Managing Mobility Markets in Melbourne

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Rationales for Transport Privatisation

- Why privatise?
- The general arguments are well-known. It is often asserted that privatisation:
  - yields private market efficiencies
  - taps into new sources of private capital
  - increases competition and institutional vibrancy
  - is more responsive to consumers and users
True or false?

- Does privatisation yield such benefits?
- More specifically, is private transport better than public transport?
- Of course the answer is: 'it depends'.
- That answer is not much use to policymakers.
- What are some principles that governments can use to make transport privatisation decisions?
- A query: how can privatisation be based on public interest?
The case of Melbourne, Australia

- This presentation will look at a leader in privatisation, for better and worse: the city of Melbourne in the Australian state of Victoria.
- Victoria has privatised much of its transport system over the last 15 years and its triumphs and travails provide some interesting policy lessons.
Privatisation began in earnest in the State of Victoria in the 1990s under a Liberal Party government (i.e. centre-right).

Liberal Premier Kennett conducted a successful turnover of the State's electricity generation to private enterprise and then turned his attention to transport.

Melbourne's trams and trains were first liberalised (more on this in a moment) and then, during Kennett's second term, outright privatised.

The building of the new Melbourne arterial road, CityLink, was also bid out to the private sector under Kennett, and this road used e-tolling exclusively.

The Kennett government also privatised freight rail.

Meanwhile the Liberal-Nationals Federal government had privatised Melbourne Airport.
Point #1: Transport is a system

- Victoria is an interesting scope because of the scale and scope of its privatisation.
- Except for a recent re-nationalisation of the relatively insignificant freight rail system, all major modes and means of travel are privately operated and sometimes outright privately owned (the lease and franchise being the primary means of public to private transfer).
- It's experience is not necessarily an endorsement for or against going 'whole-hog' but is a reminder that transport is not just about a single mode, especially in urban areas.
Point #2: There is a transport market and its product is mobility

- This raises a second point which is that transport, unlike some public goods and services, is a marketable commodity and that what people buy through its purchase is the desired outcome of mobility.

- It is an important thing for public leaders to keep in mind when either resisting or promoting privatisation.
Back to Melbourne transport – one system but many arrangements

- It should be pointed out, however, that there were many different arrangements and operators in Melbourne and Victoria transport.

- The Citylink arterial was a greenfield investment, where the private sector put up its own money in return for a long-term lease (approximately 35 years).

- The trams and trains were brownfield turnovers of existing systems conducted through franchise agreements.

- The freight line was a straight brownfield sale to a private operator.

- The airport was a long-term brownfield lease, this through the federal government.
Point #3: Think systemically, but deliberate locally

- Why these different arrangements?
- The simple answer is that although there is one system for providing mobility through transport facilities and services, the elements of that system have different economics, histories and institutions.
- For urban arterials, greenfield investments were clearly needed but financing capacity was limited.
- For transit, the immediate need was improved operation and lowered public subsidy of the existing system.
- Passenger rail also has different economics than freight rail, and airports are different from highways.
A surprise election result

- In 1999 there was a surprise victory in State elections when the Labor Party won power.
- Despite having run against privatisation, the new Bracks government immediately embraced it.
- This was partly because privatisation was not a Labor-Liberal issue. Earlier federal Labor governments of Hawke and Keating had privatised many government functions in earnest.
- Moreover the Kennett reforms, especially in transit, seemed to be working well (though they were very new).
Trouble down the road

- However the Melbourne trains and trams soon hit difficulties.
- The main problem was that increased ridership estimates upon which reduced public subsidy and franchise performance requirements were based did not materialise.
- By 2001 the franchisees were expressing concern about their financial position and in 2002, during renegotiations initiated by the government, one of the major operators, National Express, defaulted on their contracts.
- As serious as this sounds, the Bracks government was able to rely on the remaining two franchisees, Connex Melbourne and Yarra Trams and the transition was seamless.
Point #4: If you privatise, first prepare, prepare, prepare

- One thing that the Kennett government had done in transit was to make a number of operational changes to the public system prior to privatisation.

- Public subsidy was first reduced through some significant cuts to services and hard negotiations with the transport unions, which had conducted a number of serious strikes over the years, that trimmed back inefficient work-rules.

- Between 1992 and 1996, staff and taxpayer cost of the public transit system was cut in half, yet ridership increased.
And prior to privatisation, the Bracks government created new high-level government bodies to study the issues, create model service agreements, manage the negotiations and oversee implementation.

One reason there were multiple franchisees in the first place, rather than one system operator as system economies of scale might dictate, was because the Kennett task forces had thought about the possibilities of operator default.

