IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Review of fares for rural and regional buses and private ferries from 2 January 2008

Recommendations to the Minister

Transport— Report
December 2007

IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Review of fares for rural and regional buses and private ferries from 2 January 2008

Recommendations to the Minister

Transport — Report
December 2007

ISBN 978-1-921328-24-4

The Tribunal members for this review are:

Dr Michael Keating, AC, Chairman

Mr James Cox, CEO & Full Time Member

Ms Sibylle Krieger, Part Time Member

Inquiries regarding this document should be directed to a staff member:

Dion Jackomas (02) 9290 8442

Ineke Ogilvy (02) 9290 8473

Fiona Towers (02) 9290 8420

Independent Pricing and Regulatory Tribunal of New South Wales
PO Box Q290, QVB Post Office NSW 1230
Level 2, 44 Market Street, Sydney NSW 2000

T (02) 9290 8400 F (02) 9290 2061

www.ipart.nsw.gov.au

Contents

1	**Introduction and overview**	**1**
1.1	Overview of findings	1
1.2	Overview of recommendations	2
1.3	Structure of report	2
2	**IPART's review process**	**3**
2.1	Why IPART decided to retain the cost index approach	4
2.2	Changes to the cost indices	5
2.3	The need to adjust index outcomes to account for productivity improvements	6
2.4	Other matters considered	7
3	**Maximum fares for commercial bus services**	**9**
3.1	Overview of findings and recommendation	9
3.2	Calculation of the change in the Bus Industry Cost Index	10
3.3	Sharing the benefits of productivity gains with users	22
3.4	Expected impact of the recommended fare increase	25
4	**Maximum fares for private ferry services**	**29**
4.1	Overview of findings and recommendation	29
4.2	Calculation of the change in the CVACI	30
4.3	Sharing the benefits of productivity gains with users	36
4.4	Expected impact of the recommendations	38
5	**Revenue payments to rural and regional bus operators on non-commercial contracts**	**39**
5.1	Overview of findings and recommendation	39
5.2	IPART's review of the PWC model	40
5.3	Additional revenue payments made to operators over the past year	41
5.4	Revenue requirements resulting from IPART's recommended version of the PWC model	42
5.5	Expected impact of the recommendations	42
Appendices		**43**
A	Terms of reference – private buses	45
B	Terms of reference – private ferries	47
C	List of submissions and hearing participants	49
D	Comparison of ABS labour cost indices	50
E	Overview of the PWC model	51

1 Introduction and overview

The Independent Pricing and Regulatory Tribunal of New South Wales (IPART) has completed its 2007 reviews of:

- maximum fares for rural and regional bus services provided under commercial contracts
- maximum fares for private ferry services
- revenue payments related to rural and regional bus services provided under non-commercial contracts.

IPART undertook these reviews in response to a five-year standing reference from the Premier (see Appendices A and B), under section 9(1)b of the *Independent Pricing and Regulatory Tribunal Act 1992* (the IPART Act). As part of its reviews of fares for rural and regional bus services provided under commercial contracts and private ferry services, IPART reconsidered its regulatory approach, particularly the cost indices it uses to measure changes in operators' costs. In August of this year, it released an issues paper outlining some suggested changes to the cost indices. It has incorporated a number of these changes into the approach used in for the 2007 reviews.

1.1 Overview of findings

To formulate its recommendation on fares for rural and regional bus services provided under commercial contracts, IPART reviewed the increase in bus operators' costs for 2006/07, as measured by the Bus Industry Cost Index (BICI). It also reviewed and revised the weightings and inflators used in the BICI, to increase the independence, transparency and robustness of this index. IPART found that the increase in costs measured by the BICI was 2.85 per cent. It also found that a productivity adjustment equal to 0.3 per cent of the 'salaries and wages' cost item in the index was appropriate to account for expected growth in productivity over 2007/08. It concluded that a maximum fare increase of 2.72 per cent was appropriate, in line with the increase in bus operators' productivity-adjusted costs for 2006/07.

To formulate its recommendation on fares for private ferry services, IPART reviewed the increase in private ferry operators' costs for the year to the end of the September quarter 2007, as measured by the Commercial Vessel Association Cost Index (CVACI). It also reviewed and revised the inflators used in the CVACI, to increase the independence, transparency and robustness of this index. IPART found that the increase in costs measured by the CVACI was 1.45 per cent. It also found that a productivity adjustment equal to 0.3 per cent of the 'labour' cost item in the index was appropriate to account for expected productivity growth during the coming year. It concluded that a maximum fare increase of 1.33 per cent was appropriate, in line with the increase in private ferry operators' productivity-adjusted costs over 2006/07.

To calculate the recommended revenue payments for rural and regional bus operators on non-commercial contracts, IPART reviewed the revenue these operators require to recover their costs as measured by the 2007 version of the PricewaterhouseCoopers model. IPART made adjustments to the model to correct minor errors. It concluded that the revenue payments should be increased by between 3.34 per cent and 5.33 per cent (depending on the bus category involved), in line with the revenue requirements generated by this model.

1.2 Overview of recommendations

In line with the findings outlined above, IPART makes the following recommendations to the Minister:

1 That maximum fares for rural and regional bus services provided under commercial contracts be permitted to increase by 2.72 per cent.

2 That maximum fares for private ferry services be permitted to rise by 1.33 per cent.

3 That revenue payments related to rural and regional bus services provided under non-commercial contracts be increased by between 3.34 per cent and 5.33 per cent (or to between $61,147 and $105,587), depending on the bus category involved.

1.3 Structure of report

This report explains IPART's review, findings and recommendations in more detail:

- Chapter 2 outlines IPART's review process together with key aspects of this process, including why IPART chose to continue to use the cost index approach, and the changes it made to the indices.
- Chapter 3 explains IPART's recommendation and considerations in relation to maximum fares for rural and regional bus services provided under commercial contracts.
- Chapter 4 discusses its recommendation and considerations in relation to maximum fares for private ferry services.
- Chapter 5 discusses its recommendation and considerations in relation to revenue payments for rural and regional bus services provided under non-commercial contracts.

2 IPART's review process

As part of its review process, IPART undertook public consultation and conducted its own research and analysis. Specifically, it:

- invited the Ministry of Transport, the Bus and Coach Association (BCA), the Commercial Vessel Association (CVA), and other interested parties to make submissions to its review, and received four written responses
- engaged a consultant, Indec Consulting, to undertake a review of the weightings of cost items in the Bus Industry Cost Index (BICI)
- released an issues paper reviewing the cost indices for rural and regional buses and private ferries
- collected information from the BCA and CVA required for the construction of the BICI and Commercial Vessel Association Cost Index (CVACI)
- independently verified cost data provided by the BCA and CVA
- held a public hearing on 9 November 2007 and invited the BCA, CVA, Indec Consulting and other stakeholders to discuss relevant issues
- met with the BCA and CVA in regards to moving towards more independent, transparent and verifiable inflators.

IPART considered all the submissions and information it received, as well as comments made at the public hearing and in meetings with the industry associations. It then constructed the cost indices, and determined an appropriate productivity adjustment to ensure that productivity gains are passed through to passengers in the form of lower fares.

The sections below explain key aspects of this process, including why IPART decided to retain the cost index approach in reviewing fares for rural and regional bus services provided under commercial contracts and private ferry services, the changes it made to the cost indices for its 2007 reviews, the need to adjust the cost indices' outcomes to take account of productivity improvements, and the other matters it considered. Appendix C provides a list of the submissions IPART received and the stakeholders who attended the public hearing.

2.1 Why IPART decided to retain the cost index approach

In past reviews, IPART has expressed concerns about the form of regulation for both the rural and regional bus industry and the private ferry industry. The current approaches for calculating recommended fare increases for rural and regional buses and private ferries using the BICI and CVACI have been in place for approximately five years, and IPART considered that 2007 was an appropriate time to review these approaches. In general, IPART believes it is good regulatory practice to regularly review its approach to regulation in all industries. The time period between such reviews should achieve a balance between providing regulatory certainty and ensuring that the approach is as relevant and robust as possible.

In August of this year, IPART decided it would not review the use of cost indices themselves, and would limit its review to the inflators and weightings included in the cost indices. In reaching this decision, IPART recognised that the current approach to calculating the BICI and CVACI has a number of disadvantages, including:

- they are time-consuming and costly for stakeholders, who are required to collect and provide to IPART a significant amount of information on an annual basis
- although based on actual costs in the industry as a whole, the movement in each industry's index is unlikely to reflect the costs of any given operator
- the required increases are calculated by the industries themselves and are therefore not calculated on an arms length basis
- fare increases that pass through increases in an industry cost index do not pass through to customers in lower prices any efficiency gains that are achieved.

IPART also recognised that a more traditional form of regulation, such as a building block approach applied to each individual operator, would overcome many of these problems. However, such an approach would be significantly more costly and intrusive, and IPART concluded that it would come at too high a cost to industry participants.

In addition, IPART considered that some of the characteristics of the rural and regional bus and private ferry industries make it inappropriate to use a more traditional form of regulation (such as the building block approach). The private operators whose fares are governed by the BICI and CVACI vary widely in size and sophistication – from large coach or tourist/commuter ferry providers, to those offering only more limited services for local communities. In addition, many service providers offer services with regulated fares as well as services with unregulated fares, which makes regulatory accounting more difficult and costly.

Further, IPART had regard to the fact that:

- many of the operators of non-metropolitan private bus and private ferry services are small businesses that lack the resources to undertake substantial data collection
- there are a large number of private bus operators and for many of them, the current regulatory arrangements are transitional as they begin to move onto new bus contracting arrangements
- there are some legal contractual requirements that specify that these indices will be used for setting fares.

Finally, the cost index approach has some efficiency advantages. Fares are adjusted according to changes in an input price index for the industry as a whole. If an operator can make efficiency improvements that result in its costs increasing by less than the change in the input cost index, it can increase its profits. This provides an incentive for operators to make efficiency improvements.

2.2 Changes to the cost indices

As a result of its review of the inflators and weightings included in the BICI and CVACI, IPART made a number of changes aimed at improving the cost reflectivity, independence, transparency and verifiability of these cost indices. For example, IPART decided to use predominantly independent, publicly available inflators to inflate each of the cost items in both cost indices, and updated the weightings of the cost items in the BICI based on the results of an industry survey of costs conducted by Indec Consulting.

