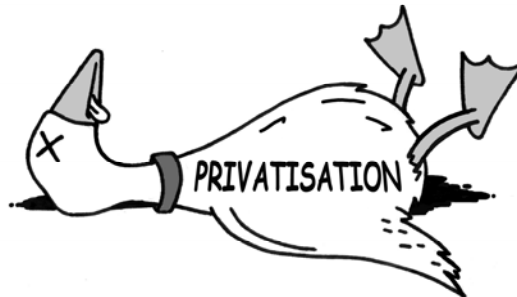
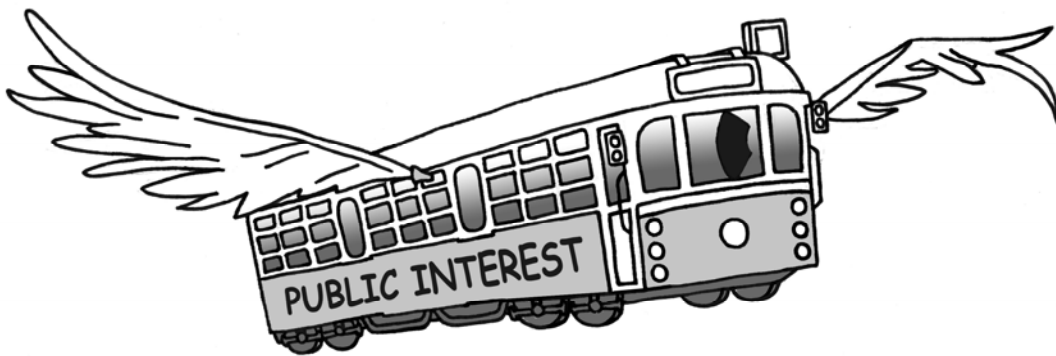


PUTTING THE PUBLIC INTEREST BACK INTO PUBLIC TRANSPORT

A report to the Victorian community



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SUMMARY

The privatisation of Melbourne's trams and trains has been an expensive failure. By June 2006, the privatised system will have cost \$1.2 billion more in public subsidies than continued operation by the former Public Transport Corporation; by 2010 this difference will blow out to \$2.1 billion. This is not counting the above-inflation fare rises at the end of 2003. Services have not improved, despite claims to the contrary; nor are the claims of a capacity crisis on the rail system correct. Private bus services consume large subsidies to provide poor services which carry low patronage levels.

Private operators are blaming the system's problems on insufficient subsidies, and are lobbying for increases. But the reverse is the case: train, tram and bus operators will receive \$1.2 billion this year in subsidies and fares – more per head than first-class overseas public operators such as Vancouver's Translink.

Privatisation has not served the public interest. The State government is preparing a 'transport and livability statement', which will reiterate proposals for public transport improvements and extensions from previous documents, such as Melbourne 2030 (released in October 2002). Regardless of the merits of these proposals, they cannot be delivered affordably or effectively under the current institutional arrangements.

The tram and train franchise agreements were released (quietly) late last year and we have analysed their contents. The franchises will expire on 30 November 2008, unless the state government gives notice that it wants to extend them. Such notice must be given by 30 November 2007 (only 19 months from now), but can be given at any time. If no such notice is given, then Melbourne's trains and trams will revert to public ownership at 3am on 30 November 2008 without the risk of compensation claims.

We recommend that instead of extending or renewing the franchise agreements, the state government replace them with a new public transport agency modelled on the very best in the world, such as those in Vancouver, Zurich or even Perth. We make detailed recommendations about the best way of establishing a dynamic, efficient, accountable public body to spend the annual \$1.2 billion budget.

The new public transport agency would have a small staff, no more than 30 or so, selected from the best people in the world. It would also have a governing board that meets in public and shares information with the public. The agency would need to be established well before the franchises expire in 2008, so it could 'hit the ground running' when it takes over the operation of services. It would then be charged with upgrading, integrating and extending trains, trams and buses to world's-best standards.

We are presenting these proposals to the Victorian community and the state government for consideration between now and 30 November next year (the last day on which the government can give notice that it wants to extend the Yarra Trams and Connex franchises). In the meantime, we call on the government not to extend the franchises, so the community has a chance to have a say about putting the public interest back into public transport.

