



COMMONWEALTH GRANTS COMMISSION

DISCUSSION PAPER CGC 2000/2

2004 REVIEW URBAN TRANSIT — A CONCESSIONS AND OTHER PAYMENTS APPROACH

JULY 2000

INTRODUCTION

1. This paper advises the States that the Commission intends to use a Concessions and Other Payments (COP) approach to the 2004 Review assessment of their needs associated with Urban Transit. It also seeks State views on the Commission's proposals and asks for assistance in the development of an appropriate assessment.

THE CASE FOR CHANGE TO A CONCESSIONS AND OTHER PAYMENTS ASSESSMENT

2. By 2004, there will be a strong case for using an approach to Urban Transit that is similar to that used in the assessment of COP categories in the 1999 Review. This is because:

- (i) there have been considerable changes in the way the States are funding Urban Transit services and we see greater movement towards privatisation and corporatisation of these services between now and 2004;
- (ii) the COP assessment approach offers scope to simplify the assessment; and
- (iii) States have concerns, which we share, about the existing Urban Transit assessment.

1999 Review

3. *The 1999 Review Urban Transit Assessment.* In the 1999 Review, the Commission undertook separate Urban Transit assessments of gross expenditure and revenue. It looked at the total operations of urban transit bodies. The category included transactions relating to the provision of urban transit services for capital cities and urban centres of 50 000 people or more. The transactions included:

- (i) the operating expenditure of most urban transit bodies, excluding depreciation, debt charges and superannuation;
- (ii) the subsidies paid to some urban transit authorities, such as the Brisbane City Council and private operators in Melbourne and Sydney; and
- (iii) fares and other revenue.

The Urban Transit category covered about 40 per cent of the total cost to the States of urban transit services. Other expenditures were in the Depreciation, Debt Charges and Superannuation categories.

4. The Commission assessed standardised expenditure and revenue and presented the result as a net figure. A standardised level of service for each State was calculated. This took into account the characteristics of the urban population and urban form of cities in each State. Standardised expenditures were calculated by multiplying the standardised level of service by standardised costs. Standardised revenues were calculated by applying an Australian average revenue effort to the standardised level of service.

5. The model used to derive the standardised level of service assumed that demand for urban transit services depended on characteristics of the city to be served — population density, size of city, urban form and the level of car ownership. It was measured in terms of standardised passenger kilometres. Standardised cost depended on economies of scale, congestion, wage levels, fuel and power prices, and vandalism and security requirements. Attachment A provides a summary of the assessment method and an analysis of the effects of Urban Transit on State grants.

6. States were critical of the assessment because they considered:

- (i) the data to be inadequate;
- (ii) the approach too complex; and
- (iii) the theory behind the model to be wrongly specified.

States also criticised the Commission for developing the assessment very late in the 1999 Review process. They did not think they were given enough time to provide comment on the method.

7. ***Public Trading Enterprises and the National Competition Policy.*** In the 1999 Review, the Commission changed the way it assessed the impact on State budgets of most Public Trading Enterprises (PTEs).

8. It recognised that States were changing the functions they undertook. These changes were largely connected with micro-economic reform and the National Competition Policy (NCP). Some of these changes began before the commencement of the NCP. The NCP included reform in the electricity, gas, water and road transport industries. As a result of the reforms, States were less likely to provide the utility services. They were more likely to be funding only the concessions some recipients of utility services needed.

9. To recognise these changes, the Commission changed its approach to assessing the budget impacts of most PTEs (or their replacements).

10. ***Concessions and Other Payments Assessments.*** The Commission assessed the net impacts of most PTEs on State budgets in the Concessions and Other Payments group. The standard budget included only the budget impact of enterprises, not the detailed financial transactions of those enterprises. The Concessions and Other Payments group were classified according to function into assessment categories for: Electricity and Gas;

Water and Sewerage; Freight; Non-Urban Passenger Transport; Other PTEs; and Other Concessions.