IPART considers that these changes will resolve a number of the concerns it has expressed in the past. These concerns include that:[1]

- the data for the BICI is high level and may not represent operators' efficient costs
- the BICI was originally designed to represent the cost structure of some metropolitan bus operators as well as rural and regional bus operators but is applied only to rural and regional operators
- the BICI applies to a diverse range of rural and regional operators, and many of these operators claim that it misrepresents their cost structure
- the relative weightings of the items within the BICI had not been reviewed since 1999.

1 See IPART, *Review of non-metropolitan fares for private buses in NSW from 2 January 2007 – Report to the NSW Minister for Transport,* December 2006, p 17.

The changes made to the BICI and CVACI are similar to the changes IPART made to the Taxi Cost Index, as part of its 2007 review of the form of regulation in the taxi industry.[2] These changes further IPART's aim of aligning its approach across transport industries, where possible.

2.3 The need to adjust index outcomes to account for productivity improvements

Productivity is a measure of the rate at which outputs of goods and services are produced per unit of input (for example, labour, capital, raw materials). Growth in productivity reflects the achievement of greater outputs for a given level of input. This can be achieved through reduced costs, but also through increased levels of value-adding, such as increased performance or improved service quality.

Adjusting the increases in operator costs produced by the BICI and CVACI to account for expected growth in productivity ensures that the gains from productivity growth are distributed to consumers through lower fares, as well as to operators through increased income/profits. It also provides a strong incentive to operators to make productivity improvements that are at least as great as the productivity adjustment in order to maintain their current level of income/profitability.

A significant proportion of the total costs in the cost indices are now inflated in a way that already includes some measure of productivity. For example, the consumer price index (CPI) or one of its components is used to inflate some cost items, and the CPI already reflects changes in output costs for a given level of inputs at the economy-wide level. However, a large proportion of the total costs are labour-related costs, which are inflated by the wage price index (WPI). Unlike the CPI, the WPI does not already include a measure of economy-wide productivity gains.

As the WPI does not include a measure of economy-wide productivity gains, it will tend to overstate the increase in unit labour costs faced by bus operators, as labour costs are affected by both the level of wages and labour productivity. In the absence of changes in the level of productivity, WPI would give an accurate measure of increase in unit labour costs, however, in the presence of productivity growth wage cost increases will exceed unit labour cost increases. It is inappropriate to inflate labour costs using WPI without adjusting for productivity gains as this will lead to fare increases which are greater than the increase in costs.

To share the benefits of expected gains in labour productivity between service providers and passengers, IPART considers that it is appropriate to adjust maximum fares to account for expected gains.

2 IPART, *Review of Form of Regulation for Taxis in New South Wales,* April 2007.

2.4 Other matters considered

In making its recommendations, IPART explicitly considered all the matters outlined in its terms of reference. These matters relate to:

- consumer protection – protecting consumers from abuses of monopoly power; standards of quality, reliability and safety of the services concerned; social impact of decisions
- economic efficiency – greater efficiency in the supply of services; the cost of providing the services concerned; relativities with the Government-owned services including in terms of service, efficiency, cost and ticketing products
- financial viability – the impact of pricing policies on borrowing and capital requirements and, in particular, the impact of any need to renew or increase relevant assets; the effect of any pricing recommendation on the level of Government funding provided to private operators, and
- environmental protection – promotion of ecologically sustainable development via appropriate pricing policies.

3 Maximum fares for commercial bus services

Under commercial contracts, private rural and regional bus operators are granted an exclusive right to provide services on a particular bus route and receive revenue from the fares they charge for those services. They also receive School Student Transport Scheme (SSTS) payments from the Government for services provided at no charge to school students travelling to and from school. More than 70 operators in rural and regional NSW hold commercial contracts, and some of these hold multiple contracts.

To formulate its recommendation on fares for rural and regional bus services provided under commercial contracts, IPART calculated the increase in bus operators' costs for 2006/07, as measured by the Bus Industry Cost Index (BICI). It also reviewed the weightings and inflators used in the BICI, to increase the independence, transparency and robustness of this index, and calculated an appropriate productivity adjustment to ensure that productivity gains are passed through to passengers in the form of lower fares.

Section 3.1 below provides an overview of IPART's findings and recommendation on maximum fares. The section 3.2 explains the calculation of the change in the BICI, section 3.3 explains the calculation of the productivity adjustment and section 3.4 outlines the expected impact of IPART's recommended increase in maximum fares.

While IPART's recommendation relates to the maximum fares these bus operators are permitted to charged for rural and regional bus services, it should be noted that in practice, many operators currently charge below the maximum fare, particularly for longer distances.[3]

3.1 Overview of findings and recommendation

IPART found that the increase in costs as measured by the BICI was 2.85 per cent. It also found that a productivity adjustment equal to 0.3 per cent of the 'salaries and wages' cost item in the index was appropriate to account for expected growth in productivity over 2007/08. It concluded that a maximum fare increase of 2.72 per cent was appropriate. This increase is equivalent to the increase in bus operators' productivity adjusted costs for 2006/07.

3 BCA submission, September 2007, p 6.

Based on these findings, IPART makes the following recommendation to the Minister for Transport:

Recommendation

1 That maximum fares for rural and regional bus services provided under commercial contracts be permitted to increase by 2.72 per cent.

The date at which any fare changes will take place is a matter for the Director General of the Ministry of Transport; however, IPART expects that fare changes will apply from 2 January 2008.

3.2 Calculation of the change in the Bus Industry Cost Index

Both the Ministry of Transport and the BCA submitted that the maximum fares for services provided by non-metropolitan private bus operators under commercial contracts should increase in line with the change in the BICI over the year 2006/07.

In essence, the BICI measures the average change in the cost of a basket of inputs considered to be representative of the costs of private bus operators in NSW. It is a weighted average of six cost items. Each year, each of these items is inflated by a specified inflator to obtain a figure that is indicative of the overall increase in costs experienced by these bus operators. In previous years, the BCA has maintained this index on behalf of private bus operators and submitted the results to IPART.

As part of the 2007 review, IPART reviewed aspects of the BICI with the aim of achieving a more independent, transparent and robust approach to making its fare recommendations (see section 2.1 for more information). IPART commissioned Indec Consulting (Indec) to undertake a review of the weightings of the cost items within the index, and adopted Indec's recommendations on revised weightings. It also changed the inflators used to inflate some of the cost items in the BICI. The following sections explain the revised weightings, the inflators used to inflate each cost item, and the resulting change in BICI for 2006/07.

3.2.1 Revised weightings

Currently, each cost item in the BICI is given a weighting that is intended to correspond with its proportion of total costs. These relative weightings have not been reviewed since 1999, and IPART has previously expressed concern that they may no longer be appropriate. To address this concern, IPART asked Indec to reassess the weightings to ensure that the BICI continues to reflect the cost structure of rural and regional private bus operators.

Indec conducted a survey of all rural and regional bus operators on commercial contracts. The survey form requested additional detail on the costs included in the 'Other Costs' cost item for the purpose of considering whether additional cost items should be included in the BICI. Indec received 35 responses (out of 78 bus operators), of the 35 responses received, 29 were used to calculate Indec's recommendations.

Indec tested a number of alternative methods of determining the BICI weights from the survey data and found that all methods yield similar results and that there is no material difference in the BICI weights calculated from the different methods.[4] Indec concluded:

- that the most appropriate method of establishing revised weightings for the BICI is on the basis of weighted averages of the survey results, adjusted to reflect commercial contract related expenses only
- there is no need for a significant change in the weightings currently used
- there is no need for additional cost items to be included in the BICI.

Indec provided its report on the appropriate cost weightings for rural and regional bus operators to IPART in November 2007. IPART made this report available on its website, and invited stakeholders to comment on it. However, it received no submissions. Indec presented the report at the public hearing on 9 November, where participants, including the BCA, supported its recommended weightings.

IPART used Indec's recommended weightings to calculate the percentage change in the BICI. However, based on the results of Indec's analysis, IPART made the following simplifications to the index:

- it amalgamated two small costs (bus registration costs (1.08 per cent) and tyres and tube costs (0.93 per cent)) into the 'other' cost category
- it amalgamated all of the components of insurance (except for workers compensation) into a single insurance cost item (1.75 per cent).

Table 3.1 shows the revised weightings in the BICI used for the 2007 review.

4 Indec Consulting, *Relative Weightings in the Bus Industry Cost Index*, November 2007, p 1.

Table 3.1 Revised weightings used for the 2007 review

Item Category	2006 weighting %	2007 revised weighting %
People Costs	48.90	48.28
- Salaries & Wages	(40.71)	(40.65)
- Workers Compensation	(2.36)	(2.12)
- Payroll Tax	(2.22)	(2.04)
- Superannuation	(3.61)	(3.48)
Bus Fuel and Lubricants	11.13	11.41
Bus Repair and Maintenance	4.72	4.78
Insurance	3.24	1.75
Capital Costs – Bus	16.75	18.55
Other Costs	15.25	15.23
Total	100	100

Note: For ease of comparison, Indec's recommended weightings for tyre costs and registration costs have been incorporated in the weighting for 'other costs' cost item.

IPART has decided to notionally 'fix' the weightings in the BICI for the next five years. However, the weightings will still be adjusted each year according to changes in the relativities in costs that result from the inflators applied in the previous year (see section 3.2.3). The weighting for each cost item represents its share of total costs. As each cost changes at a different rate, its share of the total may increase or decrease over time. The weightings are fixed in the sense that the quantity of each item represented by the index will not change, only changes in its share of the total that result from increases or decreases in the cost of purchasing those quantities. IPART does not intend to review the quantities of items in the index in depth until after 2011. IPART considers that this approach will maintain the cost reflectivity of the index without imposing additional regulatory costs. Although it will result in slight variations over time, as costs change, it will not capture substitution affects that occur as a result of changes in cost relativities. IPART also notes that this approach is consistent with that used by the ABS in cost indices such as the CPI.

3.2.2 Cost items and inflators

The BICI consists of the six cost items shown in Table 3.1 above. One of these items, people costs, is split into four components. In previous years, each item was inflated based on data on costs provided by the BCA and verified by IPART. As part of its review of the form of regulation, IPART proposed the use of independently gathered, publicly available inflators to inflate each cost item.

