

**ACTION'S BUS FARES FOR
1999/2000**

DRAFT PRICE DIRECTION

FEBRUARY 1999



INDEPENDENT PRICING AND REGULATORY COMMISSION

FOREWORD

The activities of the ACT Internal Omnibus Network (ACTION) have been the subject of extensive public discussions over recent months. The negotiation of a new enterprise bargaining agreement (EBA) and the introduction of Network 98, a new zonal fare structure and service network have been the focus of much public debate. This debate forms an integral part of the community's deliberations of what are its expectations of an urban public transport system.

The terms of reference for the Commission's examination of ACTION specify that the Commission is to review and report on appropriate pricing and pricing methodology for bus services provided by ACTION for the 12 month period 1 July 1999 until 30 June 2000. As part of such a review process, the Commission would normally give consideration to determining an appropriate asset base for the business and a rate of return to apply to that asset base, in addition to consideration of forward projections of anticipated operating costs and capital expenditure plans.

However, in the context of examining a forward price path for ACTION, the Commission has been conscious of the need to focus upon the achievement of efficiencies in operating costs and a capital expenditure plan which reflects an appropriate balance between the cost of new capital equipment and the cost of maintaining existing equipment. With ACTION being heavily dependent upon direct subsidies from the ACT Government in order to recover the difference between the farebox revenue and the costs of operating the bus transport network, the question of an appropriate rate of return or asset value for purposes of determining a price which fully recovers all cost may not be appropriate at this time. However, this does not avoid the need for some consideration to be given to an appropriate rate of return for ACTION, particularly a rate which can be used to assess the economic net benefits of new capital works programs.

The Commission has been asked to determine the prices for ACTION's services at a time when ACTION has only recently made significant changes to its prices and its bus routing arrangements. The Commission expects to receive a number of submissions relating to aspects of the Network 98 initiative. In this Draft Report which is provided for discussion purposes, the Commission has not been in a position to give any view on the success or otherwise of the Network 98 initiative. The Commission is of the view that over the current calendar year new data will become available which will help to discern whether amendments are needed to be made to Network 98 to meet the community's transport requirements. The Commission has examined consultant reports on ACTION prepared over recent years which suggest that the changes that have been made as part of Network 98 are appropriate in the context of the demand for transport services. The Commission awaits with interest the findings from initial studies to form a judgement as to whether further revisions to the pricing structure or overall level of prices are appropriate in the present context of demand for public transport. The Commission will also be interested to review the extent to which the cost savings predicted from the EBA are in fact realised and to what extent these cost savings are sustainable.

The Commission has also been invited to make comments upon the appropriate 'commercial fare' to apply to ACTION. A 'commercial fare' which incorporates a market rate of return would require a significant increase in fares above present levels. It is evident that amongst both private and public bus operators across Australia that there is a range of outcomes in terms of the farebox recovery of operating costs. ACTION is at the lower end of this range, and the recent policy initiatives are designed to improve this level of recovery up to around 29% from the current level of 24.7%.

This level of recovery could be further improved by increasing fares, reducing costs or a combination of the two. The community's expectation may be that it would not want to see costs reduced if this in turn resulted in a loss of service. However, equally the community may be of the view that fares should be further increased as a way of increasing the amount of revenue available from the farebox without reducing the level of service offered by ACTION.

The Commission is seeking the views of community on these and other issues raised in this Draft Report. Upon review of these submissions and consideration of other material that may be placed before the Commission, a Final Report will be prepared and price determination made for the 1999/2000 year.

Paul Baxter
Commissioner
19 February 1999

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1. INTRODUCTION

The Independent Pricing and Regulatory Commission (IPARC) is conducting an investigation into fares for bus services supplied by the Australian Capital Territory Internal Omnibus Network (ACTION), which should apply for the period from 1 July 1999 until 30 June 2000. The terms of reference for the investigation are included as Attachment 1.

The terms of reference establish the tasks to be undertaken by the Commission for this investigation and the various matters that are to be considered by the Commission in making the price direction. The following requirements are specified in the terms of reference in relation to the conduct of the investigation:

The Commission is to review and report on appropriate pricing and pricing methodology for the following:

- ♦ the regulated bus services provided by ACTION for the period from 1 July 1999 until 30 June 2000

In addition, the Commission is to:

determine a best practice commercial price for ACTION's services. This is to be done using best practice cost benchmarks taking into account potential patronage in the Territory and the service levels specified by the Department of Urban Services as the purchaser on behalf of the Territory Government.

This document is a draft price direction, on which the Commission invites submissions prior to the public hearing. After this, the Commission will issue a final price direction.

2. INVESTIGATION PROCESS

The release of the draft price direction represents the first stage in the public process for determining prices. In preparing this report, the Commission has investigated various studies of ACTION's operations that have been commissioned by ACTION and the Department of Urban Services (DUS). These are referred to, as appropriate, in this report.

The Commission now seeks broader community input into the price setting process. The Commission is calling for submissions in response to the draft price direction by 12 March 1999 and will hold a public hearing in the Legislative Assembly Building on 18 March 1999. It is proposed to release the final price direction by 15 April 1999.

Activity	Due Date
Release of Draft Price Direction	19 February 1999
Public Submissions (including ACTION's)	22 March 1999
Public Hearing	30 March 1999
Release of Final Price Direction	30 April 1999

All communication with the Commission in relation to this investigation should be directed to:

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Public submissions received by the Commission and transcripts of the public hearings can be obtained by contacting the Commission at the above address.

3. SUMMARY OF DRAFT PRICE DIRECTION

The principal features of the Commission's draft price direction for ACTION for 1999-2000, on which the Commission invites comment, are as follows:

- the increase in farebox revenue for the financial year 1999-2000 should not exceed the increase in the consumer price index for all groups for Canberra for the 12-month period ending March 1999¹;
- given the range of different fares available, ACTION is required to submit to the Commission at least six weeks prior to the new fare structure being announced a revised fare table which indicates which fares it proposes to increase while ensuring that its total farebox revenue does not exceed the above cap;
- this direction is made for one year only and takes account of recent changes to both network services and the new zonal fare structure.