INTRODUCTION

Why governance matters

The State government is preparing a 'transport and livability statement', for release around the time of the May budget. The statement is a response to increasing public concern about the poor state of public transport, and the non-delivery of proposals for public transport improvements and extensions made documents such as the *Melbourne 2030* metropolitan strategy (released in October 2002).

We understand that the May statement is likely to reiterate many of the public transport proposals from *Melbourne 2030*. The critical question that must be addressed, however, is why has there been so little progress more than three years after *Melbourne 2030* was released.

Last year, a team of experts from the University of Toronto published the results of a review of factors contributing to 'best practice' in urban transport. They concluded that, while adequate finance, infrastructure and urban planning are important, the critical requirement is effective 'governance' – i.e. appropriate organizations with the necessary powers, skills and responsibilities.¹

We agree with this conclusion, and contend that no substantial progress can be made on the public transport front in Melbourne until appropriate arrangements are in place to permit the planning, funding and provision of high quality public transport. This is not the case at present.

Background to privatisation in Melbourne

In 1999 the Kennett government privatised Melbourne's trains and trams (most buses had always been privately run; the remaining public buses were privatised in the mid-1990s). Three overseas firms were taken on as 'franchisees' and promised Melburnians the best of all possible worlds. Services would improve, patronage (and therefore fare revenue) would increase and public subsidies would fall.

After only two years, the franchisees began to demand additional subsidies over and above those they had agreed to. The Bracks government, which had opposed privatisation while in opposition, re-hired the officials who had presided over the 1999 privatisation to advise it. In early 2002, the government announced a rescue package: subsidies were increased, and the franchisees' service obligations under the 1999 agreements relaxed.

Despite the additional subsidies, the UK firm National Express announced in December 2002 that it was pulling out of its Melbourne tram and train operations. The State government appointed receivers to run the businesses

¹ C. Kennedy, E. Miller, A. Shalaby, H. McLean & J. Coleman (2005): 'The Four Pillars of Sustainable Urban Transportation', *Transport Reviews* 25(4), pp. 393-414.

and commenced negotiations with the two remaining firms, the French-owned Connex and Yarra Trams, to take over the system. As part of these negotiations the State government permitted higher-than-inflation fare rises at the end of 2003 (including abolition of the short trip ticket in zone 1).

In February 2004, the State government announced that it had signed new franchise agreements with Connex and Yarra, who would run the whole train and tram system in return for higher subsidies and lower service obligations. At the time, the Transport Minister Peter Batchelor was reported in the press as conceding that the new arrangements were no cheaper than public ownership. However, precise figures on subsidy payments were not released at this time; nor were details of the new franchise agreements.

Late in 2005, the Auditor-General released a report into the re-franchising process. While unfortunately this report did not compare privatisation to an efficient publicly-run system², it did set out, for the first time, the subsidies paid to Connex and Yarra (see next page). At around this time, the franchise agreements were, without fanfare, released on the 'government contracts' website.

WHAT OUR ANALYSIS TELLS US

This report is the result of our analysis of the subsidy data and the franchise agreements.

How has privatisation performed compared with public ownership?

In its last year of operation (1998-9), the Public Transport Corporation received total subsidies of around \$280 million to run Melbourne's trains and trams.³ According to the former Auditor-General Ches Baragwanath, who reported on privatisation in 1998, the PTC's subsidy had been reduced dramatically during the 1990s, and was expected to decline further with continuing efficiency improvements.⁴ To be conservative, however, we have compared the performance under privatisation with a continuation of the 1998-9 subsidy.