In its fare proposal, the BCA indicated that it did not support changes to the inflators. It argued that the present approach is sufficiently independent, cost-reflective and robust. It also argued that the current inflators (many of which are based on quotes obtained by the BCA) are more cost-reflective than those proposed by IPART because they are specific to the bus industry. In addition, it expressed concern that the timing of such changes is not appropriate, due to the Ministry of Transport's current review of funding and contracting arrangements for rural and regional bus services. At IPART's public hearing, the BCA suggested that if greater independence is required, the current method could be retained with an independent party such as IPART gathering the required information in place of the BCA.

The Ministry of Transport also expressed reservations about the proposed changes at the public hearing. It cited cost reflectivity as the main reason for its concerns, and suggested that Ernst & Young had advised them that replacing the proposed changes may be less reflective of the real cost increases that bus operators face.[5]

IPART considered the comments made by the BCA and Ministry of Transport carefully. However, it concluded that there is no persuasive reason for it to continue to rely on cost information provided by the operators or their representatives, which is only checked for 'reasonableness'. IPART considers that this approach is inconsistent with the level of accuracy and robustness that it would find acceptable in other areas of its work. It also considers that the use of publicly available information (such as ABS data) instead will provide greater transparency, as unlike currently, stakeholders will be able to replicate the cost index quite easily.

IPART acknowledges that it is important to select inflators that reflect the industry's costs. However, the rural and regional bus industry is diverse in terms of the size of operators and the number of contracts they hold (see Tables 3.2 and 3.3). Therefore, the use of industry-wide inflators will mean that the index does not reflect the costs of any individual operator, even if those inflators are industry-specific.

5 Joanna Quilty at IPART public hearing, 9 November 2007, transcript p 49.

Table 3.2 Distribution of commercial bus operators by number of buses

Number of buses for which operator is accredited	Number of 'commercial' operators
1	3
2	4
3	2
4	5
5	5
6	3
7	1
8	3
9	3
10	5
12-18	12
20-28	9
30-37	7
40-49	5
50-60	4
100-120	3
190-200	1
350	1

Source: Ministry of Transport and BCA Rural & Regional Bus Reform Consultative Taskforce, August 2006 p 22.

Table 3.3 Distribution of bus operators by number of contracts held

Number of contracts held	Number of commercial contract holders	Number of non-commercial contract holders
1	88	443
2	12	143
3	5	63
4	1	30
5	-	17
6	2	12
7	3	12
8	1	9
9	-	4
10	-	7
12	-	6
13-20	-	9
21-29	-	4
27	1	-
53	-	1

Source: Ministry of Transport and BCA Rural & Regional Bus Reform Consultative Taskforce, August 2006 p 23.

For the above reasons, IPART has used revised inflators for some cost items in its 2007 review, and will continue to use these inflators in future years. Each revised inflator was selected because it met IPART's criteria of being:

- based on independent and verifiable data that is publicly available
- a reasonable estimate of costs changes for operators
- consistent with inflators used for other transport industries where relevant.

IPART considers that the inflators it has used are no less reflective of the costs of individual operators than those currently used. The revised inflators for each cost item are discussed in detail below.

People costs - Salaries and wages

The 'people costs' cost item comprises four components:

- salaries and wages (measured by award rates of pay for drivers)
- occupational superannuation
- payroll tax
- workers compensation insurance.

This section discusses the inflator for the salaries and wages component; the following section discusses the other three components.

In the past, the salaries and wages cost component has been inflated by the annual increase in the 'Motor Bus Drivers and Conductors State Award'. The BCA argued that this approach needs to be retained to maintain the cost reflectivity of the index. However, according to Indec data, 39 per cent of the total costs associated with salaries and wages is associated with administration, mechanics, cleaners and re-fuellers. This suggests that the use of a specific bus drivers award is likely to be less cost-reflective than a more general approach to labour cost increases that captures increases in wages more broadly.

IPART proposed two alternative inflators for salaries and wages that are independent and publicly available:

- changes in Average Weekly Earnings (AWE)
- changes in the Wage Price Index (WPI).

Both these approaches measure changes in wage and salary costs. In other industries, IPART has preferred to use the WPI, because it measures the wage and salary costs for an employer for a fixed quantity and quality of labour (for example, it currently uses WPI in the taxi industry). This means that, unlike the AWE, it is unaffected by compositional changes in the workforce (see Appendix D).

IPART considers that the WPI would also better meet the criteria of an independent and verifiable measure in the private bus industry, and its use would be consistent with the approach it uses in the taxi industry. Therefore, it has applied WPI to the salaries and wages component of the BICI. The WPI[6] has been calculated using the average of four quarters based on the following formula:

$$WPI_t = \left(\frac{WPI_{Jun(t-1)} + WPI_{Sep(t-1)} + WPI_{Dec(t-1)} + WPI_{Mar(t)}}{WPI_{Jun(t-2)} + WPI_{Sep(t-2)} + WPI_{Dec(t-2)} + WPI_{Mar(t-1)}} - 1 \right) \times 100\%$$

Under this calculation the increase in the salaries and wages cost item this year is 3.78 per cent. This is comparable to the increase proposed by the BCA of 4.0 per cent.[7]

People costs – Workers compensation, payroll tax and superannuation

In previous years:

- workers compensation has been inflated by either premium quotes obtained by the BCA or by multiples published by WorkCover and applied to wages
- superannuation has been inflated by the same value as the salaries and wages cost component
- payroll tax has been inflated by the change in wages and salaries.

IPART proposed to include workers compensation costs in the insurance cost item. The BCA argued that this would not be appropriate as workers compensation insurance is a function of wage costs. Having considered this issue in detail, IPART agrees with the BCA and has retained workers compensation as a part of the 'people costs' cost item.

IPART also proposed to inflate superannuation by the WPI. The BCA raised concerns with this approach as it considered that the changes to superannuation, workers compensation insurance and payroll tax would not be adequately captured by the WPI. IPART's initial view that WPI was an appropriate inflator for non-wage people costs was based on the assumption that movements in non-wage costs would generally mirror movements in wages.

IPART has now considered the applicability of WPI to non-wage items in more detail. In addition to WPI, the ABS publishes four non-wage price indexes (NWPI). There are separate NWPIs for superannuation, payroll tax and workers compensation, available by state and by sector.

6 Total hourly rates of pay excluding bonuses, New South Wales, All industries, Private and Public, All occupations.

7 BCA submission, September 2007.

IPART considers that it is appropriate to apply the relevant NWPI to each of these items. IPART agrees with the BCA that both superannuation and payroll tax are susceptible to regulatory or legislative changes that may create deviations from the WPI (for example, legislative changes in the minimum percentage of superannuation payable by employers). For this reason, it has decided that the NWPI measures are more relevant to these items.

Over the past three years, the movement in the superannuation NWPI has been similar to that in the WPI. This is not surprising, as superannuation payments are legislated as a fixed proportion of wages. The movement in the payroll tax NWPI has also been similar to that in the WPI. However, the trend in workers compensation NWPI has been quite different. (See Table 3.4.)

Table 3.4 Recent movement in the NWPIs for superannuation, payroll tax and workers compensation and the WPI

	2004/05 %	2005/06 %	2006/07 %
WPI	3.6	4.1	3.8
NWPI – Superannuation	3.6	4.2	3.9
NWPI – Payroll Tax	4.1	4.5	4.1
NWPI – Workers Compensation	4.5	-1.3	-7.7

Note: the figures above are based on the relevant all Financial Year Index, New South Wales, All industries, Private and Public.

Source: ABS.

IPART used the relevant NWPI to inflate each of the non-wage people costs items. This resulted in:

- an increase in the superannuation item of 3.9 per cent
- an increase in the payroll tax item of 4.1 per cent
- a decrease in the workers compensation item of 7.7 per cent.

This compares with an increase of 4.0 per cent for superannuation and payroll tax and a decrease of 6.26 per cent for workers compensation, proposed by the BCA.

Bus fuel and lubricants

In previous reviews, fuel costs have been inflated by Mobil fuel data provided by the BCA. For the 2007 review, IPART proposed the use of Fueltrac data, as it considers this is a more independent measure. In its discussions with the BCA, the BCA commented that it prefers to use Mobil data, as it has to purchase Fueltrac data.

The Mobil data relates to changes in diesel fuel prices in Sydney, whereas the BICI is only applicable to operators in rural and regional areas. However, as it is the size of the change in costs that is relevant, it may be that there is not a significant difference between different regions. On the other hand, Fueltrac is able to provide a wholesale price that incorporates a freight component, arguably giving a better estimate of private bus operator fuel costs.

IPART reviewed both approaches and found that the difference between using Mobil and Fueltrac data this year is minimal – using Mobil data resulted in a reduction in the bus fuels and lubricants cost item of 3.3 per cent, while Fueltrac data resulted in a reduction of 3.0 per cent. This suggests that the implications for cost reflectivity of excluding freight from the measure are not significant. IPART also noted that the use of Mobil data is consistent with the approach used by the Ministry of Transport in determining fuel payments for the metropolitan and outer metropolitan bus system contracts.

IPART concluded that the Mobil data is sufficiently independent and transparent. Therefore it decided to continue to use Mobil data as the inflator for the bus fuel and lubricants cost item in the BICI. However, in order to improve the independence of the process, IPART will obtain the data directly from Mobil or the Ministry of Transport in future years.

In considering the inflator for fuel costs, IPART is aware that in the past, the Ministry of Transport has provided interim payments to rural and regional bus operators designed to compensate them for increases in fuel costs. As the BICI compensates for fuel costs retrospectively, it would be consistent to adjust the fare increase calculated by the BICI to take account of any additional fuel payments made to operators between 1 July 2006 and 30 June 2007. This will ensure that operators are not compensated twice for fuel costs during this period. IPART considers that the Ministry of Transport should ensure that operators are not inadvertently overcompensated for fuel costs as a result of any interim payment arrangements.

Bus repair and maintenance

In past years, bus repair and maintenance costs consisted of the cost of a major service and a tyre list price value. This year, IPART has amalgamated the tyre price into the 'other' category. Therefore, the bus repair and maintenance item consists only of the cost of a major service.

Service costs have been inflated based on a quote obtained by the BCA for a major service for a Mercedes Benz bus. While the BCA claims that the use of a quote is cost reflective, IPART notes that such an approach is only cost reflective for an operator if they use the same product as the quote. Mercedes Benz has only eight authorised dealers from which bus operators can obtain the service quoted.[8] Therefore, it may not be a viable supplier for many bus operators.