This points to the fact that privatisation is no replacement for government management and policy capacity before, during and after.
Now about the roads

- The roads of Melbourne are a different kettle of fish than the trams and trains.
- Of course they are different sorts of facilities, with different modes, different sorts of economics (and politics), different kinds of users, though there is clearly an overlap as well.
- In this particular case there is also the big difference that the roads were built by the private sector from scratch.
Melbourne Connectors

- Already mentioned was CityLink, the first tollway private greenfield expansion of urban arterials.
- This is owned and operated by Transurban. This company has since built the Western and Southern Links.
- Since then there have been improvements in and around that corridor, especially the Monash-CityLink-WestGate upgrade and
- There has also been completion of EastLink, which is run by ConnectEast.
Successes...

- These various roads have, in many ways, been successes, in that they have added substantial capacity to Melbourne's urban arterials in a relatively short time. CityLink opened in 2000 and now there have been the new expansions already mentioned.

- These investments did not require substantial up-front public money since it is toll revenues that are supposed to finance construction and operation
...and controversies and difficulties

- On the other hand, there have been issues with these roads, issues that are common to many greenfield toll roads.

- Of course one problem from the public's perspective are the tolls themselves.

- The standard proposition is that people are willing to pay for new value-adds but not mere monopoly rents.

- The roads are clearly new, but there are, as always, questions about how much travel time users actually save as compared to alternatives.
About those alternatives

- The operators of both CityLink and the newer EastLink have sometimes been perceived as having tolls that are too high, a perception which the companies obviously resist.

- (ConnectEast estimates the 'average' cost to users of its EastLink at $2.91, with Transurban averages estimated at $4).

- And to maximize toll revenue, private operators obviously prefer to have as few alternative routes available as possible.
Diversions

- The contract between the Government and Transurban allows Transurban to make a claim against the State Government if the State Government does something that reduces the number of cars that could use CityLink.

- In 2001 Transurban sued the State of Victoria over the construction of Wurundjeri Way through the Melbourne Docklands on these grounds, a doctrine that potentially also be could applied to expansions of capacity of other roads or rail routes parallel to CityLink.

- Some existing local streets have also been closed to avoid 'rat-runs.'
Traffic estimates and viability

- Of course no one likes monopolists, but it is also true that private operators need to make a profit and the public needs their roads operated.

- If traffic falls short of estimates this can threaten the viability of the road operator, in the worst case throwing the road into receivership.
Point #5: Risk allocation is everything

• “The basic principle of optimal risk management...is that risk should be allocated to the party best able to manage it.
• In the case where risk arises entirely from the possible actions of one party to a contract, that risk should be internalised, that is, borne by the party able to affect it.
• This principle provides immediate guidance on the appropriate risk allocation for the ‘standard’ infrastructure project, in which it is necessary to construct a piece of infrastructure that will then form part of a network used to provide publicly-funded services.”

Types of project risk

• “Four main components of risk may be identified.
• The first is risk associated with the construction phase, for example, the possibility of delays due to strikes or equipment breakdowns.
• The second is operational risk, for example risk associated with the cost of repairs and maintenance.
• The third is demand risk, associated with the quantity and value of the services actually provided by the infrastructure asset.
• The fourth is ownership risk, that is, the pure risk premium associated with risky capital investment.”

(source: ibid)
Point #6: The contract is paramount

- This leads to a critical point which is that once the public sector engages the private sector to deliver transport services and/or infrastructure, the agreements between those two parties need to contain all the salient points and contingencies.

- For example, the current Victoria labor government is considering some form of congestion pricing to ease Melbourne's road traffic (and also improve its transit performance since the trams share city streets with cars). However Transurban is resisting this because it doesn't want to muck up its traffic volumes.
A generic “PPP”

...have they all read their contract?
Has privatisation in Melbourne worked?

- Is Melbourne a success?

- It clearly is not a failure in that new roads have been built with little new public investment, while transit has generally performed well (though without the dramatically reduced public subsidy once anticipated).

- However the public has definitely paid for these results, especially with tolls (less so with fares).
And there have been significant crises and along the way, especially with transit.

A new crisis may be brewing with the international credit crunch and the stress that this has put on the road operators especially.

The bottom-line is that transport privatisation does not remove the key public sector responsibilities of accountability to citizens, wise management of public resources, and overall strategic policy vision.

Overall the Victoria government has brought these elements to bear on its privatisations, avoiding debacles and managing progress relatively well but if it hadn't, the picture might have been much different.