The Commission estimates that the farebox revenue increase permitted under this direction, in association with operating cost changes already in place and expected patronage increases, should assist in realising a higher cost-recovery level, from less than 25% to around 29% in 1999-2000, which still remains at the lower end of cost-recovery outcomes for other public bus operators in Australia.

As public transport charges are estimated to comprise only around 0.4% of an average household's weekly expenditure, the Commission believes that the effect of this price direction on the CPI will be negligible, ie. less than 0.1%.

Given the recent moves to implement a more commercial enterprise bargaining agreement, together with reductions in its asset holdings and associated financial obligations, ACTION is slowly moving towards a more commercial basis of operations. While direct comparisons with other public or private bus operators in Australia are difficult because of different network sizes, passenger numbers, service levels and fare structures, the Commission is of the view that this direction is consistent with a best practice "commercial price" for bus services in Canberra at the current time, subject to ACTION's fare structure response as requested above.

This direction does not contain any specific incentives for further efficiency improvements, such as a CPI-X formula which would normally be applied over a period of time. Nor does it explicitly refer to a prescribed rate of return on assets as a basis for price setting, given the absence of a well-documented investment and asset management strategy. However, the Commission acknowledges that significant changes are being made to ACTION's operating costs and efficiency levels, including major changes to its asset base, and believes that, with the new network in operation, it will be better placed later in 1999 to assess the opportunities for further efficiency

¹ Australian Bureau of Statistics, Consumer Price Index, Canberra, All Groups.

improvements which will reduce total costs and to assess appropriate rate of return criteria.

The Commission's direction has been made in the full light of ACTION's past history as an effective arm of government and a more recent trend for public service providers to balance the fiscal imperatives of the government shareholder, the need to ensure that users of the services pay the costs associated with the provision of those services and the need to satisfy broader social and environmental objectives, provided those objectives are clearly defined and can be assessed.

In the light of calculated price elasticities, a revenue-maximising outcome for ACTION would involve significant increases in fares. To prevent the possibility of such an outcome, the Commission has capped any potential revenue increase at this stage, although it acknowledges that this only reduces rather than minimises ACTION's explicit government funding requirement. Nevertheless, for 1999-2000 the Commission's direction aims to ensure that ACTION continues to reduce its costs and to improve its operating efficiency, that users increase, albeit modestly, their contribution to the costs of the services they use and that the government's financial exposure is reduced.

Over the next six months, the Commission will be in a better position to assess the extent of sustained and further potential efficiency improvements, the effects of current financial restructuring and the patronage response to both the new services and the new fare structure. These will all form the basis for the Commission's more detailed review of ACTION's fare levels for 2000-01 and beyond.

The Commission invites responses from interested parties to this draft price direction.

4. INDEPENDENT PRICING AND REGULATORY COMMISSION

The Independent Pricing and Regulatory Commission (IPARC) was established in late 1997 by the ACT Government. The functions and powers of IPARC are set out in the IPARC Act 1997. In setting prices,

... the Commission shall decide on the level of prices for services...and give a price direction accordingly to each person providing regulated services.

A price direction may specify, in relation to the supply of a regulated service, any or all of the following:

- a. a price;*
- b. a maximum price;*
- c. a maximum price and a minimum price;*
- d. a formula for calculating a price referred to in paragraph a, b or c;*
- e. a method, by reference to price indices or otherwise, by which a price referred to in paragraph a, b or c is to be ascertained;*
- f. a period or periods during which the direction, or any provision of the direction, is to apply.*

The legislation establishing the Commission lists a number of matters the Commission must consider in making its decision. These include:

the protection of consumers from the abuses of monopoly power...

standards of quality, reliability and safety...

the need for greater efficiency...

an appropriate rate of return...

the cost of providing the regulated service...

the principles of ecologically sustainable development...

the borrowing, capital and cash flow requirements...

the effect on general price inflation over the medium term; and

any arrangements that a person providing regulated services has entered into for the exercise of its functions by some other person.

Submissions to the Commission may address any of these matters.

5. ACTION

The Australian Capital Territory Internal Omnibus Network (ACTION) is an ACT Government owned enterprise supplying bus services throughout the ACT.

ACTION has over 800 employees and currently incurs annual operating costs of \$67 million with revenue derived from operations of around \$18 million and explicit government contributions of \$38 million to maintain the current level of service.

ACTION has two depots, from which its fleet provides services. These are located at Belconnen and Tuggeranong. The operational fleet status as at October 1998 totalled 383 buses with an average age of under eight years. The fleet requirements are determined by significant peak demands.

In recent years ACTION has experienced a substantial decline in patronage, down from over 24 million passenger boardings in 1995/96 to just over 17 million boardings in 1997/98, a decline of almost 30%. In order to increase patronage ACTION implemented both a new zonal fare structure and a new service network (Network 98) in January 1999. In particular, the new network structure will increase service levels and ACTION has forecast that the increased service levels will increase patronage.

ACTION also renegotiated its enterprise bargaining agreement (EBA) in 1998. The new EBA has removed some of the barriers to efficiency gains which has in turn permitted the development and implementation of Network 98. The new EBA is also seeking to improve the efficiency of ACTION's maintenance and administrative functions.

ACTION's corporate plan states that it has the following service objectives:

Vision – To be recognised as a leader in the provision of quality public transport and a vital component of Canberra's commercial, social and natural environment.

Mission – To provide the ACT community with an efficient, effective and accessible passenger transport service.

