AUSTRALASIAN RAILWAY ASSOCIATION INC
Association Number A03958 ABN 64 217 302 489

10 November 2008

Committee Secretary
Senate Rural and Regional Affairs and Transport Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir,

Inquiry into Interstate Road Transport Charge Amendment (No.2) Bill 2008, and Road Charges Legislation Repeal and Amendment Bill 2008

I refer to your invitation to make a submission to the Senate Rural and Regional Affairs and Transport Committee Inquiry into Interstate Road Transport Charge Amendment (No.2) Bill 2008, and Road Charges Legislation Repeal and Amendment Bill 2008.

The revised heavy vehicle charges proposed by the National Transport Commission in the Regulatory Impact Statement, and unanimously agreed by the Australian Transport Commission, is considered to be good economic management and is a key to redressing the current imbalance between road and rail pricing.

Current heavy vehicle charges were last Determined in 2000. While these charges have been amended annually, the increases have not kept pace with expenditure resulting in an estimated under-recovery of $168 million per annum (2007).

Failure to pass these changes will result in higher costs and adverse environmental and social outcomes. The rail industry submits that the proposed legislation, which updates heavy vehicle charges:

- should be enacted since it is justifiable on economic and equity grounds; and
- should be followed by successive stages of transport pricing reform, particularly mass-distance-location charging for heavy vehicles.

Yours sincerely

Bryan Nye
Chief Executive Officer

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Inquiry into Interstate Road Transport Charge Amendment (No.2) Bill 2008, and Road Charges Legislation Repeal and Amendment Bill 2008

Australasian Railway Association comments to the Senate Rural and Regional Affairs and Transport Committee

1. Introduction

This submission is made on behalf of members of the Australasian Railway Association (ARA).

With respect to transport charges generally and road pricing in particular, there have been numerous investigations, reports and recommendations over many years which do not need to be repeated here. Suffice to say that the Australasian Railway Association concurs with the National Transport Commission (NTC), the Productivity Commission, the Australian Transport Council (ATC) and others which conclude that the situation whereby heavy vehicles are currently undercharged in Australia can, and must be corrected immediately and permanently.

The ARA made a submission to the NTC during the development of the current Heavy Vehicle Charges Determination. This submission should be read in conjunction with the NTC submission (which is attached), the content of which does not need to be repeated,

2. Economic Inefficiency

Efficient and effective pricing of goods and services is a fundamental tenet of Australian business and Government.

The Productivity Commission's Inquiry Report "*Road and Rail Freight Infrastructure Pricing*" (December 2006) and the National Transport Commission's "*2007 Heavy Vehicle Charges Determination Regulatory Impact Statement*" (December 2007) represent comprehensive analyses of road infrastructure pricing.

The Productivity Commission concluded that:

- the NTC's charges estimations are 'conservative' (ie resulting in lower charges) compared with international practice:
  "*The National Transport Commission's cost attribution model results in a lower attribution of costs to heavy vehicles than most of the alternative approaches considered*", and
- The current charges result in undercharging of some vehicle types and usage, notably high utilisation vehicles and B-doubles which result in cross-subsidies and under recovery of costs:
  "*A major problem with PAYGO in practice is created by averaging costs across the network. This blurs price signals and leads to cross-subsidies from operators carrying light loads to those carrying heavy loads, from users of*

lower-cost roads to users of high-cost roads and, indeed, to those benefiting from roads that may be justifiable on social but not economic grounds."

- Heavy vehicle charges probably need to increase:
  "*Substantial increases in road investment in the past couple of years make it likely that heavy vehicle charges would have to rise to maintain cost recovery*"

Heavy vehicle charges which do not recover costs result in economically inefficient transport systems. In particular this means:

- others paying for truck use,
  or otherwise government revenue is reduced,
- more road freight transport; more trucks and less rail transport,
- higher greenhouse gas emissions, congestion and health impacts,
- greater demand for road construction and maintenance.

