

Rail Ownership, Governance, Regulation and Industry Structure: the case of New Zealand

From the paper by Sam Waymouth in partial
fulfilment of assessment for MMBA579, 2008

Presented on behalf of the author by Bronwyn Howell,
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Motivation

- Newly-nationalised KiwiRail
- Raised questions
 - was government the best owner?
 - how should new entity be organised to maximise returns?
 - separate operating company?
 - merged with OnTrack?
 - how might regulation be affected by nationalisation?
- Context
 - study undertaken in mid 2008
 - structures, environment, regulation may have changed since

Rail

- A 'natural monopoly'?
 - below rail yes
 - above rail no
- ⇒ Subject to regulatory intervention
 - pricing
 - economic/engineering models? 'public interest' prices?
 - industry structure
 - where to draw boundaries?
 - ownership and governance
 - Public? Private? Mixed?
- ⇒ A high-risk business
 - ⇒ market, regulatory failure
 - future demand, technology uncertainties

Rail in the Logistics Chain

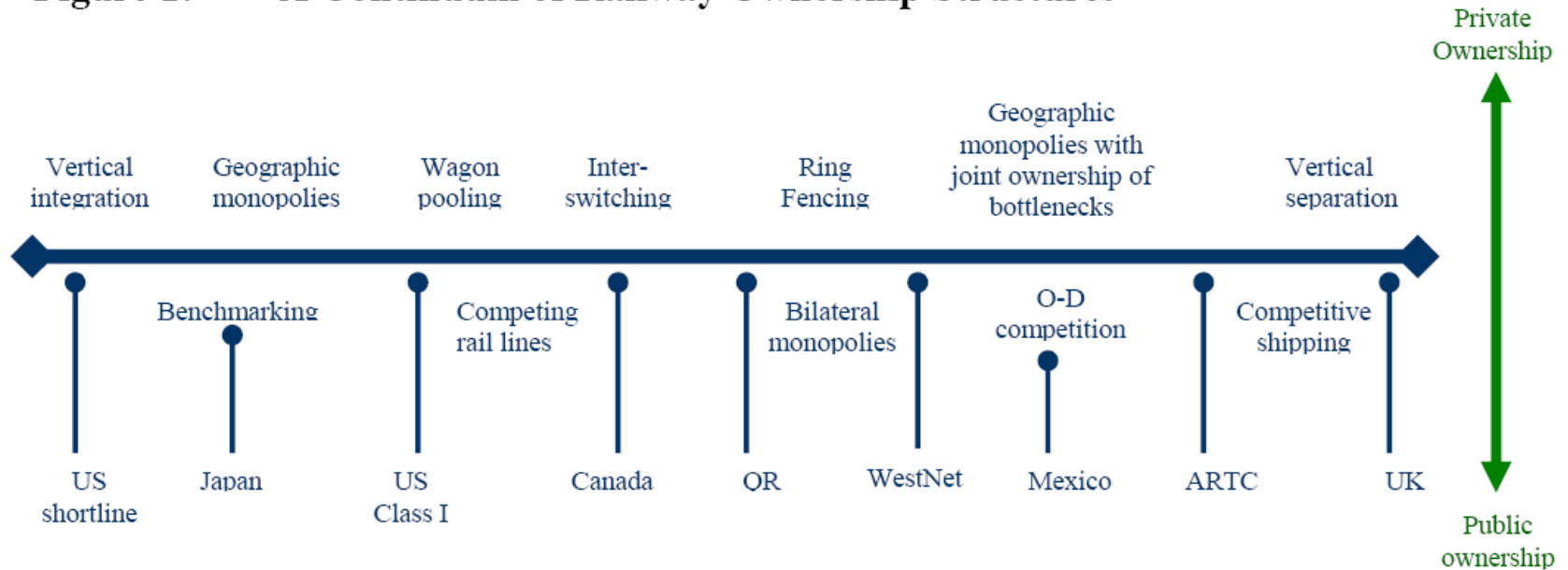
- “Railways seldom stand alone, but rather sit within logistics chains” Wills-Johnson, 2007
- Complex interactions
- Integrated part of national transportation infrastructure
 - roads, ports often owned by central/local government
 - externalities?
 - pollution? congestion? safety?
 - extensive cross subsidies
 - often politically-motivated
 - powerful strong special interest groups – e.g. employees, favoured customers Ang & Boyen, 2007

Ownership

- Private owners require adequate return in investment
 - NZ rail in government ownership a poor performer
 - improvements under private ownership
 - but still not covering cost of capital ISCR, 1999
- Can Government ownership do better?
- Government already owned below-rail infrastructure
 - => vertical integration/merger to improve efficiency?

