS, Canberra 1981, p. 25.
5. Exhibit number 26, p. 87.
6. Exhibit number 26, p. 85.
7. For further discussion on this probabilistic approach see A. Jackson and K. Linard 'Project Appraisal Under Uncertainty—Probabilistic Cost Benefit Analysis' *6th Australian Transport Research Forum*, October 1980, pp. 157-182. In essence the probabilistic approach requires the analyst to generate probability distributions for parameters which have a degree of risk of uncertainty, identify correlations between parameters and combine (in this case) revenue and expenditure to derive a probability distribution for the operating deficit in 1987-88.
8. Australia, *Supplementary Report of the Auditor-General upon other accounts for the year ended 30 June 1979*, AGPS, Canberra 1979, p. 44.
9. Evidence p. 655.
10. Evidence p. 49.

Chapter V

1. Australia, Parliament, House of Representatives Standing Committee on Expenditure, *Australian Industry Development Corporation*, AGPS, Canberra 1980, Finding (D), p. vii.
2. Australian National Railways Commission, *Annual Report* 1977-78, p. 44.
3. Exhibit number 18, p. 5.
4. Exhibit number 18, p. 5.
5. Australia, House of Representatives, Debates 1981, p. 1848.
6. Evidence, p. 297.
7. Australia, House of Representatives, Debates 1981, p. 1848.
8. Australia, Bureau of Transport Economics, *Transport Outlook Conference 1978, Papers and Proceedings Volume 1*, AGPS, Canberra, 1980, p. 46.
9. Evidence, p. 140.
10. Evidence, pp. 118-121.
11. Australia, House of Representatives, Debates 1981, p. 1849.
12. Australia, House of Representatives, Debates 1981, p. 1848.

Chapter VI

1. Exhibit number 14, p. 4.

Appendix 4

1. This section of the appendix is based on work undertaken by the Bureau of Transport Economics as reported in *A Study of Intersystem Railway Freight Rating Practices (with Particular Reference to the Riverina Area of New South Wales)* AGPS, Canberra, 1976, Annex A.
2. H. M. Kolsen, *The Economics and Control of Road-Rail Competition*, Sydney University Press 1968, pp. 40-41.
3. W. J. Baumol, et-al., 'Cost and Rail Charges', in D. Munby (ed), *Transport* Penguin Modern Economics, 1968, pp. 117-129.
4. Baumol, p. 117.
5. Baumol, p. 122.

6. Baumol, p. 126. Some of the rules of thumb used in fully distributed cost pricing are analysed in R. R. Braeutigen, 'An Analysis of Fully Distributed Cost Pricing in Regulated Industries' *Bell Journal of Economics*, Volume 11, Number 1, Spring, 1980.
7. See Chapter III, paragraphs 56-61.
8. Australian Railways Research and Development Organisation, *Definition of Public Service Obligations*, Melbourne, 1979; and *Public Interest Considerations in Australian Railways: Identification, Measurement and Compensation*, Melbourne, 1980.
9. Australian Railways Research and Development Organisation, *Public Interest Considerations In Australian Railways: Identification, Measurement and Compensation*, Melbourne, 1980, pp. 3-4.
10. E. J. Walker and J. M. Murdoch, *Government Railway Contracts*, Sixth Australian Transport Research Forum, Brisbane, 1980, pp. 341-358.
11. Walker and Murdoch, p. 343.
12. Walker and Murdoch, pp. 356-358.
13. Walker and Murdoch, p. 353.
14. Australia, House of Representatives, Debates 1917, pp. 794-796.
15. Australia, House of Representatives, Debates 1917, p. 757.
16. Exhibit number 28, p. 2.