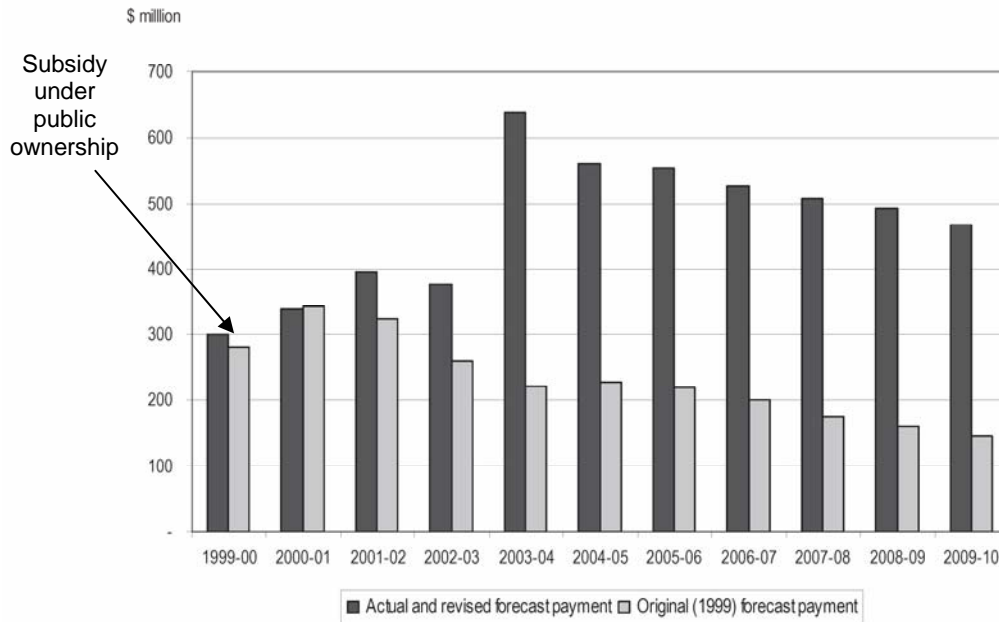
By the end of financial year 2005-6, the privatised system will have cost \$1.2 billion more to operate than a continuation of public ownership (see table 1). This compares with a projected saving of \$100 million under the 1999 contracts. If the current agreements continue until 2009-10, this extra cost will rise to \$2.1 billion (compared with the 1999 projection of a saving of \$550 million).

² It is not clear why this was not done. Instead, the Auditor General considered 'process' questions such as whether government guidelines for PPPs were followed.

³ All figures are from *Franchising Melbourne's train and tram system*, Auditor-General of Victoria, 2005, p. 25 (all figures are in real 2004-5 dollars).

⁴ *Report on Public Transport Reforms*, Auditor-General, 1998.

FIGURE 2E: MELBOURNE'S TRAIN AND TRAM PAYMENT PROFILE (2004-05 REAL DOLLARS) – PAYMENTS TO FRANCHISEES



Note: Consumer price index (CPI) sourced from the Australian Bureau of Statistics for the period 1999-2004. Base year of 1999-2000 used (March 2000). Forecast CPI sourced from the 2005-06 state budget.

Based on 30 June figures.

Includes additional costs associated with running the metropolitan train and tram system that are paid to the franchisees (such as rolling stock adjustments, concession fare payments and other service costs). These differed slightly between 1999 and 2004.

Source: Information provided by Department of Infrastructure.

Reference: Victorian Auditor General (2005) Franchising Melbourne's train and tram system, Parliament of Victoria, September. p.25.

Table 1: The cost of privatisation (\$million)

Period (financial years)	2000–2006 (incl.)	2000–2010 (incl.)
Continuation of PTC subsidy	1960	3080
Subsidy under privatisation	3160	5150
Additional cost of privatisation	1200	2070

In addition to the higher subsidies, the Melbourne community is also paying for privatisation in the form of higher fares, thanks to the above-inflation rises of 2003. Although no public data has been released on the impact of these fare rises, we estimate that the additional payments will amount to around \$100 million by 2010.

When announcing the refranchising in 2004, the Transport Minister claimed that the private operators had improved service quality and increased

patronage faster than under public ownership. Neither of these claims was correct at the time⁵, and since 2004 reliability has deteriorated, particularly on trains.