Purpose – To optimise the efficiency of passenger transport systems in the ACT.
To minimise cost to Government of ACTION's service to the community.
To contribute to environmental objectives in terms of pollution emissions and environmental sustainability.
To offer an affordable transport option for the community.
To contribute to the urban amenity of the ACT town centres by reducing traffic and parking requirements.

The ACT Government's policy towards ACTION is to encourage the use of public transport in order to reduce road and parking infrastructure costs, reduce congestion and pollution, reduce the public subsidy required to maintain bus services and help meet the ACT's obligations in relation to policies such as those designed to meet greenhouse gas reduction, sustainability and integrated land use and transport planning.

Strategies to promote public transport include increased bus frequencies, better coordination of timetables, reducing the need for interchanging, equitable fares based on distance travelled, better access to services particularly for the aged and people with disabilities, on-road bus priority measures, parking policies and placing employment and residential locations in closer proximity.

In relation to bus fares, the Government has set concession and student fares at 50% and 35% of the adult fare respectively. Special off-peak fares are also available to pensioners and seniors. Students of families on low incomes are eligible for significant travel concessions based on the level of need.

The Government has also limited the zone fare to a maximum of two zones thus ensuring that bus fares for those having to travel across Canberra is affordable.

6. ISSUES CONSIDERED BY THE COMMISSION

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a Determination is required to consider a number of factors and indicate what regard it has had to each factor. The Commissions' assessment of each of the Part IV factors is detailed below.

6.1 Costs and Efficiencies

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a determination is required to consider the cost and efficiency factors, as detailed below:

- *the cost of providing the regulated services (Part IV 20.(2e))*
- *the need for greater efficiency in the supply of regulated services to reduce costs to consumers and producers (Part IV 20.(2c))*
- *any arrangements that a person providing the regulated services has entered into for the exercise of its functions by some other person (Part IV 20.(2k))*

6.1.1 Operating Costs

ACTION's financial statements indicate that the organisation recovers significantly less than the accrual-based costs of providing the services. Over the past five years, farebox cost recovery has fallen within the range of 22.1% to 24.7%. While there are opportunities for efficiency improvements, future years' costs will be higher because the ACT Government has introduced an equivalent tax regime for its utilities, which now imposes a payroll tax, sales tax, insurance and increases in superannuation; these amount to around \$6.5 million per annum for ACTION. Also, the cost of special needs transport increased in 1997/98 by \$900,000, representing a full year payment from the services following the part-year funding in 1996/97.

Table 6.1: Operating Costs (\$'000)

	1993-94	1994-95	1995-96	1996-97	1997-98
Employee Costs	40,920	39,099	38,414	42,473	42,658
Administrative Expenses					
Bus Running and Maintenance	8,044	7,289	7,290	7,149	7,356
Other	5,347	6,188	7,139	7,781	6,568
Depreciation and Amortisation	7,404	7,496	7,467	7,368	7,041
Interest	8,554	8,345	6,851	6,381	3,441
TOTAL	70,269	68,417	67,111	71,152	67,064
Revenue (Fares)	15,527	16,429	15,676	17,235	16,583
Farebox Cost Recovery	22.1%	24.0%	23.4%	24.2%	24.7%

Changes in accounting procedures in 1995-96 make inter-year comparisons difficult, but overall operating costs have fallen modestly. The major contributor to this reduction has been a fall in interest payments as a result of an equity injection from the ACT Government of almost \$24 million. However, ACTION still suffers from high depreciation and interest costs on its asset base, which has a written down value of \$97 million at 1997. In 1998, land, buildings, bus shelters and termini were handed over to the Department of Urban Services (DUS), which effectively reduced ACTION's asset basis to just under \$80 million. Nevertheless, it has a fleet of 383 buses with an average age of just under eight years, and as a result its capital cost per peak bus is over 15% higher than that for average public bus operators (and over 50% higher than the average private bus operator). Given that other bus operators have a higher average aged fleet, it is unlikely that ACTION need undertake any major fleet replacement over the next year or so.

The major part of ACTION's operating costs are variable costs associated with labour, both for drivers and maintenance. ACTION currently employs over 500 drivers, with a number of maintenance staff also having a part-time driver function. Previous studies have indicated that the average driver cost per bus hour for ACTION was between 11% and 19% higher than for an average public bus operator and close to double that of an average private operator. The higher figures are attributed to higher wage rates paid to ACTION drivers and restrictive work practices which result in inefficient rostering, with the latter contributing up to 15% of wages paid for unproductive time. While public transport providers with skewed peak demands have to manage their cost functions around those peaks, ACTION has done little in the past to address this issue. However, the new enterprise bargaining agreement (EBA) which has been negotiated with the Transport Workers Union, the Community and Public Sector Union and the Australian Manufacturing Workers Union introduces split shifts, lower projected wage rises (down from 7.5% to 4.5% over three years), more flexible arrangements for taking meals, and the greater use of casual drivers. These new arrangements are expected to generate cost savings in the order of \$3.0 million per annum. Associated with these arrangements, the new EBA will also affect maintenance functions and is expected to reduce the number of maintenance staff, in the order of 50%, from 125 to 64, thereby producing an annual saving of around \$2.3 million.

Other variable costs refer to corporate and general overheads. Previous studies have suggested that ACTION's operating overheads are more than 25% higher than an average public bus operator. Again, the DUS has estimated that the new EBA will reduce the number of administrative staff by 36, and with other administrative reforms will result in almost \$2.4 million in cost savings.

A further issue affecting ACTION's costs is the recent introduction of the new bus services, Network 98, which operates on a double fountainhead principle with buses running the full length of Canberra. While this new network is designed to be more customer responsive, it will have cost implications: ACTION has indicated that service hours will rise by 25%, offset by improved driver productivity of 12.8%, while the costs associated with additional hours and the split shift penalty will result in a 5% net increase in wage costs and a net increase in vehicle operating costs. Once

the new services are operational, the costs will need to be reviewed and compared with the previous network's costs to establish the extent to which changes can be attributed to the benefits of the new EBA and other cost reduction measures and those specifically associated with new services.