8 Dealers are located in Port Macquarie, Goulburn, Tamworth, Coffs Harbour, Taree, Wagga Wagga, Orange and Dubbo.

IPART proposed that the annual change in the 'motor vehicle repair and servicing' expenditure class of the CPI would be a more appropriate inflator for this item. This approach would be consistent with the method IPART uses in the taxi industry. Further, as bus repair and maintenance costs are only a small proportion of the costs in the BICI, IPART does not consider that the use of a CPI measure for this item will have an adverse impact on the cost reflectivity of the index.

Given the above, IPART decided to use the change in 'motor vehicle repair and servicing' expenditure class in the CPI for the 2007 review. This resulted in an increase in the bus repair and maintenance cost item of 2.64 per cent. This compares with the 5.27 per cent proposed by the BCA.

Insurance

The bus insurance cost item consists of the cost of green slips and comprehensive insurance. In previous years, changes in each of these costs were based on quotes obtained by the BCA. The cost of green slips was calculated as a simple average of the quoted costs of a country and an urban green slip. However, because the BICI now relates only to rural and regional buses, IPART considers that it is not cost-reflective to maintain this approach. For the 2007 review, the BCA provided quotes obtained from an insurance company called ALIB Businsure.[9]

In line with its proposal, IPART decided that it is more appropriate to inflate insurance items by the 'insurance services' sub group of the CPI. While this inflator does not focus on bus-specific insurance costs, it should provide an indication of the movement in insurance costs in the economy as a whole. As insurance costs are a very small proportion of the BICI, the use of a global inflator for this item is unlikely to have a significant adverse impact on the cost reflectivity of the index.

The use of the change in the 'CPI – Insurance services' expenditure class resulted in a increase in the insurance cost item of 3.98 per cent. This compares with an increase of 3.2 per cent for comprehensive insurance and a decrease of 1.72 per cent for green slips proposed by the BCA.

Capital costs - Bus

In previous reviews, bus capital costs have been inflated by the increase in the cost of a monthly loan payment on a bus chassis and custom coach body. Quotes were obtained by the BCA and a 10-year bond rate was used as the relevant interest rate. IPART proposed using the 'CPI – motor vehicles' and 'CPI – parts and accessories' expenditure classes to inflate the value of the chassis and custom body respectively.[10] IPART also sought comment on the appropriate interest rate to use.

---

9 ALIB Businsure is the Insurance arm of the BCA <http://www.alibbusinsure.com.au/>

10 IPART, *Review of cost indices for non-metropolitan buses and private ferries – Alternative approaches to calculating the Bus Industry Cost Index and Commercial Vessel Association Cost Index,* August 2007, p 12.

For the 2007 review, the BCA provided one quote from Mercedes-Benz for its 'City Bus' low entry chassis with a Custom Coach City bus body.

While IPART accepts that the annual change in bus capital costs is adequately captured by calculating an estimated change in loan repayments in each year, it does not consider that there are persuasive reasons why the change in costs should be based purely on one quoted price for a specific bus. The Mercedes Benz is not the only type of bus used by rural and regional bus operators; therefore the current approach is unlikely to provide a true representation of bus capital costs to rural and regional operators.

Bus capital costs are a large proportion of the BICI, around 20 per cent. A comparison of the past five years to 2006 shows that the under the CPI-based inflators, bus capital costs would have been inflated by approximately 1.6 per cent. In contrast, the use of the current approach resulted in a 36 per cent increase in this cost item. Given the large discrepancy between these measures and the fact that bus capital costs do have a significant impact on the BICI outcome, IPART considers that a CPI based measure may not be an appropriate inflator for this item.

However, to address IPART's concerns about the independence and relevance of the inflator for this item, IPART intends to obtain multiple quotes in future years. The BCA supports this proposal and has agreed to work with IPART to ensure that the quotes obtained are relevant and comparable between years. The BCA recommends obtaining eight quotes each year to provide a full picture of changes in costs. IPART will consult the BCA next year on the appropriate specifications for the relevant buses. For this year, IPART used the single quote obtained by the BCA in its calculations.

In relation to the interest rate used, the BCA noted that the use of a five-year interest rate would be more appropriate than the 10-year rate currently being used.[11] IPART considers that both the rate and its term should be clarified in order to improve the transparency of the process. For this year, it has used the five year swap rate published daily in the Australian Financial Review.

The use of the BCA-provided quote and the five-year swap rate resulted in an increase in the 'capital costs – bus' cost item of 5.37 per cent, taking the value of this item from $8,748.00,[12] to $9,218.49. This compares with the increase of 3.83 per cent proposed by the BCA.

11 BCA Submission, September 2007, p 10.

12 IPART, *Review of Non-metropolitan fares for private buses in NSW – From 2 January 2007,* December 2006, p 6.

Other costs

In the past, the other costs item has been inflated by the change in the CPI. IPART has decided to continue this approach. Nothing in the work carried out by Indec or in submissions or comments from the BCA suggests that this is no longer an appropriate inflator for this category.

The use of the change in the CPI resulted in an increase in the 'other costs' cost item of 2.87 per cent.

3.2.3 Total change in the BICI for 2007

The calculations discussed above resulted in a total increase in the BICI of 2.85 per cent, prior to any adjustment for productivity (Table 3.5). The main drivers of this increase were increases in the 'salaries and wages' and 'capital costs – bus' cost items.

Table 3.5 Increase in costs measured by the BICI

Cost Item	Weighting	Inflator	Change	Contribution to Index
	%		%	%
Capital Costs - Bus	18.55	(Loan Payment)	5.37	1.00
- Chassis		Quote	3.02	
- Custom Body		Quote	2.62	
- Lease Interest		5yr swap rate	6.42	
Salaries and wages	40.65	WPI	3.78	1.54
Superannuation	3.48	NWPI - Super	3.89	0.14
Payroll Tax	2.04	NWPI - Pay roll tax	4.14	0.08
Workers Compensation	2.12	NWPI- Workers Compensation	-7.66	-0.16
Insurance Costs	1.76	Insurance Services CPI	3.98	0.07
Fuel and lubricants	11.41	Mobil Fuel Price Data	-3.30	-0.38
Bus Repair and Maintenance	4.78	Repair & Servicing CPI	2.64	0.13
Other Costs	15.22	CPI	2.87	0.44
Total	100			2.85

Note: totals may not add due to rounding.

Source: BCA and IPART calculations.

As noted in section 3.2.1, IPART has decided to fix the weightings used for the 2007 review for the next five years. Nevertheless, the weightings will still change from year to year, according to the increase in the cost of each cost item in the previous year's review. IPART has calculated the weights for the 2008 review based on this year's BICI (see Table 3.6).

Table 3.6 Weightings for the 2008 review

Cost Item	2007 Weighting	Change in cost measured by inflator	2008 Weighting
People Costs	48.28		48.50
- Salaries & Wages	(40.65)	3.78	41.02
- Workers Compensation	(2.12)	-7.66	1.90
- Payroll Tax	(2.04)	4.14	2.06
- Superannuation	(3.48)	3.89	3.52
Bus Fuel and Lubricants	11.41	-3.30	10.73
Bus Repair and Maintenance	4.78	2.64	4.77
Insurance	1.75	3.98	1.78
Capital Costs – Bus	18.55	5.37	19.00
Other Costs	15.23	2.87	15.22
Total	100		100

Note: totals may not add due to rounding. Weightings in brackets are a subset of people costs.

Source: IPART calculations.

3.3 Sharing the benefits of productivity gains with users

The cost index approach compensates operators for changes in the price of their inputs. This approach maintains incentives for operators to be efficient. If they can hold the increase in their costs below the change in the input price index by producing more efficiently, their profits will increase. However, if their costs increase faster than the growth of the input price index, then their profits will be reduced. It is important to note that the index measures changes in the price of inputs to the industry *on average*, not the costs of an individual operator.

However, the index approach does not capture changes in the usage of a particular input relative to the level of output (for example, greater fuel economy). In addition, it does not provide a mechanism for operators to share productivity gains with their customers. IPART considers that this is unfair. In its view, the overall change in costs calculated via the BICI needs to be adjusted to account for expected growth in productivity to improve fairness. Such an adjustment ensures that the gains from productivity growth are distributed to consumers through lower fares, as well as to operators through increased income/profits. It also replicates what might be expected to happen in a competitive market.

A proportion of the cost items in the BICI are inflated using measures that already incorporate productivity changes to some extent. For example, some of the cost factors are inflated by the CPI (or one of its components) and the CPI incorporates economy-wide productivity changes. However, a large proportion of the total costs measured by the BICI are labour-related costs that are inflated by the WPI, and the WPI does not incorporate productivity changes. Using WPI without adjusting for productivity gains will overstate labour cost increases, as unit labour costs to operators are affected by both the level of wages and labour productivity. For all of the above reasons, IPART considers that it is appropriate to adjust the overall change in costs measured by the BICI to account for expected gains in *labour* productivity.

The BCA did not include any productivity adjustments in its fare proposals. The Ministry of Transport's submission supported the BCA proposals, and noted that its Director-General did not accept the productivity adjustment for rural and regional buses IPART recommended in 2006.

In the past, rural and regional bus operators have not been able to provide IPART with objective measures of their changes in productivity. While IPART recognised that some of the bus operators are small businesses, it considers that the operators should be able to provide basic data such as passenger kilometres travelled. Until data is provided by the bus operators or the Ministry, IPART will be forced to base its assessment on the scope for productivity improvements on economy-wide data.

Table 3.7 below summarises labour productivity data obtained from the ABS. Gross value added per employee is measured at constant prices, at the sector level. One of the sectors measured is the 'transport and storage' industry. However, the ABS does not separately identify the passenger transport industry within this industry, and the definition of the industry includes many business units that are unrelated to passenger transport.[13]

Labour productivity itself refers to the amount of output produced per unit of labour. Changes in labour productivity relate to either a change in capital per worker, or the more efficient combination of labour and capital through changed work practices, better management, or the better allocation of resources across industries (multi-factor productivity).

13 For example, freight transport by road, rail, water or air; freight terminal facilities; services related to transport (such as car parking, stevedoring, harbour services, navigation); booking, travel, freight forwarding, crating or customers agency services; storage facilities; and operating pipelines for the transportation of gas, oil etc.