One thing the private operators did was purchase around \$500 million worth of new rolling stock. Not only is \$2.2 billion in additional subsidies and fares a lot to pay for such an investment (some of which would have occurred anyway under continued PTC operation), it is clear that the trains and trams, which were ordered in haste to meet contract deadlines, have serious design flaws. The new trams have poor suspensions (which makes the ride less comfortable but also increases vibration and wear & tear) and poor internal layouts with fewer seats than equivalent older vehicles. Some of the new trains have only two doors per carriage rather than three, which slows boarding and alighting, while the others are subject to speed restrictions because of braking problems. And because Connex and National Express purchased different vehicles from different suppliers, fleet complexity has increased, adding to maintenance costs and delays.

What do the franchise agreements say?

The franchise agreements are lengthy documents, running to thousands of pages in total. However, the two agreements are largely similar, and the key provisions are relatively short.

The franchises terminate at 3am on 30 November 2008 (clause 4.2), unless the government (through the Director of Public Transport) elects to extend them. The franchises can be extended until 31 May 2010 (clause 4.3), following which they can be further extended by agreement. The government must give at least a year's notice of its intention to extend the contracts, meaning the deadline is 30 November 2007 (cl. 4.3). However, notice of an extension can be given at any time before then, meaning the government could do so tomorrow if it wanted to.

What this means is that, provided the government doesn't give notice that it wants to extend the franchises, Melbourne's trains and trams revert to public ownership at 3am on 30 November 2008. The government is free to hand the services over to any other person (a term which is defined to include a public or private corporation); Connex and Yarra are required to cooperate with the handover (clause 21). No compensation is payable if this occurs, although the government is required to buy back assets for either their "net realisable value" (for new assets purchased by the operators), or a token sum for older rolling stock (schedule 18). In either case, the cost would be relatively modest, because the rolling stock cannot operate anywhere else in the world but Melbourne, so its realisable value is minimal.

⁵ See P. Mees (2005) 'Privatisation of Rail and Tram Services in Melbourne: What went wrong?', *Transport Reviews Journal* 25(4), 433-449.

Is there a capacity crisis on the rail system?

The 1999 privatisation agreements were based on the assumption that private operators would dramatically increase patronage, and therefore revenue, permitting a reduction in subsidies. The 2002 and 2004 rescues were based on the proposition that this assumption was over-optimistic and that patronage would increase more slowly than projected. It is therefore surprising that within a year of the second rescue package, Connex was claiming that the rail system is suffering a 'capacity crisis' and cannot carry more passengers without expensive new investment. It is even more surprising that the government regulator is supporting this claim.

In 1999, Connex and the regulator (who was then advising the Kennett government on privatisation) believed the rail system could accommodate a huge increase in patronage without additional capacity being required – that was the whole logic of the 1999 privatisation. Patronage has increased only modestly since then, so how can there now be a capacity problem?

In fact, there is no such problem. The rail system carries many fewer passengers and trains than it did in the past. The City Loop and the current signalling system were planned to enable at least 181 suburban trains to operate through Flinders Street in the busiest hour of the day; currently, there are only 87 trains.⁶

Connex have started talking about capacity problems on the rail system for three main reasons:

- to deflect public concern over poor reliability;
- to avoid having to incur the expense of adding services to cope with recent (modest) increases in patronage; and
- to stake a claim for further increases in subsidies when the current franchise expires.

This behaviour is not unexpected: private firms have a duty to earn profits for their investors, which means maximising income and minimising expenditure. It is governments and regulators, not private firms, who are charged with protecting the public interest: the surprising thing about the current situation is their apparent unwillingness to do so.

Problems with bus services

Buses in Melbourne, as mentioned earlier, have been largely privately run from the beginning. While it is not possible to conduct a before-and-after analysis, the results of decades of private bus operation are well-known. Buses are the weakest link in the public transport system, with service levels much lower than those for trains and trams. The private operators' own association concedes as much, stating:

⁶ P. Mees 2005: *Rail Infrastructure Capacity Constraints in Melbourne: An engineering problem or a political problem?*, State of Australian Cities Conference, Brisbane, 2005.