11. The COP categories were assessed using a standard framework of:

$$\begin{array}{l} \text{Standardised expenditure (impact on budget)} \\ = \text{ standard concession} \quad \times \quad \text{level of service disability} \\ \quad \quad \quad \quad \quad \quad \quad \quad \quad \times \quad \text{cost disability} \end{array}$$

Where:

- (i) the standard concession was the per capita average expenditure for the category;
- (ii) level of service disabilities were calculated as the relative numbers of pensioners or other population groups in receipt of the standard concession; and
- (iii) cost disabilities recognised things that altered the relative cost of the standard concession, such as the physical environment or access to competitive markets.

The Role of State Governments in Urban Transit Provision

12. While the provision of urban transit services is not subject to a specific reform agreement, there has been increased privatisation and corporatisation of service providers and all State PTEs have an increased commercial focus. States have established separate bodies to oversee prices. Several States have tendered out the use of their urban transit infrastructure.

13. The level of private provision of urban transit services has grown substantially since the 1999 Review. State budget papers indicate that this trend will continue. The larger States now purchase most services, particularly bus services. The three smallest States still directly provide their major urban transit (bus) services. Victoria is alone in privatising the provision of rail services.

14. Table 1 summarises the way States provide urban transit services. A detailed analysis is contained in Attachment B.

Table 1 URBAN TRANSIT SERVICES NATURE OF PROVISION

	Rail	Light Rail	Bus	School Bus Services
NSW	State	State	State & Private	State & Private
Vic	Private	State	Private	Private
Qld	State	NA	Local Gov't & Private	Local Gov't & Private
WA	State	NA	Private	Private
SA	State	State	Private	Private
Tas	NA	NA	State	State
ACT	NA	NA	State	State & Private
NT	NA	NA	State	State & Private

NA - not applicable.

15. Implicitly, States recognised the economic and social benefits of urban transit provision by funding transport PTEs' operating deficits. More recently, however, and associated with the movement to privatisation or corporatisation, States have increasingly been making explicit community service obligation payments (CSOs) to fund PTEs.

16. CSOs can take the form of:

- (i) concessional CSOs — for the cost of providing concessional travel to students, the unemployed and pensioners;
- (ii) service level CSOs — to ensure the provision of minimum service levels; and
- (iii) service level CSOs — for the provision of non-commercial services in excess of minimum service level requirements; and
- (iv) pricing CSOs — for fares below a commercial level.

17. Most rail PTEs receiving explicit CSO payments also receive contributions from government to cover operating losses and capital expenditure.¹ These could be seen to reflect externalities such as pollution reduction, traffic density reduction and enhanced quality of life.

¹ Productivity Commission, 1998, *Performance of Government Trading Enterprises 1991-95 to 1996-97*, p241.

URBAN TRANSIT A CONCESSION AND OTHER PAYMENT ASSESSMENT?

18. The Commission did not include Urban Transit in the Concessions and Other Payments group in the 1999 Review. This was because the NCP agreements did not include Urban Transit and the States directly provided a large proportion of the services. The Commission also thought it necessary to look closely the accounts of the authorities to properly estimate the expenditure and revenue disabilities.

19. The task now is to develop an assessment that better matches the likely provision and funding of 'Urban Transit services' in the period 2004-2008. We think that, during that period, the level of direct public provision will be even lower than at present and the provision of identified CSO funding will become standard policy. We also think that, as the level of public provision falls, the type of data available will change to reflect the change in the States' role. Availability of detailed accounting and other information relating to the operations of urban transit providers is likely to decline greatly. Lastly, we share State concerns about the complexity of the current Urban Transit assessment. We consider that a simpler assessment is highly desirable.

20. In summary, we have concluded that a COP approach to the assessment of Urban Transit in the 2004 Review is the way forward. It will best reflect what States are doing. It may be the only option and should result in a simpler assessment.

21. The simplicity of the assessment will depend on the range of purposes for which States make CSO payments. We note that State governments at present pay CSOs to urban transit providers for:

- (i) concessional purposes — discount fares for students, seniors, unemployed persons and so on; and
- (ii) non-concessional purposes — an amount paid for all passengers regardless of their status, to provide minimum service levels and to reduce congestion and other environmental damage.

22. The simplest COP assessment for Urban Transit would recognise only those needs relating to CSOs paid for concessional purposes. All States provide such concessions. It is clearly appropriate to recognise socio-demographic differences between States in the assessment. Those populations eligible for the concessions would receive a cost weight. The weights would be based on the ratio of the concessional fares to standard fares.