The net effect of the EBA, offset by the new network and the additional tax imposts, suggests that ACTION will have difficulty reducing its operating costs in 1998-99 and 1999-2000 much below current levels, which already incorporate reduced depreciation and interest costs because of the transfer of asset ownership to DUS.

6.1.2 Efficiency

The recently negotiated EBA represents an acknowledgment that ACTION's operating costs have been too high. As indicated above, some of those cost disadvantages were of a structural nature in terms of past infrastructure decisions, associated with bus acquisitions, the size and features of depots and the treatment of those assets on ACTION's balance sheet. Many of those features are currently being addressed.

In recent years, ACTION has been subject to reviews by different consultants, covering different aspects of its operating and financial performances. There was general agreement in those studies that ACTION's cost structure was higher not only than an average private bus operator but also, and more significantly for benchmark purposes, higher than an average public bus operator. In general terms, ACTION's cost margin over an average public operator was between 10% and 20%. Where broad estimates of achievable cost savings could be made, those studies suggested figures in the order of \$19 million per annum. The major contributor to these savings are wages (\$6 million), maintenance (\$1.5 million), salaries (\$750,000), debt servicing (\$2.5 million), corporate overheads (\$2.6 million) and depreciation (\$3.7 million). Around one-half of these savings appear to be broadly taken up in the EBA while some of the debt servicing and depreciation reductions are already in place.

The following table summarises the results of previous benchmarking reviews, undertaken by various consultants, of ACTION's operations. These reviews were based on costs prevailing before the recently negotiated EBA and the changes in asset ownership.

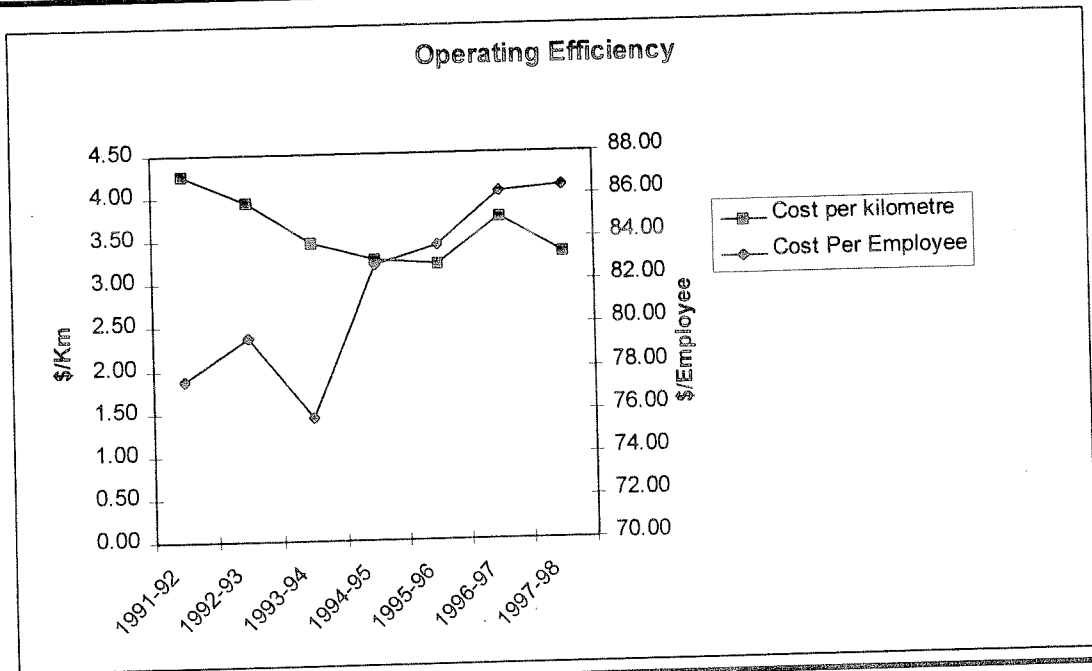
Table 6.2: Benchmarking Summary

	Resource Measure	Average Public Bus Operator	ACTION	Average Private Bus Operator
Drivers				
Driver Labour	per bus hour	\$32.01	\$35.58	\$19.08
Driver Wages	average wage	\$37,200	\$41,100	\$36,100
Maintenance				
Bus Repairs/Mtce	bus km	31.3c	35.0c	24.8c
Overhead Costs				
Overhead Costs	peak bus	\$29,800	\$37,700	\$17,300
Infrastructure				
Capital - Buses	peak bus	\$26,650	\$31,210	\$20,360
Capital - other	peak bus	\$8,400	\$12,080	\$2,300

Source: INDEC 1998, Graham 1997.

In terms of broader operating efficiency parameters, the following figure illustrates recent trends in ACTION's performance.

Figure 6.1: Operating Efficiency



Since 1991-92, ACTION has reduced the number of its employees from 1,050 to 776. Over the same period, the number of kilometres travelled has remained between 19 and 21 million kilometres. Over the same period, ACTION's operating costs have decreased from \$81 million to \$67 million. As a result of the reduction in ACTION's operating costs, ACTION's costs per kilometre have decreased by 22% and its costs per employee have increased by 10%. Importantly, the reduction in operating costs per kilometre has largely resulted from a reduction in ACTION's interest bill and not from efficiency improvements. Further investigation of employee costs demonstrates

that, over the period, the wage and salary costs per employee have increased by 29 %. This indicates that, while ACTION has succeeded in delivering the same level of service with fewer staff, the cost increases have more than offset the efficiency gains.