The current charges were Determined in 2000 and while they have been adjusted annually the increases have not kept pace with expenditure resulting in under recovery. Currently trucks underpay an estimated $168 million per annum (2007) and the cost of road damage is paid by taxpayers.

Continued under-charging of road transport attracts freight to road resulting in more trucks on major highways and less freight on safer and more environmentally efficient rail transport.

3. Currency

Put simply, the current heavy vehicle charges are out of date since the last full Determination was in 2000. Although the charges have been 'updated' annually, the increases have not kept pace with expenditure, resulting in under-recovery of heavy vehicle charges. The under-recovery continues to increase annually.

If the charges are not corrected now (ie increased), they become increasingly harder to correct later and inefficiencies in the transport system continue compound and grow.

4. Further Improvements

The proposals by the NTC described in the Regulatory Impact Statement only propose to correct some of the pricing weaknesses inherent in the existing scheme. Therefore this legislation should only be the first step towards more comprehensive pricing reform. Subsequently, other road freight charge distortions should be corrected, particularly:

- the averaging problem where highly utilised vehicles (those travelling more than average distance and/or carrying more than average mass) are undercharged, and
- inclusion of externalities not currently accounted for, and
- full introduction of a greenhouse gas charge and elimination of the offset to heavy vehicles proposed under the current carbon pollution reduction scheme.

The ARA also promotes the early introduction of mass-distance-location charging currently being widely introduced in Europe to solve the first 2 of these. All of these improvements are supported in principle by virtually every economist, transport planner and environmentalist.

The rail industry also favours the Productivity Commission, ATC, NTC and Garnaut proposals adopting mass-distance location charging as part of future reform. This universally agreed charging methodology is being widely deployed in Europe.

5. Conclusion

The rail industry submits that the proposed legislation, which updates heavy vehicle charges:

- should be enacted since it is justifiable on economic and equity grounds; and
- should be followed by successive stages of transport pricing reform, particularly mass-distance-location charging for heavy vehicles.

AUSTRALASIAN RAILWAY ASSOCIATION INC
Association Number A03958 ABN 64 217 302 489

31 July 2007

Mr Chris Egger
National Transport Commission
Level 15/628 Bourke Street
Melbourne Vic 3000

Dear Mr Egger

2007 Heavy Vehicle Charges Determination
Draft Regulatory Impact Statement

I refer to the 2007 Heavy Vehicle Charges Determination Draft Regulatory Impact Statement (RIS) dated July 2007.

Attached is the submission by the Australasian Railway Association on behalf of its members who may also choose to make submissions independently.

In general the ARA supports the charges determination proposed as they will go some way to meeting proper economic principles for infrastructure charging. At the same time the ARA suggests that there are further changes which should be incorporated either within this current determination, in a further determination in the near future, or with a complete overhaul of the charges structure and regime.

The ARA looks forward to continuing to work co-operatively with the National Transport Commission on issues relevant to the rail industry. In future could you please liaise with ARA's Manager Policy, Brett Hughes on (02) 6270 4508 or bhughes@ara.net.au and our other rail industry members.

Yours sincerely

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2007 Heavy Vehicle Charges Determination
Draft Regulatory Impact Statement

Australasian Railway Association submission to the National Transport Commission

Introduction

The Australasian Railway Association is making this submission in response to the National Transport Commission's *2007 Heavy Vehicle Charges Determination - Draft Regulatory Impact Statement* of July 2007.

The ARA's interest is optimum use of the whole transport system taking all factors into account. This is consistent with the Australian Transport Council pricing principle quoted on page 15 of the draft RIS: *"National heavy vehicle road use prices should promote optimal use of infrastructure, vehicles and transport modes."* One mechanism to achieve this is for road users to fully pay for their infrastructure and other costs of use. The market systems in which transport operates dictates that optimal results occur where competing suppliers (in this case alternative modes of transport) are treated equivalently. This overriding principle should guide decisions with respect to the 2007 Heavy Vehicle Charges Determination. While constancy of pricing principles and practice between road and rail transport is considered very important, it remains only one aspect of fair competition between the modes which is resulting in market distortions and therefore suboptimal transport system outcomes.