23. The CSOs paid for non-concessional purposes are potentially more difficult to assess. States do not seem to have a common set of policies in this area, maybe because they face differing requirements. We will need to establish which of the many observed CSOs paid to urban transit providers are related to need and not simply a State's policy choice. We will also need to understand how States cost the CSOs they provide.

24. We think that a COP Urban Transit assessment may need to recognise that States provide CSOs for purposes other than concessions. But we will not do so unless clear evidence of the need and standard costs can be established.

- (i) A number of States still appear to be gap-filling — that is providing subsidies equal to their urban transit authorities' deficits.
- (ii) Some States provide subsidies which allow service providers to achieve a reasonable rate of return and to provide a return to shareholders, including to the State. Is this need or policy?
- (iii) Some States argue that they need to subsidise urban transit authorities to guarantee minimum levels of service in areas of low demand.
- (iv) Other States argue that high levels of urbanisation require subsidies to urban transit authorities to enable them to provide higher levels of services and lower prices to encourage commuters to use public transport rather than their cars — to reduce congestion and other environmental damage. If this is need, how do we quantify it?
- (v) Some modes of travel are said to require higher subsidies than others. Heavy rail has high capital costs and is provided in cities above a certain size to handle the demand. This has implications for how States' depreciation and debt charges costs are handled, both by the State in calculating CSOs, and by the Commission in its assessments. Depending on how these costs influence States' CSO payments, a COP assessment may cover the Depreciation and Debt Charges costs associated with urban transit infrastructure.
- (vi) Some argue that subsidies are required to ensure services are provided in ways which overcome disadvantages caused by the urban form of cities. For example, how much higher must a CSO payment be to ensure urban transit services are provided in very dispersed cities or cities with rivers or harbours?

Moving to a Concessions and Other Payments Approach

25. We think that assessing urban transit as a COP category would have a number of advantages. These include:

- (i) better reflecting how States are providing the service;
- (ii) ensuring greater consistency in the Commission's assessments;
- (iii) simplifying the assessments, including those for Depreciation and Debt Charges;
- (iv) removing the necessity for the Commission to have a detailed understanding and analysis of the operations of urban transit providers; and

- (v) reducing the data needs of the assessments.
26. In assessing Urban Transit as a COP category, it will be necessary to ensure that:
- (i) the issues that the States consider in determining the level of CSO payments for Urban Transit services are taken into account;
 - (ii) needs relating to debt charges and depreciation associated with the provision of these services are properly recognised;
 - (iii) differing policies regarding fare revenue, and the reasons behind such differences, are accounted for; and
 - (iv) differences in the level of subsidy to public and private sector providers are appropriately attributed to policy or need.

VIEWS OF THE STATES

27. We seek State views on the following.
- (i) Is the Commission on the right track in proposing a COP type assessment?
 - (ii) Have we correctly identified (in the paper and in Attachment B) how urban transit services are being provided now and what is likely in the period 2004-08? What other changes are likely?
 - (iii) Can States provide information on other important differences? For example, are there differences in the ownership of infrastructure and equipment that are relevant to how depreciation and debt charges impact on State budgets?
 - (iv) What CSOs are States funding in relation to urban transit? What factors influence the cost of providing these CSOs? Do the States have any suggestions on how to assess non-concessional CSOs?
 - (v) For what size urban centres do States provide CSOs for urban transit? The current cut off of 50 000 persons may not reflect State practice.
 - (vi) Does the type of ownership (public or private) effect the level and type of CSOs paid for urban transit services?
 - (vii) What other implications might there be in moving to a COP assessment?
 - (viii) What data do States have that would facilitate a COP assessment?

1999 REVIEW ASSESSMENT METHOD

Assessment Method

A.1 In the 1999 Review, the Urban Transit category covered the operating expenditure — excluding depreciation, debt charges and superannuation — and the user charges and other revenue associated with urban transit services for capital cities and major urban centres with a population of 50 000 or more. The Urban Transit category thus covered about 40 per cent of the total cost of urban transit services to the States.