The Commission is concerned that past efficiency improvements appear to have been absorbed by increases in wages and is keen to see the effects of the new EBA and subsequent efficiency improvements leading to lower requirements for taxpayer subsidy. Other consultants' reports have indicated that there is still scope for efficiency improvements beyond those expected under Network 98 and the new EBA.

6.1.3 Contracting Out

To date, little consideration has been given to the outsourcing of any of ACTION's operating functions. There is an increasing trend in other jurisdictions to outsource non-core functions as a means of containing costs and ensuring maximum efficiency. While the introduction of the new EBA is designed to lower unit costs, there may be further opportunities to review ACTION's functions to investigate the merits of potential outsourcing, particularly of maintenance functions. The Commission is particularly keen to see more widespread investigation by ACTION of these opportunities.

6.2 Consumer Protection

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a determination is required to consider the consumer protection factors, as detailed below:

- *the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of regulated services (Part IV 20.(2a));*
- *standards of quality, reliability and safety of the regulated services (Part IV 20.(2b));*
- *the social impacts of the decision (Part IV 20.(2g));*
- *the effect on general price inflation over the medium term (Part IV 20.(2j)).*

6.2.1 Pricing

ACTION's fares have been increasing in recent years, although there has been a marked difference between tickets purchased by more regular users than those for more casual passengers. These fare changes are summarised in the following table:

Table 6.3: Adult Fares 1991/92 – 1998/99

Fare Band	1991-92 (\$)	1992-93 (\$)	1993-94 (\$)	1994-95 (\$)	1995-96 (\$)	1996-97 (\$)	1997-98 \$(a)	1998-99 \$(b)	1991-92 to 1997/98 Change in Fares (Nominal)
Cash	1.40	1.60	1.80	2.00	2.00	2.00	2.00	2.00 – 4.00	43%
Fare-Go 10 (per journey)	0.92	0.96	1.00	1.06	1.10	1.40	1.70	1.70 – 3.40	85%
Daily	4.60	4.60	4.80	4.80	5.00	6.00	6.70	6.70 – 13.40	46%
Weekly	15.60	16.30	17.00	18.00	18.50	24.00	29.00	16.20 – 32.30	85%
Monthly	58.80	61.40	64.00	68.00	70.00	90.00	109.00	55.00 – 110.00	88%

- (a) Pre 1998/99 there was no zonal structure, rather the tickets cover a single journey in one vehicle.
 (b) In 1998/99 ACTION is introducing a three zone, two fare structure, hence the fare ranges.

Including concessions, over 56% of journeys in 1996-97 were undertaken using Farego 10 tickets. This compares with less than 19% of journeys undertaken using single tickets. This suggests that a significant proportion of ACTION's patronage is captive. This is borne out by survey results which indicated that the main reason why passengers use the buses is because they either do not have a driver's licence or do not have access to a car.

This table shows that the growth in fares for multi-ride tickets over the period was faster than for both single and daily fares. However, earlier in the period, between 1991 and 1994, multi-ride ticket discounts were around 50%. Consistent with discount policies employed by other public bus operators, which suggest that multi-ride ticket users are more likely to be in full-time employment and tend to be more affluent than cash fare payers (IPART 1998 Determination for STA, page 17), ACTION subsequently reduced the discount to 15% in 1997-98.

6.2.2 Pre and Post Network 98 Fares

The pre Network 98 fares represented a flat fare structure, with a new fare charged for each transfer. ACTION and the DUS decided to change the fare structure to a zonal structure with the introduction of Network 98. The following table details the current and new fare structure.

Table 6.4: Pre and Post Network 98 Structures

Fare Types	Pre	Pre- 2 Vehicles	Pre- 3 Vehicles	Post	Post	Post
	1 Vehicle	(1 Interchange)	(2 Interchanges)	Zone 1	Zone 2	Zone 3
FareGo 4	1.80	3.60	5.40	1.80	3.60	3.60
Cash	2.00	4.00	6.00	2.00	4.00	4.00
Adult Daily	6.70	6.70	6.70	6.70	13.40	13.40
FareGo 10	1.70	3.40	5.10	1.70	3.40	3.40
Adult Monthly	109.00	109.00	109.00	55.00	110.00	110.00
Shoppers Off-peak Daily	4.00	4.00	4.00	4.00	4.00	4.00
Adult Weekly	29.00	29.00	29.00	16.20	32.30	32.30
Conc FareGo 4	0.70	1.40	2.10	0.85	1.70	1.70
Conc Cash	1.00	2.00	3.00	1.00	2.00	2.00
Conc Daily	2.70	2.70	2.70	3.30	6.60	6.60
Conc FareGo 10	0.70	1.40	2.10	0.85	1.70	1.70
Conc Monthly	45.00	45.00	45.00	27.00	55.00	55.00
Pensioner Off-peak	1.00	2.00	3.00	1.00	1.00	1.00
Conc Quarterly	105.00	105.00	105.00	64.00	128.00	128.00
Conc Weekly	12.00	12.00	12.00	8.10	16.20	16.20
Student FareGo 4	0.45	0.90	1.35	0.60	1.20	1.20
Student Cash	1.00	2.00	3.00	1.00	2.00	2.00
Student FareGo 10	0.45	0.90	1.35	0.60	1.20	1.20
School Term	68.00	68.00	68.00	45.00	90.00	90.00

ACTION Web page (www.netinfo.com.au/action/fares.html).

ACTION and the DUS employed a consultant to develop the new fare structure based on information gathered from an on-board survey commissioned in November 1996, as well as ACTION's estimates of the own-price elasticities for the different ticket types. The objective of the model was to maintain revenue neutrality, while revising the fare structure. Of note is that, while adult fares have not changed in the three zone structure, student multi-use fares have increased by around 30% and concession multi-use fares have increased by around 20%. This compensates for the fall in passenger journeys that results from the fare increases.