Putting the public interest back into public transport

Average bus service levels in Melbourne are arguably the worst of any major Australian city – with peak hour average frequencies of just 40 minutes, and the vast majority of services finishing before 7pm.... Without adequate bus services that are frequent, reliable and operate evenings and weekends, people are forced to purchase and travel in private cars. As a consequence it is no surprise that buses are largely used by people who do not have a choice.⁷

The bus operators' solution to this problem is higher public subsidies, but first we should consider how much the community is already paying for bus services that everyone agrees are inadequate.

According to the 2005-6 Budget Papers, the subsidy for private bus operators in Melbourne is \$308 million this year. In addition, the operators receive 20% of all fares collected, bringing total payments to around \$388 million. This represents a cost of \$4.09 for each of the 95 million bus passengers carried in 2005-6. By contrast, Vancouver's (public) Translink spent \$442 million in 2005 to carry 201 million bus passengers, a cost of \$2.20 each. Because more of Vancouver's bus passengers are 'choice' passengers paying full fares, the public subsidy per passenger is less than half the level in Melbourne.⁸

Current arrangements for the provision of bus services in Melbourne result in high subsidies being paid in return for a poor service that carries few passengers. Rather than showing that subsidies should be increased even further, these results confirm the findings for train and tram services: privatisation is not serving the public interest.

Is lack of funds the problem?

The private train and tram operators, like their bus counterparts, have been vocal over the last year in claiming that increased government funding is the answer to the rail and tram system's problems. Our analysis suggests that this claim is baseless.

Operating subsidies and fare revenue for 2005-6 for Melbourne's trains, trams and buses total approximately \$1.2 billion, but this figure may be even higher as a result of any additional expenditure in the state government's forthcoming Transport and Livability Statement. The current figure is twice the public transport budget of Vancouver's Translink. Melbourne has 1.7 times Vancouver's population, but only 1.4 times as many public transport

⁷ Bus Association Victoria submission to Victorian Competition & Efficiency Commission inquiry into traffic congestion, 2005, pp. 18-19.

⁸ Budget Paper No. 3 of 2005, Service Delivery, pp. 111-112; Vancouver figures from Translink (2005): *2006 Transportation Plan*, pp. 7-10 (converted to Australian dollars at current exchange rates).

passengers: per head of population, we are paying 30% more for a system that is used 30% less.⁹

The main problem is that Melbourne is receiving poor value for the very substantial sums currently expended on the privatised system. As with buses, the correct response is not to give the private operators even more money, but to fix the inefficiencies. Until this has occurred, any additional subsidies are likely to be wasted.

A CHOICE FOR MELBOURNE:

Persist with failure or adopt best practice?

The critical time-period is the next 19 months until 30 November next year, in which Melbourne must decide whether to persist with privatisation, by extending and renewing the franchises, or allow them to expire and replace the private franchisees with an efficient, accountable public agency.

The choice is stark, but relatively simple. Melbourne has conducted an expensive experiment to test whether privatisation makes urban public transport more efficient and the results are clear. The experiment has failed spectacularly and unambiguously: subsidies have increased, services have not improved, inappropriate rolling stock has been purchased, accountability and transparency have disappeared, the regulator has been 'captured' by those he is supposed to be regulating, there is no real planning for the future. The public interest has not been served.

Significantly, no other first-world city has followed Melbourne's lead: we have become the salutary example of why privatised urban public transport does not work. All the best public transport systems – across Europe, North America and even in Perth – remain under the control of public agencies.

Although privatisation has performed poorly compared to the former Public Transport Corporation, it is important to recall that the PTC was not a particularly dynamic, efficient or accountable public agency. As an organization that had presided over decades of decline in patronage and market share, the PTC had a defensive, inward-looking corporate culture.¹⁰

The choice is not between continuing a failed privatisation and reinstating a poorly-performing public agency; rather, the alternative to privatisation is a new, more dynamic public body of the type that runs the best public transport systems in the world – bodies like Vancouver's Translink, or Zurich's *Zurcher Verkehrsverbund* (ZVV), or even Perth's Transperth.¹¹

⁹ Vancouver figures are for 2005, from Translink's 2006 Transportation Plan, converted to Australian dollars.

¹⁰ See P. Mees (2000): *A Very Public Solution*, Melbourne University Press, Melbourne.