Table 3.7 Changes in labour productivity over the past five year (% per annum)

	2002/03	2003/04	2004/05	2005/06	2006/07	5-year average
Gross value added per hour worked						
Transport and storage industry	6.8	-2.2	2.6	2.0	4.1	2.7
All industries	0.5	2.2	0.5	1.2	0.7	1.0
Labour productivity						
Hours worked	1.7	3.0	0.3	2.5	0.4	1.6
Quality-adjusted hours worked	1.6	3.0	0.2	2.5	0.2	1.5
Capital productivity	-0.1	-0.1	-1.4	-2.6	-1.9	-1.2
Multifactor productivity						
All industries hours worked	0.9	1.7	-0.5	0.2	-0.6	0.3
Quality-adjusted hours worked	0.8	1.7	-0.6	0.2	-0.7	0.3

Source: ABS Australian System of National Accounts, Catalogue Number 5204.0 Tables 25 and 22.

As this table indicates, ABS labour productivity measures suggest that productivity growth has eased over the past year. The one exception is gross value added per hour worked in the transport and storage sector, which rose by 4.1 per cent in 2006/07, compared to 2.0 per cent in the previous year.

At the economy-wide level, gross value added per hour worked rose 0.7 per cent in 2006/07, and has averaged a modest growth of 1.0 per cent over the past five years. Labour productivity, measured as the increase in hours worked compared to the increase in market sector output, rose 0.4 per cent in 2006/07, which represents a substantial reduction compared to the previous year. When adjusted for quality (labour force improvements in terms of educational attainment and work experience), labour productivity rose 0.2 per cent.

Multifactor productivity (the component of labour productivity that has shown the most momentum over the past productivity cycle) decreased by 0.6 per cent in 2006/07. In quality-adjusted terms, multifactor productivity at the economy-wide level fell by 0.7 per cent over the past year.

IPART recognises that the ABS measures of labour productivity discussed above do not measure private bus industry-specific trends. Assessing labour productivity changes for that industry would require data and assumptions on:

- outputs for bus operators, which could be distance adjusted passenger trips, or passenger kilometres travelled
- inputs for bus operators, which could be full-time equivalent employees and their share of total costs
- information regarding economies of scale related to bus operators

- the parity between the marginal products of capital and labour and their respective real market prices.

IPART also notes that a recent wage decision for Sydney Buses bus drivers was based on expectations of productivity improvements of 1.5 per cent per year. IPART does not consider that such gains can be achieved in the rural and regional bus industry. Sydney Buses have made a number of changes to their services, such as expanding the pre-pay bus routes that should make it easier for it to achieve productivity gains. Nevertheless, the fact that Sydney Buses are expecting to improve their productivity by as much as 1.5 per cent suggests that there is at least modest scope for productivity improvements in other bus networks.

Last year, IPART conservatively estimated labour productivity growth of 0.5 per cent in the NSW rural and regional bus industry. Given that growth in labour productivity across the economy appears to have eased over the past year, labour productivity growth in the industry in 2007/08 is likely to be slightly less. Therefore, IPART considers that a productivity adjustment of 0.3 per cent to the 'salaries and wages' portion of the BICI is appropriate.[14]

After applying this productivity adjustment, the total change in the BICI for 2007 is 2.72 per cent. As indicated in section 3.1, IPART recommends that maximum fares for rural and regional bus services provided under commercial contracts be permitted to increase by this amount.

3.4 Expected impact of the recommended fare increase

Before finalising its recommendation of maximum fares for rural and regional bus services, IPART considered how these bus fares have changed over the last few years, and the impact of its recommended increase on the various stakeholders. In particular, IPART considered:

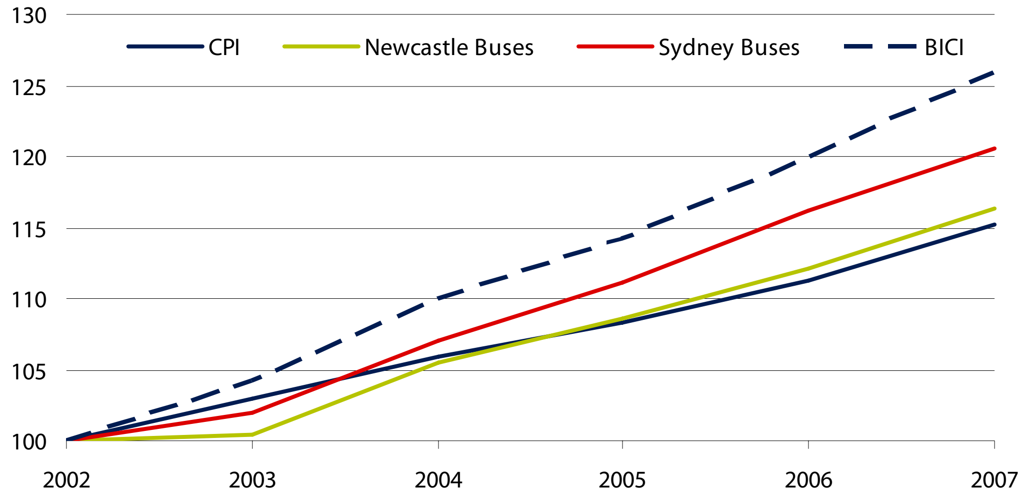
- the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of service
- the need to maintain ecologically sustainable development
- the social impact of the recommendations
- the effect of any pricing recommendation on the level of Government funding.

3.4.1 Protection of consumers from abuses of monopoly power

Over the past five years, the BICI has led to increases in maximum fares for rural and regional bus services provided under commercial contracts that have been well above the change in the CPI and generally above those for other bus services in NSW. This is illustrated in Figure 3.1.

14 Productivity adjusted costs are calculated by applying the following formula: productivity adjusted % change = (1+% change in costs)/(1+% productivity adjustment) - 1.

Figure 3.1 Index of changes in bus fares compared with CPI over the past five years



Note: Fare increases in 2002 and 2003 each cover more than a single calendar year due to the timing of the fare reviews. CPI used is for calendar years.

Data source: ABS, IPART annual reports.

NCOSS raised concerns with IPART about the rate of fare increases for rural and regional bus services, noting that these fares have increased significantly in real terms since 2002.[15] NCOSS also raised concerns about what it considers is the high cost of rural and regional bus fares on a time basis, due to the distance-based fare system. In addition, it noted that currently rural and regional bus users do not have access to the same range of concessions as city bus users, and that an inability to afford private transport is the main driver of low patronage on rural and regional buses. NCOSS submitted that these issues combine to provide a disproportionate adverse impact on lower earning households.

IPART is aware that its recommended fare increase for 2008 comes on top of a pattern of above CPI fare increases. However, it considers that the recommended increase is modest, and that the impact on passengers will not be significant. IPART is also satisfied that the increase is based on increases in costs, and allows for the sharing the benefits of changes in productivity with passengers.

3.4.2 Implications for bus industry operators

IPART considers that the recommended fare increase is likely to maintain the industry's current level of financial viability. The recommended fare increase is slightly higher than the increase proposed by the BCA, due to changes in the weightings and inflators used in the BICI (discussed above).[16]

15 NCOSS provided a copy of a paper submitted to the Ministry of Transport on this issue: NCOSS, *A Growing Divide?*, January 2007.

16 BCA submission, September 2007, p 3.

3.4.3 Implications for passengers

The overall impact of the estimated maximum fares on passengers is likely to be small, because spending on transport fares represents a small proportion of average household incomes. However, the impact on individual passengers of bus services is likely to be somewhat higher.

IPART notes that the fare increase recommended is modest, being below CPI for the financial year 2006/07, and is of the view that the impact on passengers will be small. However, it also notes that the BCA contends that rural and regional bus operators currently do not charge the maximum fares allowed for longer journeys.[17]

3.4.4 Implications for the environment

In general, public transport results in lower pollution, carbon emissions and traffic congestion, compared with private car transport. Higher fares tend to discourage passengers from using public transport and therefore reduce these environmental benefits. However, a fare increase in line with general consumer price inflation is unlikely to significantly affect consumer behaviour. IPART therefore considers that the environmental impacts of its determination will be negligible.

3.4.5 Implications for the government

The recommended fare increase will affect the government through increases in subsidies and in concessions payments. An increase in fares is likely to increase the amount of funding required for rural and regional bus services.

[17] BCA submission, September 2007, p 6.

4 Maximum fares for private ferry services

Private ferry services are provided by seven separate operators, each of which serves distinct routes in the Sydney, Central Coast and North Coast areas of NSW. Most of these operators is small in size.

To formulate its recommendation on maximum fares for private ferry services, IPART reviewed the increase in private ferry operators' costs for the year to the end of the September quarter 2007, as measured by the Commercial Vessel Association Cost Index (CVACI). It also reviewed and revised the inflators used in the CVACI, to increase the independence, transparency and robustness of this index, and calculated an appropriate productivity adjustment to ensure that productivity gains are passed through to customers in the form of lower fares.

The section below provides an overview of IPART's findings and recommendation on maximum fares. The subsequent sections explain the calculation of the change in the CVACI, the calculation of the productivity adjustment, and the expected impact of the recommended fare increase.

In previous reviews, IPART raised concerns that little information was available regarding private ferry services. Action for Public Transport also expressed similar concerns in its submission to the 2007 review.[18] IPART notes that ferry operators are now required to provide patronage information to the Ministry of Transport, and as a result it expects that private ferry data will be more easily accessible for future reviews.

4.1 Overview of findings and recommendation

IPART found that the increase in costs measured by the CVACI was 1.45 per cent. It also found that a productivity adjustment equal to 0.3 per cent of the 'labour' cost item in the index was appropriate to account for expected productivity growth during the coming year. It concluded that a maximum fare increase of 1.33 per cent was appropriate, in line with the increase in private ferry operators' productivity-adjusted costs over the year to the September quarter 2007.

Based on these findings, IPART makes the following recommendation to the Minister for Transport:

2 That maximum fares for private ferry services be permitted to rise by 1.33 per cent.

---

18 APT submission, October 2007 p 4.

Table 4.1 below shows the change in maximum fares for each ferry route that will result from the implementation of this recommendation. The 2008 fares shown were derived by increasing the unrounded 2007 fare by 1.33 per cent, then rounding (up or down) to the nearest 10 cents.