The following table details the elasticities that were used in the model. These elasticities are consistently low, with even discretionary categories (eg shoppers off-peak daily) recording only a -0.25 elasticity. These results are further reinforced by survey information which indicated that ACTION's failure to attract more patronage was largely independent of the fare levels. That suggests that a farebox revenue maximising strategy involves increases in fares.

Table 6.5: Elasticities in the Model

Fare	Elasticities
FareGo 4	-0.15
Cash	-0.20
Adult Daily	-0.15
FareGo 10	-0.15
Adult Monthly	-0.15
Shoppers Off-peak Daily	-0.25
Adult Weekly	-0.15
Conc FareGo 4	-0.20
Conc Cash	-0.25
Conc Daily	-0.15
Conc FareGo 10	-0.20
Conc Monthly	-0.15
Pensioner Off-peak	-0.25
Conc Quarterly	0.00
Conc Weekly	-0.15
Student FareGo 4	-0.10
Student Cash	-0.15
Student FareGo 10	-0.10
School Term	-0.15

Source: Booz Allen and Hamilton 1998.

The following table details the revenue changes associate with the introduction of the new fare structure, which was largely predicated on a revenue neutrality directive:

Table 6.6: Farebox Revenue

	Base	New	Change (%)	Change (\$)
Adult	\$9,409,000	\$8,919,000	-5.2	-490,000
Student	\$1,983,000	\$2,334,000	17.7	351,000
Concession	\$5,076,000	\$4,983,000	-1.8	-93,000
Total	\$16,468,000	\$16,236,000	-1.4	-232,000

The change in farebox revenue was modelled on pre-Network 98 patronage. The introduction of Network 98 is expected to lead to increases in passenger journeys and therefore higher revenue, which may eliminate the \$232,000 shortfall calculated on the old network. ACTION forecasts that farebox revenue will increase by between \$1.8 million and \$2.4 million by 1999-2000 as a result of the new fare structure.

The Commission considers that, following the introduction of Network 98, surveys should be undertaken in March/April and August/September 1999. These surveys should seek to determine whether the new network, through improvements to service

levels and changes in fares, has changed people's attitudes and, furthermore, whether the number of passengers has increased.

6.2.3 Social Impacts

The Commission assesses the social impacts of price and policy changes to minimise any adverse impacts upon consumers. The progressive implementation of reforms assists in ensuring that the impact of changes is not onerous. ACTION has an extensive concession fare system covering disabled, pension and student passengers.

The fares model (discussed above) assessed the impact of the implementation of the new three zone system. The new zonal system is essentially revenue neutral. However, the new zonal system will have particular impact on students with fare box revenue from students forecast to increase by 17%, while student journeys are also forecast to decrease by 3%. This move should reduce the previous cross subsidy whereby shorter journey passengers for students subsidised those travelling longer distances. The number of pensioner journeys is forecast to decrease by 0.7% and the impact on adult journeys is marginal. Importantly, these impacts assumed that the network does not change. However, Network 98 will increase service levels and is forecast to increase patronage growth.

Furthermore, the introduction of zone based fares will benefit those users who previously had to pay for each interchange, whereas the journey for those users who did not previously interchange but who travelled further than one zone (longer distances) will become more expensive.

With increases in more customer-focused service levels and a zonal-based fare structure, ACTION is seeking to improve both efficiency and customer satisfaction.

6.2.4 Effect of Pricing Proposals on the Cost of Living

The Australian Bureau of Statistics conducts a Household Expenditure Survey. Public transport charges are estimated to comprise around 0.4% of an average household's weekly expenditure (ABS Cat No 6535.0 1993-94).

Therefore, the Commission is of the opinion that a fare increase corresponding to an increase no greater than the recent CPI will have a negligible impact on the overall CPI for 1999/00, ie. less than 0.1%.

6.3 Financial Viability

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a determination is required to consider the financial viability factors, as detailed below:

- *an appropriate rate of return on any investment in the regulated industry (Part IV 20.(2d));*

- *the borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry (Part IV 20.(2i)).*

In addition, the Commission has been requested to consider ACTION's financial viability in the light of best practice "commercial price", taking account of cost benchmarks and potential patronage and service levels.

6.3.1 Government Contributions to ACTION

The following table details ACTION's operating statement for the last five years.

Table 6.7: Operating Statement (\$'000)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99 ^(d)	1999-00 ^(d)
Expenditure	70,269	68,417	67,111	71,152	67,064	71,250	62,989
Revenue	17,555	19,172	18,174	18,877	17,871	17,912	19,423
Government Contribution	57,782	51,423	46,640	45,964	38,178	41,906	41,382
Operating (Deficit)/Surplus	5,068	2,178	(2,297)	(6,311)	(11,015)	(11,432)	(2,184)
Abnormal & Extraordinary	0 ^(a)	(2,354)	637	(1,340)	0	0	0
Items							
Operating (Deficit)/Surplus after Abnormal and Extraordinary Items	5,068 ^(a)	(724)	(1,660)	(7,651)	(11,015)	(11,432)	(2,184)
Accumulated Funds	44,961 ^(a)	44,237	42,577	59,377 ^(b)	52,578 ^(c)	41,146	38,962

^(a) Estimates to determine Accumulated funds.

^(b) \$24 million in debt converted to equity.

^(c) \$4.2 million cash contribution from Government.

^(d) ACTION's forecasts.

Despite direct government funding, ACTION has relied on its accumulated funds to finance its recurrent operating deficits. While the recent equity injections from the ACT Government have provided some further support, the declining financial trend over the last three years demand action. Given the expected net zero effect on costs at best, as discussed above, and only modest expectations about fare revenue increases, government contributions will remain crucial to ACTION's overall viability.