¹¹ cf. E. D. Sclar (2001) *You Don't Always Get What You Pay For: The Economics of Privatization*, Cornell University Press, New York, p. 162.

Putting the public interest back into public transport

We recommend that Melbourne take the opportunity to establish a new public transport agency modelled on international best practice. This agency would take over all modes of public transport as the franchises expire and improve, extend and integrate them¹² to provide a network that offers the 'go anywhere, anytime' convenience necessary to compete with the car, with a safe travelling environment and affordable fares.

As indicated above, the new agency would begin with an annual budget of around \$1.2 billion, plus any further amounts arising from the Transport and Livability statement. This is more than sufficient to upgrade the existing system to world's best standards, but additional funding may be required for extensions.

Designing a best-practice public transport agency

Jurisdiction

Some best practice agencies (e.g. Translink in Vancouver) are responsible for roads as well as public transport; most focus solely on public transport (e.g. ZVV in Zurich). Because Melbourne would be seeking to build a dynamic public transport management culture from scratch, the new agency would need to concentrate on this task; we therefore recommend a public transport only agency – i.e. the Zurich model, not the Vancouver model.

Responsibilities

Some agencies (e.g. the Toronto Transit Commission) run public transport services using their own staff and consequently have many employees. Others focus on planning, funding and marketing and leave the actual operation of services to subsidiaries or sub-contractors. In Vancouver, Translink doesn't directly run any services: trains and buses are operated by subsidiaries; local mini-buses by private sub-contractors. The ZVV in Zurich sub-contracts rail services to the Swiss Federal Railways, and buses and trams to local municipalities and (in rural areas) the Swiss Post Office. Perth is a mixed model: the Public Transport Authority runs the trains, but private sub-contractors run buses. For similar reasons to those applying to jurisdiction, the best model in Melbourne is likely to be a small, lean agency in charge of planning, funding and marketing, with subsidiary agencies and (where appropriate) sub-contractors providing services.¹³

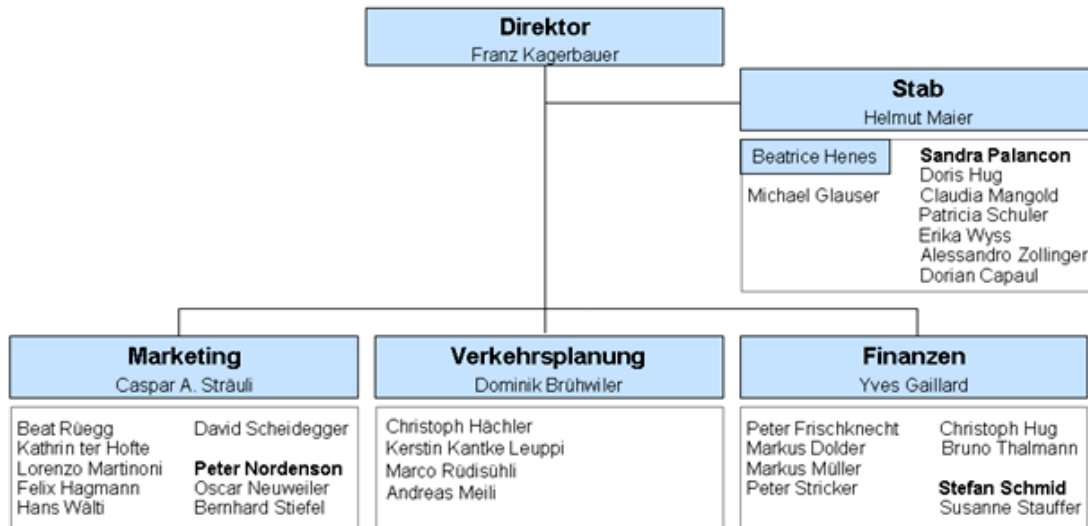
¹² It is not our intention here to describe in detail what the new agency would need to do. A good outline can be found in: J. Scheurer, J. Kenworthy & P. Newman (2005): *Most Livable and Best Connected? The economic benefits of investing in public transport in Melbourne*, Metropolitan Transport Forum, Melbourne.