Table 4.1 Recommended maximum private ferry fares from 2 January 2008 ($ Adult Ticket)

Operator	Route	2007 Actual fares	2007 fares unrounded	2008 fares unrounded	2008 fares (after rounding)	Absolute change
Central Coast Ferries	Woy Woy – Empire Bay	6.10	6.14	6.22	6.20	0.10
Church Point	Scotland Island – Morning Bay	6.20	6.24	6.33	6.30	0.10
Clarence River Ferries	Illuka - Yamba	6.00	6.03	6.11	6.10	0.10
Cronulla – National Park	Cronulla - Bundeena	5.30	5.29	5.36	5.40	0.10
Dangar Island	Brooklyn – Dangar Island	5.30	5.29	5.36	5.40	0.10
Matilda Cruises	Circular Quay – Darling Harbour	6.00	6.03	6.11	6.10	0.10
	Circular Quay – Lane Cove	6.00	6.03	6.11	6.10	0.10
Palm Beach	Palm Beach – Mackeral and the Basin	6.20	6.24	6.33	6.30	0.10
	Palm Beach – Ettalong Wagstaffe	9.00	8.99	9.11	9.10	0.10

4.2 Calculation of the change in the CVACI

The CVA proposed that maximum fares for private ferry services increase in line with the change in the Commercial Vessel Association Cost Index (CVACI) over the year to the September quarter 2007.

The CVACI measures the weighted average change in private ferry operators' costs from year to year. Given the nature of the industry – particularly its relatively small size and the fact that many of the operators are small businesses – this index is simple. It consists of five items that reflect the key costs of the industry. These include insurance, interest, wages, fuel and other costs. 'Other costs' includes those of repairs and maintenance, depreciation, berthing/mooring, advertising and motor vehicles. In previous years, the CVA has maintained this index on behalf of private ferry operators, and submitted the results to IPART.

As part of its 2007 review, IPART reviewed the inflators used to inflate the cost items in the CVACI. It did not review the weightings used in the index (as it did for the BICI) because it fixed these weightings for five years in the 2006 review. The following sections explain the inflators used to inflate each cost item, the weightings for each cost item, and the overall change in the CVACI for the year to the September quarter 2007.

4.2.1 Inflators used for each cost item

In previous years, three of the five cost items that comprise the CVACI – insurance, interest and fuel – were inflated based on data on costs provided by the CVA and verified by IPART. For this year's review, IPART proposed the use of independently gathered, publicly available inflators to inflate each cost item.

In its fare proposal, the CVA indicated that it would prefer to continue to use industry-specific inflators. However, during subsequent discussions it recognised that the IPART's proposed inflators would result in an outcome that is similar to its fare proposal.

IPART considered the comments made by the CVA. It concluded that there is no persuasive reason for it to continue to rely on cost information provided by the operators or their representatives, which is only checked for 'reasonableness'. IPART considers that this approach is inconsistent with the level of accuracy and robustness that it would find acceptable in other areas of its work. It also considers that the use of publicly available information (such as ABS data) instead will provide greater transparency, as unlike currently, stakeholders will be able to replicate the cost index quite easily.

For these reasons, IPART has used revised inflators for some cost items in its 2007 review, and will continue to use these inflators in future years. Each revised inflator was selected because it met IPART's criteria of being:

- based on independent and verifiable data that is publicly available
- a reasonable estimate of costs changes for operators
- consistent with inflators used for other transport industries where relevant.

IPART considers that the inflators it has used are no less reflective of the costs of individual operators than those currently used. The revised inflators for each cost item are discussed in detail below.

Labour

In the 2006 review, labour costs were inflated using Average Weekly Earnings (AWE). In its fare proposal, the CVA suggested that the wages cost item be inflated based on changes in the Marine Charter Vessel (State) Award. Applying Award wage increases requires assumptions to be made about the proposition of staff covered by each different award wage change. IPART does not consider that this approach meets its requirements for inflators to be based on independent and verifiable measure that is publicly available. In addition, this approach would not necessarily be cost reflective for any particular operator.

IPART proposed using the Wage Price Index (WPI) as the inflator, rather the AWE. Both these approaches measure changes in wage and salary costs. In other industries, IPART has preferred to use the WPI, because it measures the wage and salary costs for an employer for a fixed quantity and quality of labour (for example, it currently uses WPI in the taxi industry). This means that, unlike the AWE, it is not affected by compositional changes in the workforce.

IPART considers that the WPI would also better meet the criteria of an independent and verifiable measure in the private ferry industry, and its use would be consistent with the approach it uses in the taxi industry. Therefore, it has applied WPI to the salaries and wages component of the CVACI. The WPI[19] has been calculated using the average of four quarters based on the following formula:

$$WPI_t = \left(\frac{WPI_{Dec(t-1)} + WPI_{Mar(t-1)} + WPI_{Jun(t-1)} + WPI_{Sep(t)}}{WPI_{Dec(t-2)} + WPI_{Mar(t-2)} + WPI_{Jun(t-2)} + WPI_{Sep(t-1)}} - 1 \right) \times 100\%$$

Under this calculation the increase in the wages cost item this year is 3.81 per cent. This is comparable to the increase proposed by the CVA of 2.82 per cent.

Fuel

In previous reviews fuel costs have been inflated by Mobil fuel data provided to IPART by the CVA. IPART proposed using data supplied by Fueltrac, a third party provider, as it may be more independent. The CVA indicated that it preferred to continue to use the Mobil data.

IPART gave further consideration to this issue. It notes that the Ministry of Transport uses Mobil data to determine fuel payments for the metropolitan and outer metropolitan bus system contracts. It also noted that its analysis as part of its review of fares for rural and regional bus services found that there is little difference in the Mobil and Fueltrac data this year. It concluded that the Mobil data is sufficiently independent and transparent, and decided to continue to use Mobil data as the inflator for the fuel cost item in the CVACI. However, in order to improve the

19 Total hourly rates of pay excluding bonuses, New South Wales, All industries, Private and Public, All occupations.

independence of the process, IPART will obtain the data directly from Mobil or the Ministry of Transport in future years.

Using the Mobil data resulted in a decrease in the fuel cost item of 10.04 per cent for the year to the September quarter 2007. This compares with a decrease of 3.14 per cent proposed by the CVA.

In considering the inflator for fuel costs, IPART noted that in the past, the Ministry of Transport has also provided interim payments to operators designed to compensate them for increases in fuel costs. As the CVACI compensates for fuel costs retrospectively, it would be consistent to adjust the fare increases calculated by the CVACI for any additional fuel payments made to operators between 1 July 2006 and 30 June 2007 so as to ensure that operators are not compensated twice for fuel costs during this period.

IPART has been advised that no additional payments for fuel have been given to operators for the period of October 2006 – September 2007. IPART considers that it is appropriate for the Ministry of Transport to ensure that operators are not inadvertently overcompensated for wage increases and fuel costs as a result of the interim payment arrangements.

Insurance

The insurance cost item accounts for 5 per cent of the costs measured by the CVACI. In previous years, insurance costs were inflated using quotes for insurance provided by the CVA. For the 2007 review, the CVA provided a quote obtained from a marine insurance broker.

IPART proposed to inflate insurance items by the 'insurance services' sub group of the CPI. It considers that this inflator is preferable to the quote-based approach because it is based on independently gathered, publicly available data. It also considers that the quote-based approach is not cost-reflective for each business because it is based on one quote, and the insurance costs of the different operators are likely to differ due to differences in the type, size and age of their ferries. In addition, IPART used this inflator to inflate the insurance cost item in the Taxi Industry Cost Index, so its use in the CVACI is consistent with IPART approach in the taxi industry.

While the 'insurance services' sub group of the CPI does not focus on ferry-specific insurance costs, it should provide an indication of the movement in insurance costs in the economy as a whole. As insurance costs are a very small proportion of the CVACI, the use of a global inflator for this item is unlikely to have a significant negative impact on the cost reflectivity of the index.

For these reasons, IPART decided to use change in the 'insurance services' sub group of the CPI to inflate the insurance cost item. This resulted in an increase in this cost item of 2.97 per cent. This compares with an increase of 1.75 per cent proposed by the CVA.[20]

Interest

Interest costs account for only 4 per cent of the total costs measured by the CVACI. In past reviews, this cost item has been inflated using the average of two business-lending rates obtained as quotes by the CVA and verified by IPART. The magnitude of the loan required for private ferries is not measured; the interest cost is only determined using changes in the interest rate. For this year's review, the CVA obtained quotes for capital borrowing and working capital facilities from the National Australia Bank.

In other industries, IPART tends to measure changes in interest rates using Commonwealth bond rates. There are two primary reasons for this. The first is that the use of bond rates is more likely to mean that comparable data is available from year to year. Using a specific interest rate of a commercial bank could create problems should the bank change the product or cease to publish the interest rate in question. The second reason is that bond rates are collected by IPART and therefore are administratively simpler than using commercial bank rates.

IPART proposed the use this approach to inflate the interest cost item in the CVACI in the 2007 review. It does not anticipate that the use of bond rates will significantly lessen the cost reflectivity of the CVACI.

The CVA noted that the use of bond rates was not its preferred approach, but did not raise any specific objections. Therefore, IPART has inflated the interest cost item using a one-year Commonwealth Bond swap rate, as published by the Australian Financial Review. This resulted in an increase in this cost item of 11.14 per cent. This compares with an increase of 1.86 per cent proposed by the CVA.

Other costs

In previous reviews, the 'other costs' cost item has been inflated by the change the CPI. IPART decided to continue to use this approach in the 2007 review. It has received no information that suggests that this is no longer an appropriate inflator for this cost item.

This approach resulted in an increase in the 'other costs' cost item of 2.10 per cent.

20 CVA submission, September 2007, p 3.

4.2.2 Weighting of each cost item

As noted above, IPART 'fixed' the weightings in the CVACI in the 2006 review for five years. However, the weightings will still be adjusted each year according to changes in the relativities in costs that result from the inflators applied in the previous year. Cost items that experience a larger than average increase will therefore increase in weight. This allows for the index to adapt to changes in certain costs, relative to other costs, experienced by operators from year to year.

IPART calculated the weights for this year's review based on last year's CVACI (see Table 4.2).