A detailed breakdown of the government's contribution is only available for the last two years, as shown in the following table:

Table 6.8: Government's Contribution (\$'000)

	1996-97	1997-98
Pricing CSO	16,340	13,376
General Route Off Peak Services CSO	9,038	7,779
School Services CSO/ School Transport Services	9,387	9,684
General Subsidy	3,000	1,000
Concessional travel payments (Dept of Education and Community Services)	3,501	3,606
Special Needs Transport	1,022	1,922
Resources Provided free of Charge	-	31
TOTAL	42,288	37,398

Different nomenclature was applied for previous years, and therefore no direct comparisons can be made.

The three major areas of government support in 1997-98 were in:

- pricing CSOs, which represent reimbursement for offering fares below a commercial level;
- school transport services, which is the estimated cost of subsidised travel;
- service CSOs, which represent reimbursement for providing non-commercial off peak services.

In addition to these cases, the Department of Education and Community Services funds bus travel concessions for:

- people in receipt of one or more of the following Centrelink benefits:
 - ◊ Youth Allowance;
 - ◊ Partner Allowance;
 - ◊ Sickness Allowance;
 - ◊ Additional Parenting Allowance;
 - ◊ Special Benefit;
 - ◊ Widow Allowance;
- children;
- pensioners; and
- in off-peak periods, seniors.

Further to the school CSO the Department of Education and Community Services also provides free bus tickets to children of parents on low income. Following the

introduction of zone fares the Department of Urban Services also provides school term tickets at a discount for eligible students travelling two or more zones.

The recent trend to reduce explicit government CSO payments reflects a growing concern that this may not be an effective means of allocating taxpayers' funds. If bus services are priced below their efficient costs, then bus users are not bearing the full cost of their transport decisions. In open market conditions, such subsidies lead to distortions, but this may not be the case in public transport if alternative modes are inappropriately priced, eg. if the cost of road vehicle use does not adequately reflect environmental or congestion costs that such use may incur on the community.

6.3.2 Cost Recovery

As a proportion of total costs, ACTION receives 57% (1997-98) as explicit government contributions. This proportion has fallen from 82% in 1993-94. The consequent effect on cost recovery is around 24% as shown below.

Table 6.9: Cost Recovery Trend

	1993-94	1994-95	1995-96	1996-97	1997-98
Fares	15,527	16,430	15,676	17,235	16,583
Operating Cost (Total Expenses)	70,269	68,967	67,111	71,152	67,064
Farebox Recovery	22.1%	23.8%	23.4%	24.2%	24.7%

Cost recovery is affected by changes to either costs or fares. Given the earlier discussion on efficiency, the Commission would want to ensure that strenuous measures are put in place to effect substantial improvements in operating efficiency, so that such low cost recovery levels are not maintained through excessive cost structures. On the other hand, a cost recovery outcome also reflects particular fare structures, which may be unrealistically low in commercial terms but which may be endorsed by government for broader social policy reasons.

On the basis of the new fare structure and the new network services effective from January 1999, cost recovery levels for 1998-99 and 1999-2000 are expected to be broadly similar to recent history, with higher fare revenues being offset by higher costs associated with additional services and higher statutory taxation and charges applied to ACTION, as discussed above.

Given the very low price elasticities discussed above, the ACT government could expect to achieve higher cost recovery outcomes by fairly modest fare increases independently of improvements achievable on operating costs.

Essentially, if ACTION can achieve the substantive cost savings identified by previous consultants' reviews, then the benefits may be taken either by bus users directly by minimising any required fare increases or by the taxpayers generally through lower government funding.

6.3.3 Rate of Return

Little evidence has been furnished to date to suggest that ACTION has applied a rigorous assessment of new investments in terms of prescribed rate of return criteria. Where bus acquisitions and depot construction have largely been determined by government, there has been little pressure for ACTION to adopt more disciplined evaluation processes comparable to commercial enterprises.

With the transfer of fixed assets to DUS, ACTION needs to establish clear investment guidelines for capital decisions, for bus acquisition and replacement, consistent with accepted commercial practice. This requires determining a prescribed net return on assets which will guide subsequent decision making. ACTION's ability to justify such investment will be driven by its capacity to increase patronage and therefore fare revenue or to reduce other operating costs. In the case of new buses, the choice of size and type of buses should be assessed against customer responsiveness and the services to be provided as well as the impacts on maintenance and life cycle costs of those buses.

The Commission seeks comment on the issue of an appropriate rate of return which should apply to future investments.

6.3.4 Best Practice 'Commercial Price'

In its reference, the Commission has been asked to determine a best practice "commercial price", taking account of cost benchmarks, potential patronage and service levels. The Commission has already noted in section 6.1.2 above that ACTION's current benchmark cost measures indicate a lower performance than comparable public bus operators. However, as already discussed, ACTION is embarking on major restructuring which should lead to lower operating costs.

Despite these improvements, ACTION can expect to record modest cost-recovery levels, estimated in 1997-98 at just under 25%. To establish whether a more "commercial price" would constitute higher fares and therefore higher cost-recovery levels, the Commission is mindful of the corresponding financial performances of other public bus operators. A comparative summary of the cost-recovery levels of a sample of operators is outlined in the following table.

Table 6.10: Farebox Cost Recovery

Public Bus Operator	Farebox Cost Recovery
ACTION	24.7 % (1997-98)
PTB, Adelaide	22.6% (1997-98)
Transperth	22.5% (1997-98) ^(a)
Brisbane Transport	35-40% (1997-98)
Newcastle Buses	23.5% (1996-97); forecast 23.3% (1997-98)
Sydney Buses	61.3% (1996-97); forecast 59.0% (1997-98)

^(a) Includes bus, rail and ferry services.

A wide spread of cost-recovery outcomes is recorded, but the table indicates that ACTION's cost-recovery performance is at the lower end of the range.

Clearly, the absolute fare levels and the resultant cost-recovery levels are heavily influenced by the policies of different State governments. Even in cases where the service providers are private commercial operators, such as in Perth and Adelaide, fares have been constrained by government policy. In the ACT, the government is seeking to reduce ACTION's reliance upon direct subsidies to meet its operating costs.

