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Integration Versus Separation of Australian Rail

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This paper considers whether, and under what market circumstances, economic efficiency in the delivery of rail freight and passenger services in Australia would be facilitated by structural separation of the infrastructure and train operating components. Reasons for vertical integration include: economies of scope across the two production stages, in terms of day-to-day operations, investment decisions and financing options; and lower transaction costs in coordinating the demand for and supply of train paths. Arguments for structural separation include: greater opportunities to allow for the interplay of competitive forces in the train operations sector where natural monopoly scale economies and sunk costs are less important than at the infrastructure stage; opening greater opportunities for economies of specialisation and of learning by doing; and comparable market transaction costs in the buying and selling of train paths. The choice of integration versus separation of the track and train stages will vary with market circumstances. These include: the importance of scale economies relative to market demand for rail services; the closeness and intensity of competition from road, sea and air transport alternatives; and the form and extent of other forms of competition, including private capital market disciplines, and the opportunities for tendering and franchising.

Applying these general ideas to different tasks of the Australian rail industry, some tentative conclusions about industry structures to achieve economic and technical efficiency are drawn. When demand is small relative to train operation scale economies, and there is inter-modal competition, as with interstate general freight, an unregulated integrated private firm structure is efficient. Even though interstate freight demand supports two or more train operators, it is not clear that vertical separation with a monopoly infrastructure supplier and an oligopoly train operator sector would be more efficient than a vertically integrated private firm structure. For the transport of coal and some bulk minerals where road transport is a weak substitute and there are resource rents, it may be desirable to regulate the rail provider to minimise the use of monopolistic power.