Table 4.2 2007 weightings for the CVACI (%)

Cost Item	2006 Weighting	Change	2007 Weighting
Labour	40.32	3.20	39.28
Fuel	12.03	26.49	14.36
Insurance	5.64	0.00	5.32
Interest	4.08	6.29	4.10
All Other	37.93	3.20	36.94
Total	100.00		100.00

Note: totals may not add due to rounding.

Source: IPART calculations.

4.2.3 Total change in the CVACI

The calculations discussed above resulted in a total in the CVACI of 1.45 per cent, prior to any adjustment for productivity (Table 4.3). The main drivers of this increase were increases in the 'wages' and 'other costs' cost items.

Table 4.3 Increase in private ferry operators' input costs as measured by the CVACI (%)

Cost Item	Weighting	Change	Contribution to index
Labour	39.28	3.81	1.50
Fuel	14.36	-10.04	-1.44
Insurance	5.32	2.97	0.16
Interest	4.10	11.14	0.46
All Other	36.94	2.10	0.78
Total	100.00		1.45

Note: totals may not add due to rounding.

Source: IPART calculations.

As discussed in section 4.2.2 above, the weightings for the 2008 review will be the 2007 weightings, adjusted according to changes in the relativities in costs that result from the inflators applied this year. Table 4.4 shows the weightings for the 2008 review.

Table 4.4 2008 weightings for the CVACI (%)

Cost Item	2007 Weighting	Change	2008 Weighting
Labour	39.28	3.81	40.19
Fuel	14.36	-10.04	12.73
Insurance	5.32	2.97	5.40
Interest	4.10	11.14	4.49
All Other	36.94	2.10	37.18
Total	100.00		100.00

Note: totals may not add due to rounding.
Source: IPART Calculations.

4.3 Sharing the benefits of productivity gains with users

The cost index approach compensates operators for changes in the price of their inputs. This approach maintains incentives for operators to be efficient. If they can hold the increase in their costs below the change in the input price index by producing more efficiently, their profits will increase. However, if their costs increase faster than the growth of the input price index, then their profits will be reduced. It is important to note that the index measures changes in the price of inputs to the industry *on average*, not the costs of an individual operator.

However, the index approach does not capture changes in the usage of a particular input relative to the level of output (for example, greater fuel economy). In addition, it does not provide a mechanism for operators to share productivity gains with their customers. IPART considers that this is unfair. In its view, the overall change in costs calculated via the CVACI needs to be adjusted to account for expected growth in productivity to improve fairness. Such an adjustment ensures that the gains from productivity growth are distributed to consumers through lower fares, as well as to operators through increased income/profits. It also replicates what might be expected to happen in a competitive market.

Some of the cost items in the CVACI are inflated using measures that already incorporate productivity changes to some extent. For example, some of the cost factors are inflated by the CPI (or one of its components) and the CPI incorporates economy-wide productivity changes. However, a large proportion of the total costs measured by the CVACI are labour-related costs that are inflated by the WPI, and the WPI does not incorporate productivity changes. As noted in section 2.3, using WPI without adjusting for productivity gains will overstate labour cost increases, as unit labour costs to operators are affected by both the level of wages and labour productivity. For all of the above reasons, IPART considers that it is appropriate to adjust the overall change in costs measured by the CVACI to account for expected gains in *labour* productivity.

The CVA did not include any productivity adjustments in its fare proposals, and IPART did not have access to sufficient data to allow it to identify a measurable change in the private ferry industry's productivity over the past year. IPART notes that the CVA has suggested that, due to the nature and size of private ferry operations, productivity gains have not been realised in the private ferry industry. The CVA pointed to decreasing passenger numbers and stagnant staffing levels as evidence of declining labour productivity.[21] IPART accepts that the nature of the industry means labour productivity gains may be small. But it considers that they are nonetheless achievable, and that users of private ferry services should benefit from productivity gains within the industry through lower fares.

Private ferry operators have not been able to provide IPART with objective measures of their changes in productivity. While IPART recognises that most of the private ferry operators are small businesses, it considers that the operators should be able to provide basic data such as passenger numbers. Until data is provided by the ferry operators or the Ministry of Transport, IPART will be forced to base its assessment on the scope for productivity improvements on economy-wide data. As private ferry operators are now required to provide patronage information to the Ministry of Transport, IPART expects that private ferry data will be more easily accessible for future reviews.

Given the lack of sufficient industry-specific data, IPART based its assessment of the scope for productivity improvements on economy-wide data (see Table 3.7). On balance, this data suggests that growth in labour productivity across the economy has eased over the past year, and the private ferry industry is likely to be no different in this regard.

Last year, IPART conservatively estimated labour productivity growth of 0.5 per cent in the NSW private ferry industry. Given the economy-wide trend discussed above, it considers that productivity growth could possibly be slightly less than this in 2007/08. Therefore, IPART considers that a 0.3 per cent productivity adjustment applied to the 'labour' portion of the CVACI is appropriate. This reflects a decrease in all productivity measures except for the transport and storage sector's gross value added per hour worked and the labour productivity capital productivity which both increased in 2006/07.[22]

21 CVA submission, September 2007 p 2.

22 ABS, *Australian System of National Accounts,* Catalogue Number 5204.0, Tables 25 and 22.

4.4 Expected impact of the recommendations

Before finalising its recommendation of maximum fares for private ferry services, IPART considered the impact of its recommended increase on the various stakeholders. In line with its terms of reference, IPART considered:

- the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of service
- the need to maintain ecologically sustainable development
- the social impact of the recommendations
- the effect of any pricing recommendation on the level of Government funding.

The expected implications for four key stakeholder groups – private ferry operators, passengers, the environment and government – are outlined below.

4.4.1 Implications for private ferry operators

The recommended fare increase is likely to maintain private ferry operators' current level of financial viability. The estimated increase in fares is slightly higher than the increase proposed by the CVA (due to the changes IPART made to the inflators used in the CVACI).[23]

4.4.2 Implications for passengers

The overall impact of the estimated maximum fares on passengers is likely to be small, because spending on transport fares represents a small proportion of average household income. However, the impact on individual passengers of ferry services is likely to be somewhat higher.

IPART notes that the fare increase recommended is modest, being well below CPI. Therefore it considers the overall impact on passengers will be small.

4.4.3 Implications for the environment

The impact of the recommended maximum fare increases on the environment in terms of pollution and congestion is likely to be minimal, given that the increases are relatively small.

4.4.4 Implications for the government

The recommended fare increases will influence the government through subsidies as well as through concessions payments. An increase in fares is likely to increase the amount of funding required for concessional and student private ferry services.

23 CVA submission, September 2007, p 2.

5 Revenue payments to rural and regional bus operators on non-commercial contracts

There are approximately 1700 non-commercial bus contracts currently in place in rural and regional NSW. Under these contracts, the Ministry of Transport pays a private bus operator to provide specified bus services (typically school bus services). The operator does not collect fares for these services and is not granted an exclusive right to provide the services (as they would if they were on commercial contracts).

As no fares are charged for these services, IPART makes recommendations on the revenue payments to bus operators on these contracts. IPART's recommendations are based on a required revenue model developed by PriceWaterhouseCoopers (the PWC model). Each year the Bus and Coach Association (BCA) populates this model and submits it to IPART for approval. The Ministry of Transport then calculates the revenue payments for each non-commercial contract using the version of the model recommended by IPART. For each contract, the Ministry of Transport inputs the number of kilometres per day and hours per day (as specified in the contract). See Appendix E for further information on the PWC model.

The section below provides an overview of IPART's findings and recommendation on the revenue payments for rural and regional bus operators on non-commercial contracts. The subsequent sections discuss IPART's review of and recommended adjustments to the PWC model, the additional payments made to operators over the past year, the revenue requirements resulting from IPART's recommended version of the PWC model, and the expected implications of IPART's recommended revenue requirements.

5.1 Overview of findings and recommendation

To calculate the recommended revenue payments for rural and regional bus operators on non-commercial contracts, IPART reviewed the revenue these operators require to recover their costs as measured by the 2007 version of the PricewaterhouseCoopers (PWC) model submitted by the BCA. IPART made adjustments to the model to correct minor errors. Based on this adjusted version of the model, it concluded that the revenue payments should be increased by between 3.34 per cent and 5.33 per cent (depending on the bus category involved), in line with the revenue requirements generated by this model.

Based on these findings, IPART makes the following recommendation to the Minister for Transport:

3 That revenue payments related to rural and regional bus services provided under non-commercial contracts be increased by between 3.34 per cent and 5.33 per cent (or to between $61,147 and $105,587), depending on the bus category involved.

5.2 IPART's review of the PWC model

In the past, IPART has expressed concerns with the continued use of the PWC model. However, it has decided not to review the PWC model this year because such a review would be likely to substantially overlap with the current process of funding and contract reforms that are currently being undertaken by the Ministry of Transport. Rather, it focused on checking the BCA's inputs to the model and confirming that the method used to calculate each cost is unchanged.

Table 5.1 shows the revenue requirements obtained by the PWC model submitted by the BCA (assuming an operator travelling 100km and 4 hours per day).

Table 5.1 Revenue requirements in the BCA submission and changes from 2006

	Category 1	Category 2	Category 3	Category 4
Total revenue required per bus	61,138	72,347	92,210	105,574
Change from last year	3.33%	4.08%	5.31%	4.71%

Note: categories reflect the different size and type of bus used to provide the contract services.
Source: Bus and Coach Association submission, September 2007, p 4.

IPART's review of the PWC model submitted by the BCA found that there have not been any changes to the calculations in the model. However, the model did contain two minor errors that IPART has adjusted in its recommended version of the model. These adjustments are outlined below.

5.2.1 ANTS adjustment to CPI

In 2003, IPART reviewed the approach to adjusting CPI to account for the impact of the introduction of A New Tax System (ANTS), or the GST, on non-commercial private buses. IPART committed to making a long-term adjustment to the CPI to apply over the five-year period to which the existing standing reference applies (2003/04 to 2007/08). At this time, IPART calculated the ANTS adjustment for the private bus industry, and the BCA has applied this adjustment each year since that time.

The PWC model submitted by the BCA for this review includes the ANTS adjustment, but contains a cell reference error that results in application of an incorrect ANTS adjustment factor. Once this error is corrected, the ANTS adjustment factor in the model is consistent with IPART's 2003 decision.