The changes to ACTION's EBA and Network 98 are forecast by ACTION to improve its farebox cost recovery to 29% in 1999-00. Given the low price elasticities, a revenue cap associated with the recent CPI increase should assist in realising this higher cost-recovery outcome. Despite this improvement, the Commission understands that there are grounds for continued improvement in ACTION's farebox cost recovery position, as there are still substantial cost efficiency gains available to ACTION. Consultants' reports have indicated that ACTION could potentially improve its farebox cost recovery to around 40%. Any target of this type needs to be considered in the context of the potential for further cost reductions combined with revenue growth opportunities. Assessment of the success of the Network 98 initiative will indicate the extent to which further cost recovery through the farebox may be possible.

6.4 Environmental Issues

- *The principles of ecologically sustainable development referred to in subsection 7 (2) of the Territory Owned Corporations Act 1990 as modified by virtue of subsection 4(I) of that Act (Part IV 20.(2f)).*
- *Considerations of demand management and least cost planning (Part IV 20.(2h)).*

The philosophy of ecologically sustainable development (ESD) requires the implementation of improved valuation and pricing of environmental resources. Utilisation of urban public transport services is a critical component of government initiatives to reduce air pollution. ACTION has the potential to remove up to 80

private cars from the road per journey, thereby improving air quality. The Commission is aware that onerous price rises could result in customers switching to alternative transport modes, predominantly cars, which have higher environmental costs.

The Commission questions ACTION's lack of CNG buses. The use of CNG buses significantly reduces emission levels compared to diesel powered buses. The transition to CNG buses would further increase the externality benefits of public transport. ACTION currently has two CNG buses but they claim that they are unreliable and costly to maintain. Given the broader environmental benefits of such buses and the increasing take-up by other public bus operators, ACTION may need to revisit this strategy as part of its subsequent fleet replacement policy given technology improvements and the opportunities available for further efficiency improvements.

In attempting to satisfy the principles of ESD, the Commission seeks to balance the requirement for government support for higher bus patronage outcomes and the payments by users. However, the Commission has no influence on decisions affecting the road infrastructure network or car parking policy, in terms of price or availability, both of which have significant impact on transport users' choice of mode and on the Canberra environment.

6.4.1 Demand Management

ACTION's morning and afternoon peak timetables utilise almost all available vehicles and hence dictate fleet size requirements. The Commission is pleased to note that since 1991 the proportion of buses in excess of maximum daily demand has fallen by nearly 50% from 16.6% to 8.5% .

For ACTION, weekday journeys comprise nearly 90% of all journeys. With the morning and evening peaks constituting approximately 40% of weekday services, this percentage does not appear to be high given Sydney Buses weekday peak period journeys comprise approximately 45% of all journeys. The lull in demand occurs on Sundays where journeys fall to around 25% of average weekday journeys. As such, the Commission recognises that ACTION's cost structure, as with most private and public bus operators, is high due to the need to satisfy peak period commuter and school demand.

The Commission also recognises that in January 1999 ACTION introduced a new network (Network 98). This network will increase the number of bus services by around 25%, using the existing fleet, particularly in off-peak periods. Thus the new network will better utilise ACTION's fleet and seek to generate adequate demand to increase ACTION's fare revenue.

ACTION has increased its revenue from charters since 1993-94 from \$552,000 to \$626,000. Historically ACTION has priced charter services on an avoidable cost basis plus a mark up (where possible) as a contribution towards fixed costs. This approach to pricing is economically efficient although the application of this methodology may require further review of ACTION's charter charges now that drivers wages can be

costed as an avoidable cost under the new EBA. With greater competition currently emerging for short term charters which have been the usual type of charter provided by ACTION, the ability of ACTION to set prices will be limited by the availability of other bus service providers.

Attachment 1: Terms of Reference

Australian Capital Territory

Independent Pricing and Regulatory Commission Act 1997

Declaration of Regulated Industries Under Section 4 and

Reference for Investigation Under Section 15 and

Specified Requirements in Relation to Investigation Under Section 16

Instrument No 265 of 1998

Declaration of Regulated Industries Under Section 4

Pursuant to subsection 4(1) of the *Independent Pricing and Regulatory Commission Act 1997* ('the Act') I declare the public transport bus services provided by ACTION within the Australian Capital Territory (the 'Territory'), to be a regulated industry.

Pursuant to subsection 4(2) of the Act, I certify that the industry involves the provision of services in the Territory in whole or in part by or on behalf of the Territory or a Territory authority.

Reference for Investigation Under Section 15

Pursuant to subsection 15(1) of the Act, I refer to the Independent Pricing and Regulatory Commission (the 'Commission') the matter of an investigation into the determination of prices for public transport bus services provided by ACTION within the Territory for the period from 1 July 1999 until 30 June 2000.

Specified Requirements in Relation to Investigation Under Section 16

Pursuant to subsection 16(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

- (a) The final report is to be provided to the Minister of Urban Services in relation to determined public transport prices for the period from 1 July 1999 to 30 June 2000 and the determination of the best practice 'commercial price' (specified below) – by 15 April 1999;
- (b) A draft report in relation to determined public transport prices for the period from 1 July 1999 to 30 June 2000 is to be provided to the Minister for Urban

Services and be made available for public examination and consultation in accordance with Section 18 of the Act – by 13 February 1999;

The Commission in conducting its investigation into the determination of prices shall specifically determine a price path based on best practice 'commercial price'. This will be done using best practice cost benchmarks taking into account potential patronage in the Territory and the service levels specified by the Department of Urban Services as the purchaser on behalf of the Territory Government.

Dated this fifteenth day of December 1998

BRENDAN SMYTH
MINISTER FOR URBAN SERVICES