For some transport flows competition has little relevance - e.g. export minerals which largely move by rail, and urban delivery which is largely performed by trucks. However for much intrastate freight (e.g. grain, timber) and interstate freight (e.g. manufactured goods) the road and rail modes compete, and the rail mode is generally uneconomic (returns are less than the cost of capital). In this context fair road pricing, with full recovery of costs, is essential.

For many years the ARA has been concerned about several aspects of the heavy vehicle charges regime which collectively have resulted in an under-recovery of road costs and a cross subsidy towards the type of truck (B-double) that most competes with rail freight. We are pleased therefore to see that the NTC's proposed 2007 Heavy Vehicle Charges Determination goes some way to address these concerns. However, as discussed in this submission, major distortions - effectively with a pro-road bias - will remain, and the Determination will not fully satisfy the criteria for new regulations as set out in the RIS guidelines. We urge the Commission to reconsider those aspects.

The ARA continues to be concerned about an underlying sympathy for heavy vehicle users in relation to charging changes and their impacts, which could be read into parts of the proposals and the process by which they were developed.

Positive developments

Removal of cross subsidy of B-doubles. This cross subsidy was criticised in the Productivity Commission inquiry report on Road and Rail Freight and Infrastructure Pricing, and resulted in a significant distortion to proper economic pricing resulting in overly favouring this type of truck and resulting in substantial under-recovery of expenditure. The ARA is pleased to see that the NTC intends to remove this cross subsidy (however see below on timing). It should be noted however that the existing under-recovery and any removal is only as valid as the underlying cost attribution and allocation approach used by the NTC, which has weaknesses that result in inadequate allocation of costs to heavy trucks that compete with rail freight:

- averaging within vehicle classes due to different rates of utilisation and other effects;
- inclusions of all relevant costs in all circumstances;
- the conceptual problems of allocating common costs between heavy vehicles and passenger vehicles and the sympathetic bias in favour of heavy freight vehicles that appears to result ;
- attribution of pavement maintenance costs;
- the limitations of relying on only two charging instruments (registration and fuel excise);
- timing lags.

These are further discussed below.

Recovery of enforcement costs. The ARA agrees with the Productivity Commission finding that *"The costs of enforcing heavy vehicle mass and speed restrictions are appropriately recovered through road user charges."* Rail freight covers its infrastructure and safety enforcement costs; road freight should do likewise. The ARA supports the proposed move towards recovery of enforcement costs, but does not agree that there is a case for limiting this to infrastructure related enforcement (see below).

Reduction of constraints on annual adjustments. The CPI cap has been a substantial and unjustified constraint on annual adjustments to road user charges, especially in an era of increasing infrastructure spending and higher road construction prices. It is one of the reasons for charges falling short of expenditure. The ARA would support a charging option that fully recovers road and related expenditure. The ARA strongly supports annual adjustment for both the registration and fuel charges consistent with economic principles.

As we understand the RIS, option 2 (page 32) would best meet this criterion, assuming that option 4 would be too difficult to implement. The principle should be that annual adjustments should cover all expenditure and not leave a gap.

Decisions based on better research. The ARA is pleased to see the Commission's emphasis on improving the data and research base, and its use in helping inform decisions - e.g. the discussion on page 51 of the draft RIS which uses recent research to rebut suggestions to retain inadequate aspects of the old Second Determination.

Further Improvements Required

There are three types of lag proposed which would have a negative and cumulative effect: the three-year transition, the seven year averaging, and the proposal not to use the latest year's expenditure figures. These propositions result in under-recovery and distortions to proper economic pricing which can and should be eliminated.