A.2 Table A-1 shows the category standard for the five years used in the 2000 Update, and the previous year. In 1998-99, this category represented 2.3 per cent of total standard expenditure.

Table A-1 EXPENDITURE AND REVENUE STANDARDS, URBAN TRANSIT, 2000 UPDATE

	1993/94	1994-95	1995-96	1996-97	1997-98	1998-99
Standard expenditure (\$pc)	133.89	127.40	132.64	110.83	130.21	135.44
Standard revenue (\$pc)	53.42	54.16	58.01	50.58	48.15	46.96
Net expenditure (\$pc)	80.47	73.25	74.63	60.25	82.05	88.48
% of total standard expenditure	2.49	2.26	2.25	1.77	2.31	2.30

Note: Numbers may not add due to rounding

A.3 Conceptually, the assessment is relatively simple. The Commission calculated a standardised level of service for each State, taking into account the characteristics of the urban population and urban form. This standardised level of service was multiplied by the standardised unit cost to generate standardised expenditure. Standardised revenue was calculated by applying an Australian average revenue effort to the standardised level of service.

A.4 ***Expenditure assessment structure.*** The Commission allocated Urban Transit expenditure to two components and assessed the following disabilities:

- (i) public transport operating expenditure — a joint demand and cost factor; and
- (ii) national capital — a national capital factor.

A.5 The joint demand and cost factor was derived using estimates of the standardised expenditures associated with providing urban transit services. Standardised expenditures were calculated by:

- (i) estimating a standardised number of journeys for each of the three main groups of passengers (regular passengers [mainly commuters], concessional passengers and students) in the capital city;
- (ii) converting the estimates of passenger journeys to passenger kilometres by applying average journey lengths for each city;
- (iii) applying a notional cost per passenger kilometre to the estimated passenger kilometres (the notional cost per passenger kilometres was derived from data for all States to reflect the economies of scale associated with increases in the size of the task, together with adjustments for the effects on expenditures of differences between the States in congestion, wage levels, fuel and power prices, vandalism and security requirements); and
- (iv) adding estimated expenditure for services provided in the State's other urban centres with populations of more than 50 000, imputed using details for the State capital cities of comparable size.

A.6 The most difficult part of this calculation was the estimation of the standardised number of passenger journeys for each city. The Commission based these on a policy-neutral travel propensity for each group of passengers in each capital city — that is, estimates of the likelihood of people in each city using public transport, assuming that States provide the average level of service and charge the Australian average fares. The propensities were derived by:

- (i) calculating a *city-wide propensity* of residents in each city to travel by public transport; and
- (ii) applying a *basic access adjustment factor* that reflected the effects of differential access to private vehicles.

A.7 **Revenue assessment structure.** The Commission allocated revenues to:

- (i) a fare revenue component (with revenue raising capacity based on the Australian standard fare multiplied by standardised passenger kilometres for each State); and
- (ii) an other revenue component assessed as equal per capita.

A.8 **Urban transit depreciation assessment.** The need for different amounts of depreciation on urban transit stock in each State was recognised in the 'urban transit construction' and 'urban transit plant and equipment' components of the Depreciation category. These capital requirement factors were based on the standardised service levels (passenger kilometres) calculated in the Urban Transit assessment. The service levels were adjusted to recognise differences in the efficiency with which States could use capital because of the size and form of their urban areas. The capital adjustment factors were based on the relationship between seat kilometres and passenger kilometres for transport tasks of various sizes, using data from all States.

A.9 The asset life factor used in both urban transit components reflected the effect on depreciation costs of the shorter useful lives of assets in northern Australia.

A.10 A construction cost factor was applied in the urban transit construction component. It measured the differences between States in the construction costs incurred to provide a standard level of infrastructure at a standard cost. The Commission based the standard infrastructure requirements on judgement and the standard construction costs on data provided by the States.

A.11 **Urban transit debt charges assessment.** The depreciation disability factors for the urban transport components (weighted by 75 per cent) and the Urban Transport category factors (weighted by 25 per cent) were used to calculate standardised capital expenditure on urban transit in the Debt Charges assessment.

A.12 **Urban transit superannuation assessment.** The Urban Transit category factor was used to assess superannuation needs for urban transit services.