Tailoring Structure to Markets

Figure 1: A Continuum of Railway Ownership Structures



Source: Wills-Johnson, 2007

Vertical Integration

- Assurance of supply
- Specialised assets
- Lower transaction costs from improved co-ordination
 - customer demands for cargo movement and train scheduling
 - especially if integrated with trucking business
- VI the norm in United States Pitman, 2004
- Multiple models in Australia Wills-Johnson, 2008

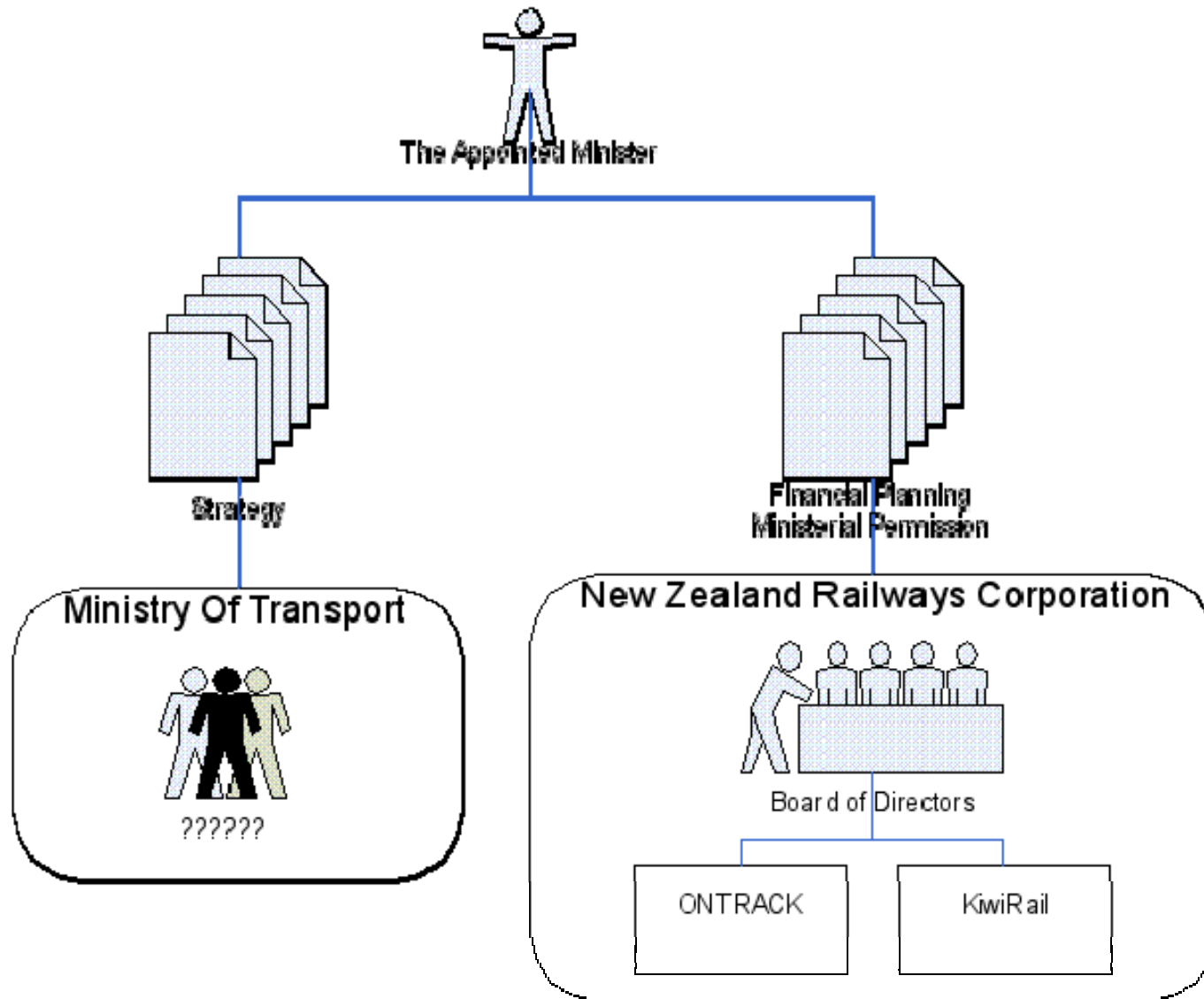
Vertical Separation

- Competition for above-rail services
 - different rail operating companies
 - between rail and trucks/shipping
- Loss of scale and scope advantages
 - separated companies in US 20%-40% less efficient
- Little evidence of extensive competitive entry in EU
 - ‘cream-skimming’ by competitive niche operators
- No marked efficiency improvements in Australia

Australian Experience

- Only Queensland fully integrated
- Initial entry followed by consolidation
- Oligopoly of large firms, niche players at the margins
 - Victoria, Western Australia – private monopoly replaced government monopoly Everett, 2005
- Fragmentation of regulatory arrangements across states
 - duplication of resources
 - higher transaction costs may be muting benefits

Rail in NZ



Rail in NZ

- Government ownership
- Separated rail, track businesses
 - loss of synergies from integration with trucking
 - what about Cook Strait Ferries?
- Mixed objectives
 - “in meeting its objective the entity must aim to recover its direct and indirect costs of operating the rail network” Rail Network Bill
 - “ensuring the efficient use of transport infrastructure”
 - but “wherever feasible, the government will encourage transport of products by rail” National Transport Strategy

Market Realities

- History of declining levels of asset replacement
- Little scope for intramodal competition in NZ rail sector
ISCR 1999
- Hard to get customers to change personal travel habits or logistics chain patterns
Woodburn 2008
- Increased scope for political interference in pricing signals sent to customers
- Easier to integrate policy in NZ than in Australia
 - but Australian experience far from convincing
 - NZ will still separate above and below rail activities

Conclusion

- Vertically integrated private operator (including trucking operation) competing with road and shipping has best chance of financial success
 - separated Ontrack, KiwiRail likely more difficult, costly to govern, manage, co-ordinate
- But unlikely any owner could generate returns sufficient for a self-sustaining operation given NZ market conditions
- NZ arrangements principally support delivery of political objectives
 - subsidies and other incentives required to induce modal shift
- Should rail be allowed to fail?