Seven-year average. This would be a retrograde step because, in an era of continuing economic prosperity and of governments trying to catch up on infrastructure spending, it would result in charges that continue to be well below what is needed to recover current expenditure, year after year. It is inconsistent with the PAGYO principle, instead of pay-as-you-go it would be pay-partially-as-you-went.

The statement about the possibility of expenditure later falling (page 14) is implausible - history shows that the rate of growth can vary but that absolute declines rare (page 7). The concern about possible over recovery in such circumstances is misplaced as such hypothetical over recovery would have been offset by previous under recovery. The ARA notes that the Productivity Commission did not support the seven year idea because it exacerbates the reliance on historic expenditure data.

Three-year transition. The draft RIS proposes a three-year phase in of the increased registration charges for B doubles in order to give time for the road freight industry and its customers to adjust. However as the draft RIS notes registration charges are only a small proportion of total costs. The road freight industry, like the rail and other industries, has had to adapt to bigger and quick changes in other costs, e.g. fuel. The ARA is not advocating an unjustified disruption to trucking businesses, merely that it should be put on a proper footing and a transition to that outcome is a reasonable way to achieve it. In principle it would be preferable to minimise the transition period to minimise under recovery and hence continuation of the road rail freight modal choice distortion given B doubles' prominent competitive role.

Inclusion of current expenditure year. The draft RIS notes that the existing charging model excludes expenditure for the current year. This means that heavy vehicle charges are artificially and unnecessarily discounted by the amount of expenditure increase in the current year. The ARA supports the inclusion of costs for the years to which the charges are applicable, which requires the current year's expenditure to be included. This should not be unrealistic given the timing for implementation of charges.

Attribution of pavement maintenance costs. The NTC relies less on ESA-kms than do other countries when attributing road damage costs, as discussed on page 111 of the PC report. The effect is a lower cost allocation to trucks than would be the case if ESA-kms were used. According to the PC report, the NTC view is that the factors influencing pavement wear are not well understood. However a footnote on p102-3 of the PC report, in defining ESA-kms, refers to a NTC view that the [fourth power rule] is thought to be the best approximation of pavement wear across the road network, and says that no generally accepted alternative currently exists. Heavy trucks are thus benefiting from a reluctance to follow current international best practice on the grounds that some new understanding might emerge later. A more appropriate practice would be to attribute costs on the basis of current knowledge and adjust the attribution when (and not before) new knowledge becomes available.

Inclusion of Enforcement Costs. The ARA is opposed to the proposal in the draft RIS to recover only the enforcement costs related to infrastructure and not the enforcement costs related to safety. This seems to be based solely on the Commission's internal view (page 21) that charges should relate only to infrastructure. There are several problems with it:

- this is inconsistent with the Productivity Commission's view quoted above, and also with their view quoted on page 23 of the draft RIS "prices charged to users of freight transport network services should at least cover the directly attributable or incremental costs of providing the services they consume" (if there were no trucks, there would be no safety enforcement costs related to trucks);
- it is not based on any COAG or ATC direction;
- it is not based on any legal constraint, as noted on page 13 of the RIS, the NTC's constitutional advice confirms "that there was no legal constraint to recovering enforcement costs";
- it creates an estimation problem because, as stated on page 21 "...these costs are not easily distinguishable from the enforcement costs...". Estimation, using proxies, is prone to error and, as the draft RIS says, "Such an adjustment is not... cost reflective...";
- it is inconsistent with the treatment of other modes, and is thus distortionary;
- it is also inconsistent with efforts to reduce the serious problem of trauma related to truck crashes, and government and public concern about those crashes. It is ironic that a safer mode (rail) carries its own safety related costs while the more dangerous mode (road) could escape them.