A.13 Table A-2 shows the effect on grants of the Urban Transit assessment and of the assessment of superannuation, depreciation and debt charges relating to urban transit.

Table A-2 EFFECT OF URBAN TRANSIT ASSESSMENTS ON GRANTS, 1999 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Urban Transit Category	-32.7	6.5	14.7	7.1	23.4	-15.9	6.4	-9.4	58.0
Superannuation	14.5	2.6	-7.0	-3.9	-1.6	-2.9	-0.2	-1.5	17.1
Depreciation	96.0	11.0	-49.6	-21.8	-10.6	-14.0	-4.6	-6.3	107.0
Debt Charges	154.2	19.7	-81.4	-34.4	-16.6	-23.0	-8.4	-10.2	174.0
Combined redistribution	232.0	39.8	-123.3	-53.0	-5.4	-55.8	-6.8	-27.4	271.8

Source: Commonwealth Grants Commission, *Report on General Revenue Grant Relativities 1999*, Vol II, p166.

HOW DO STATES PROVIDE URBAN TRANSIT SERVICES?

B.1 This attachment summarises the Commission's understanding of how States are providing urban transit services. State governments are now purchasing a large proportion of services from private providers, although it is not always clear who owns the infrastructure.

New South Wales

B.2 In New South Wales, the Department of Transport contracts for the provision of public transport services with private operators and two Government-owned agencies — the State Transit Authority (STA) and the State Rail Authority (SRA). All funding arrangements for public and private transport services are on a commercial basis. This ensures greater accountability and transparency of funding by eliminating cross subsidies between entities.

B.3 State Transit operates buses and ferries that cover much of metropolitan Sydney and Newcastle. On July 1 1996, the NSW Government divided the provision of rail services between four entities:

- (i) Rail Access Corporation (RAC) owns the rail network;
- (ii) FreightCorp undertakes freight train operations;
- (iii) The Rail Services Authority provides maintenance services; and
- (iv) SRA operates passenger services through CityRail and Countrylink.

B.4 The School transport subsidy scheme provides eligible students throughout the State with free transport to and from school. The subsidy goes to private transport providers, the State Rail Authority and the State Transit Authority.

B.5 Table B-1 shows how much is paid for services.

Table B-1 NSW GOVERNMENT PURCHASE OF PUBLIC TRANSPORT SERVICES 1999-2000

Nature of the Payment	\$ million
Private operators of buses, taxis and ferries	359.367
Light rail project	12.300
STA bus and ferry services	55.205
STA – School Students Transport Scheme and Pensioners concessions	120.439
SRA – School Students Transport Scheme and Pensioners concessions	200.472
SRA – CityRail and Countrylink services	262.729
SRA – capital grants	236.000
Maintenance Grant to SRA	115.000
Rail Access Corporation – capital grants	6.938
Total	1 368.450

Source: NSW Budget Estimates 2000-2001, p 20.29.

Victoria

B.6 Private franchisees provide metropolitan passenger rail and tram services under government contract. The contracts require a full range of services to be provided according to fares and timetables determined by the Government. There are financial incentives in the contracts for operators to attract extra customers. The conditions in the contracts require the expansion of public transport networks and fleet modernisation and refurbishment programs.

B.7 The franchises have four main sources of income — fares, government subsidies, top-up payments for concession tickets, and incentive payments for passenger growth. Subsidies cover revenue shortfall and indirectly underwrite an investment program in rolling stock upgrades, bus replacements and infrastructure.

B.8 The Victorian government provides bus services in Melbourne through contract arrangements with 41 private operators.

B.9 Table B-2 provides a summary of the subsidies to be provided by the Victorian Government in 2000-01.

Table B-2 ESTIMATED SUBSIDIES TO BE PROVIDED BY VICTORIAN GOVERNMENT 2000-01

Nature of the Payment	\$ million
Metropolitan train services	546.8
Metropolitan tram services	293.5
Metropolitan bus services	217.3
Total	1 057.6

Source: Victorian Budget Estimates 2001-01, pp 128-129.

Queensland

B.10 Brisbane City is the only local government council to provide a major urban transit service. It operates bus and ferry services in the Brisbane region and receives a subsidy payment from the State Government. Private operators provide the majority of services outside the Brisbane City Council area.