¹³ Many private bus firms also operate in Perth and other places where subcontracting is practised, and are familiar with it. It may therefore be practical to use subcontractors to provide some, or all, bus services. The situation is different with trains and trams, where private operation has been a disaster and there is no existing efficient agency corresponding to the Swiss Federal Railways: operation via public subsidiary companies, as in Vancouver, may be preferable here. The choice should be made by the new agency itself, which should be empowered to decide on efficiency grounds, not ideological ones.

Putting the public interest back into public transport

Staffing

The ZVV in Zurich only has 35 staff (in total – i.e. including receptionists and typists: see diagram below), and an equivalent body in Melbourne should require no more than this. The Melbourne experience shows that it actually requires many more staff to monitor complex franchise agreements than it does to directly plan and manage public transport. It is essential to have a small staff to create a cohesive organization with high morale and clear lines of accountability. Not over-staffing is also important because the skills required to run a best-practice transport agency are relatively rare internationally. It will be important to select the best talent in the world for the new agency rather than, for example, simply transferring existing DOI employees to the new agency. Fortunately, there are staff of this calibre available: some are even native Melburnians who have moved to other places because their skills were not valued here.



Governance and accountability

A public agency using public funding to provide a public service needs to be accountable to the community. This is not just an ethical issue: accountability keeps the agency responsive and efficient and guards against capture by vested interests. In Zurich, accountability extends to the ZVV publishing its organisational structure with the staff responsible for different activities named individually (see above)! Best practice agencies are governed by boards that meet in public, and publish their minutes and other documents. Citizens, community groups and local governments can make representations directly to the board.¹⁴ The usual practice – as in Toronto, Vancouver and Zurich – is for the boards to be comprised entirely of elected officials (generally from local government), but because we are unused to such a model in Melbourne, a mixture of elected officials and appointed experts may be appropriate in the

¹⁴ The introduction of Vancouver's successful U-Pass ticket provides an example of accountability in action. Students and staff at the two largest universities presented the idea in a delegation to the Translink board. Following feasibility assessments and discussions, the proposal was refined and implemented. U-Pass has won international awards for transit innovation and is being copied in other places.

Putting the public interest back into public transport

initial stages. The agency would need to be independent of the State government, to give it the freedom to advocate measures that would support its work – for example, adequate funding and on-street traffic priority.

Abolition of redundant bodies

The following redundant bodies would be abolished as the new agency takes over their functions: Metlink, Transport Ticketing Authority, Public Transport Customers Consultative Committee, Public Transport Ombudsman. The bulk of the Office of the Director of Public Transport would also become redundant, but some responsibilities (e.g. for rural services) would remain.

What the government should do

The first thing the state government must do is promise not to renew the franchises until the community has been given a say on the issues raised in this report. It would be a tragedy if the government simply extended the franchises and passed up the opportunity to put the public interest back into public transport. Similarly, the contracts for private bus services which expire next year, should not be extended beyond the end of 2008 – a complete restructure of bus services, to reduce waste and increase service quality and integration with trains and trams, will be an essential task for the new agency.

Providing the idea of a best-practice public transport agency has community support (and we are confident it will), the next step is to establish the board for the agency and appoint the initial staff, including the chief executive. It is critical that the new body be 'up and running' well before the public transport system is transferred to it.

Once the body is functioning, the state government should then exercise its right under clause 1.8 of the franchise agreements, and transfer the Director of Public Transport's powers to extend and re-tender the franchises to the new agency (the Director should retain his existing monitoring responsibilities until the franchises terminate; the new agency should not be burdened with pointless, time-consuming work of this kind). The new body can then investigate current operations and prepare plans for controlling finances, restoring public confidence (by fixing safety, cleanliness, reliability and other problems) and short-term service improvements. These plans would be prepared with the assistance of consultants selected from the best operators in the world.

When the franchises expire, or earlier if Connex and Yarra can be persuaded by commercial reality, the new agency takes control of public transport and begins the task of upgrading it to world's-best standards. While the already-planned immediate improvements are being implemented, the new agency consults widely with the community and government to establish medium- and long-term plans for system expansion.