It was always intended that June 2007 would be the final period of adjustment. Beyond the current review, no further adjustment will be made to the CPI for the impact of the introduction of the GST.

5.2.2 CPI figure for June quarter 2007

The PWC model submitted by the BCA contains an estimate for the June quarter 2007 CPI figure of 157.2, which is slightly less than the actual CPI figure of 157.4.

Once this is updated and the cell reference error described above are corrected, the annual change in the CPI is 2.87 per cent instead of the BCA's figure of 2.82 per cent.

5.3 Additional revenue payments made to operators over the past year

IPART is aware that the Ministry of Transport has made additional or interim revenue payments to operators in the past to compensate them for cost increases. IPART understands that these interim payments are made to operators in the period between approval of the PWC model (January) and the date to which revenue payments are backdated (the previous July) to assist with cost increases in this period.

For example, the Ministry of Transport made an additional payment based on a four per cent wage increase effective from 1 July 2007. In the past, the Ministry of Transport has also provided interim payments to compensate operators for increases in fuel costs.

As the PWC model compensates for cost increases retrospectively, it would be appropriate to adjust the revenue requirements calculated by the PWC model for any additional payments made to operators between 1 July 2006 and 30 June 2007, to ensure that operators are not compensated twice for fuel costs during this period.

At last year's review, IPART decided that additional or interim payments to operators should be left to the discretion of the Ministry of Transport rather than be incorporated into the PWC model in an ad hoc way. IPART still prefers this approach, as revenue payments are calculated by the Ministry of Transport and not by IPART. However, IPART considers that it is appropriate for the Ministry of Transport to ensure that operators are not inadvertently overcompensated for wage increases and fuel costs as a result of the interim payment arrangements. It notes that the Ministry of Transport has advised that the revenue payments to operators are adjusted to ensure that operators are remunerated in accordance with the PWC model.

5.4 Revenue requirements resulting from IPART's recommended version of the PWC model

The revenue requirements calculated using IPART's recommended version of the PWC model (assuming a contract that provides for 100km and 4 hours) are set out in Table 5.2.

Table 5.2 Revenue requirements resulting from IPART's recommended version of PWC model for 2007

Items in Non-Commercial model	Category 1 $	Category 2 $	Category 3 $	Category 4 $
COSTS				
Bus-related costs	14,969	16,780	19,486	21,098
Driver-related costs per hour	21,384	21,384	21,384	21,384
Driver-related costs per day	2,411	2,411	2,411	2,411
Fuel-related costs	3,491	3,202	4,658	5,302
Other distance-related costs	4,198	4,336	6,892	8,237
	46,453	**48,112**	**54,831**	**58,432**
DEPRECIATION				
Depreciation	2,995	5,644	6,915	9,506
Depreciation (spare bus allowance)	299	564	691	951
REQUIRED RETURN				
Return on Investment	5,310	10,417	19,456	24,636
Return on Investment on spares	531	1,042	1,946	2,464
NET REVENUE REQUIRED PER BUS	55,588	65,779	83,839	95,988
GST	5,559	6,578	8,384	9,599
TOTAL REVENUE REQUIRED PER BUS	61,147	72,357	92,222	105,587
Change from last year	3.34%	4.09%	5.33%	4.73%

5.5 Expected impact of the recommendations

Given there have been no significant changes to the PWC model this year, IPART considers the revenue requirements resulting from its recommended version of the PWC model will allow operators to recover the costs of providing the services concerned without imposing unreasonable increases on the level of Government funding required.

Appendices

A Terms of reference – private buses

"I, Bob Carr, Premier, approve, under Section 9(1)(b) of the *Independent Pricing and Regulatory Tribunal Act 1992*, the Tribunal entering into an arrangement with the Minister for Transport to investigate and report on the following matters related to the private bus industry:

1. fares for regular services regulated under the *Passenger Transport Act 1990*
2. level of remuneration received from the Government for commercial and non-commercial school services.

A final report is to be provided to the Minister for Transport by June each year.

In conducting this investigation, the Tribunal should consider:

i. the cost of providing the services concerned;

ii. relativities with the Government owned bus services, including in terms of service, efficiency, cost and ticketing products;

iii. the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of service;

iv. the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers;

v. the impact of pricing policies on borrowing and capital requirements and, in particular, the impact of any need to renew or increase relevant assets;

vi. the need to maintain ecologically sustainable development;

vii. the social impact of the recommendations;

viii. standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise and any suggested or actual changes to those standards as notified to the Tribunal by the Minister for Transport); and

ix. the effect of any pricing recommendation on the level of Government funding provided to private operators under commercial and non-commercial contracts.

In conducting the investigation the Tribunal will invite submissions from the Bus and Coach Association, the relevant unions and other stakeholder groups, including the general community."

B Terms of reference – private ferries

"I, Bob Carr, Premier, approve, under Section 9(1)(b) of the *Independent Pricing and Regulatory Tribunal Act 1992*, the Tribunal entering into an arrangement with the Minister for Transport to investigate and report on the following matters relating to the private ferry industry:

1. Fares for regular services regulated under the *Passenger Transport Act 1990*.

2. Level of remuneration received from the Government for school student services delivered under commercial contracts.

A final report is to be provided to the Minister for Transport by June each year.

In conducting this investigation, the Tribunal should consider:

i. the cost of providing the services concerned;

ii. relativities with the Government owned ferry services, including in terms of service, efficiency, cost and ticketing products;

iii. the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standards of service;

iv. the need for greater efficiency in the supply of services so as to reduce costs for the benefit of consumers;

v. the impact of pricing policies on borrowing and capital requirements and, in particular, the impact of any need to renew or increase relevant assets;

vi. the need to maintain ecologically sustainable development;

vii. the social impact of the recommendations;

viii. standards of quality, reliability and safety of the services concerned (whether those standards are specified by legislation, agreement or otherwise and any suggested or actual changes to those standards as notified to the Tribunal by the Minister for Transport); and

ix. the effect of any pricing recommendation on the level of Government funding provided to private operators under commercial and non-commercial contracts.

In conducting the investigation the Tribunal will invite submissions from the private ferry operators, the relevant unions and other stakeholder groups, including user groups.”

C List of submissions and hearing participants

The following tables provide details of the submissions received for the review and the participants in the public hearing held on 9 November 2007.

Table C.1 List of submissions received

Submitter	Date received
Bus and Coach Association	17 September 2007
Commercial Vessel Association	27 September 2007 (revised)
Ministry of Transport	28 September 2007
Action for Public Transport	26 October 2007

Table C.2 Participants at the public hearing

Speaker	Organisation
Mr Allan Miles	Action for Public Transport
Mr Rick Banyard	Individual
Ms Joanna Quilty	Ministry of Transport
Mr Frank D'Apuzzo	Buslines
Mr David Cribb	Commercial Vessel Association
Mr David Gotze	Indec Consulting
Mr Darryl Mellish	Bus and Coach Association

D Comparison of ABS labour cost indices

Table D.1 Comparison of ABS labour cost indices

	WPI [a]	AWE
Definition	A price index designed to measure the change in wage rates for a set of constant quality jobs — measuring wage changes not wage levels.	A measure of the level of average gross (before tax) earnings of employees at a point in time — measuring the wages bill per employee. AWE estimates total earnings. AWE (OTE) is the same as AWE but excludes overtime payments.
Estimation methodology	Prices a fixed quantum of labour services for specific jobs in terms of wage and salary payments to employees occupying the jobs. Excludes non-wage labour costs such as severance payments and superannuation contributions. Analogous in its construction to the Consumer Price Index.	Obtained by dividing estimates of weekly total earnings by estimates of number of employees. Excludes non-wage labour costs such as severance payments and superannuation contributions.
Sample selection	Collects information from businesses each quarter on price changes in selected jobs.	Collects information from businesses on their number of employees and their total gross weekly earnings for a specific pay period each quarter.
Advantages and disadvantages	Does not reflect compositional changes in the workforce such as any replacement of lower skilled (and paying) jobs with higher skilled (and paying) jobs, or other changes in the quality of labour. Does not reflect productivity because it is not affected by changes in labour quality or quantity. The exclusion of compositional and productivity changes makes the WPI less volatile and more useful in assessing short-term wage trends.	Affected by changes in hours worked and by compositional changes in the employee workforce. Changes in the averages are also affected by changes in the overall composition of the wage and salary earner segment of the labour force, which makes the measure more volatile. Reflects productivity driven by compositional changes in the workforce.

[a] WPI was formerly known as the Wage Cost Index.

E Overview of the PWC model

The PWC model calculates an annual revenue requirement per bus. The number of kilometres per day and hours per day are input into the approved PWC model for each operator (these details are specified in the non-commercial contract) to calculate the annual revenue for each contract.

Each of the costs below is converted into an annual rate and the costs are summed to give a total revenue requirement for each of four categories of bus. Table E.1 sets out the basic cost components and how they are incorporated into the PWC model.

There are also a number of assumptions built in to the model including:

- number of days per year that bus operates
- depreciation rate
- residual value of buses
- number of buses
- average bus age.

Table E.1 Cost components of the PWC model

Cost item	What is included	How cost changes are measured
Depreciation	Average depreciation over the past 16 years	Average depreciation is included in cost build up
Bus related costs	Non-bus wage costs plus miscellaneous/ other costs	Costs escalated by CPI
Driver related costs per hour	Includes hourly rate, casual loading, leave loading, long service leave, super, payroll tax and workers compensation	Hourly rate, casual loading and leave loading come from Award. Super is standard 9 per cent, payroll tax is zero and workers comp rates are as published by Workcover.
Driver related costs per day	Includes daily labour costs, super, payroll tax, workers compensation	Daily labour costs come from the Award and other rates are as above.
Fuel related costs	Fuel costs based on an assumed number of kilometres and litres	The net fuel cost is multiplied by kilometres travelled per day and number of days in operation per year.
Distance related costs	Oil, repairs and maintenance (parts and labour) and comprehensive insurance costs	Costs are escalated by CPI
Return on investment	Bond rate plus premium applied to bus capital cost	Required rate of return is applied to assumed average bus cost
Spare bus allowance	Allowance fixed at 10 per cent for all categories	10 per cent added to calculated depreciation and return on investment to represent cost of spare bus allowance

Note: Super, payroll tax and workers compensation for the amount of daily labour costs.