B.11 Citytrain, a division of Queensland Rail (a Queensland Government owned Corporation), provides passenger rail services in the Brisbane region. The Queensland Government pays for the provision of socially required but non-profitable services.

B.12 Table B-3 shows the subsidies paid for public transport by the Queensland Government in 1998-99

Table B-3 SUBSIDIES PROVIDED BY QUEENSLAND GOVERNMENT 1998-99^(a)

Nature of the Payment	\$ million
Bus and ferry subsidies to Brisbane City Council	133.000
Bus and ferry services to private operators	118.293
Services purchased from Queensland Rail	539.736
Total	791.029

(a) Includes subsidies to non metropolitan areas.

Source: Queensland Transport Annual Report 1998-99, pp 98 and 113.

Western Australia

B.13 Perth has an integrated transport system of State owned buses, trains and ferries that display Transperth colours. Passengers may transfer from bus to train to ferry on one ticket. Private companies and government organisations compete to run Transperth services. Perth Water Transport has the contract for the Transperth ferry service. Westrail is the government owned operator of the train services. Table B-4 provides a summary of the Government subsidies to be provided for urban transit in Perth in 1999-2000.

Table B-4 ESTIMATED SUBSIDIES TO BE PROVIDED BY WESTERN AUSTRALIAN GOVERNMENT 1999-2000

Nature of the Payment	\$ million
Fastrak Westrail	98.554
Private bus operators	99.565
Ferries service	0.339
Metrobus	18.442
Total	216.900

Source: 2000-2001 Budget Statements, Volume 3 p1426.

South Australia

B.14 The Passenger Transport Board, a statutory authority, regulates and funds land-based passenger services in South Australia. Table B-5 provides a summary of its revenues and expenditures. It sets fares and manages both the integrated ticketing system and passenger information centre. TransAdelaide, a publicly funded Government owned enterprise, provides rail services. The government contracts out metropolitan bus services to five private sector companies, but retains ownership of the buses and depots and leases them to the operators. There are financial incentives for operators to increase patronage.

Table B-5 PASSENGER TRANSPORT BOARD METROPOLITAN EXPENDITURES AND REVENUES 1998-99

Nature of the Payment	\$ million
Payment to metropolitan service contractors	206.840
State rail concession reimbursement	0.300
Metroticket sales	-46.713
Ticket equipment lease	-6.433
State Government reimbursements for concessional travel	-24.203
Total	129.791

Source: Department of Transport, Urban Planning and the Arts, Annual Report, 1998-99, pp152 and 159.

Tasmania

B.15 Metro Tasmania Pty Ltd, a State-owned company, provides a public bus service in the metropolitan areas of Hobart, Launceston and Burnie. During 1999-2000, Metro Tasmania's contract with the Government provided for the payment of \$18.3 million² of CSOs. This funding provides for fares subsidies and the provision of the full range of Metro services to pensioners, students and the unemployed.

² Tasmania, 2000-2001 Budget Paper Number 2, p171.

Australian Capital Territory

B.16 ACTION, a division of the ACT Government's Department of Urban Services, provides Urban Transit services in the ACT. ACTION provides public transport services in the form of scheduled bus services, school bus services and special needs transport services. The ACT private bus sector is small and concentrates on charters and some special school services. It is subsidised by the ACT government. Table B-6 provides information on the subsidies provided.

Table B-6 SUBSIDIES PROVIDED BY ACT GOVERNMENT 1999-2000

Nature of the Payment	\$ million
School services, including rural school service	10.548
Fare level CSO	19.069
Late night/weekend CSO	10.586
Injections for operations	5.241
Capital injections	2.785
Total	48.229

Source: 2000-2001 Budget Paper No.4, pp160 and 198.

Northern Territory

B.17 The Territory Public Transport Services provides an urban and school bus service in Darwin. The Darwin Bus Service (DBS), a Government Business Division, carried 3.143 million passenger in 1998-99 and the dedicated school bus service run by a private operator carried 0.627 million passengers. The subsidy to DBS in 1998-99 was \$7.3 million³.

³ Department of Transport and Works, *Annual Report 1998-99*, p31 – 32.