The ARA would not support a netting off of fines from enforcement costs. The fines are there primarily to encourage behavioural change. The equivalent in the rail sector, that of instructions to modify the design or implementation of safety management plans backed by the threat of fines or of loss of accreditation to operate, imposes costs on the rail operator.

Reliance on annual registration fees. The new proposal involves even greater reliance on annual registration fees which are a particularly poor proxy for road related costs. The structure favours trucks that do high distances each year, which are those the railways face as competitors. The ARA strongly supports annual adjustment for both the registration and fuel charges consistent with economic principles and elimination of the CPI cap.

Fuel excise is also a poor proxy because the costs trucks impose on the roads have only a very indirect relationship to fuel consumption. Diesel engines continue to become more and more fuel efficient, diesel consumption per net tonne kilometre by large trucks that compete with trains is lower than for smaller trucks, and many truck related costs, especially those related to equivalent axles and road damage, have little to do with fuel use.

This illustrates a substantial shortcoming of the 2007 review: although marking a step forward compared with current practice, it is constrained by the crude structure of the small number of charging instruments inherited from the past. The ARA favours moving towards mass distance charging as soon as possible and is frustrated at the slowness of the progression towards it (New Zealand introduced a form of it in the late 1970s).

NTC and governments consistently agree with mass distance charging in principle. However they appear transfixed on achieving this through a 'perfect' solution based wholly on modern electronic, information and communication technology. The evidence is that:

- such modern technology is available for implementation for the distance component immediately;
- the technology is not yet sufficiently advanced for mass measurement;
- there may be outstanding charging issues with respect to mass distance charging which remain to be resolved;
- there are alternative mass measurement and monitoring techniques suitable for application which have not yet been considered (eg self reporting, weighbridge reporting, permit approvals based on project outputs, independent assessment, etc.);
- staged introduction of mass distance charging to the competitive element of the heavy vehicle fleet is desirable for all stakeholders and to minimise risks during the roll out of new technology.

The ARA proposes that these issues be investigated as a matter of urgency and priority.

Cost allocation. The draft RIS quotes Productivity Commission views about the conservative nature of the NTC's approach as if they were complimentary, because they result in lower heavy vehicle charges (summary page). Several times the RIS refers to the views of "industry" (meaning the road transport industry). The ARA infers that the NTC sees its task is getting trucks' road use charges as low as possible within the constraints placed upon it. One observes:

- the cost base is too low because of the lags and exclusions discussed above;
- the allocation of costs to "attributable" and "common" is at the extreme end of the range (a low allocation to attributable (Productivity Commission report pages 102-106);
- the allocation of common costs is at the extreme end of the range, being based on vehicle kilometres travelled (overwhelmingly cars) rather than on a more general measure such as PCUs which would allocate a higher portion than at present to trucks. It is normal in economics and business to allocate common or overhead costs using a general rule related to relative size of activity. The alternative of allocating them nearly all to one particular area (cars in this case) is undertaken only where there is a particular policy reason to do so.

The combined effect (low costs, low attribution to trucks, low allocation of common costs to trucks) is to minimise the cost allocation to heavy trucks. The rail industry, in contrast, has to carry its attributed *and* common costs, it has no-one else to share them with. The cost allocation to heavy trucks is generous (to road transport) compared with other countries and compared with Bureau of Transport Economics analysis (Productivity Commission page 105).

The ARA is pleased to note (from page 112 of the Productivity Commission report) that the NTC will be undertaking further work on the relationship between road expenditure and road use a product the context was the PC's observation that " The National Transport Commission's cost attribution model results in lower attribution of costs to heavy vehicles than most of the alternative approaches considered."

Introduction of externality costs: the new charges do not attempt to cover the external costs imposed on other parties by road use, greenhouse emissions, other emissions, noise, accidents (non-insured component, i.e. pain and suffering) and general public unease about increasing numbers of trucks on roads. There would be little economic distortion if the rail mode had similar levels of external costs per ntk, but in practice its externalities per ntk are lower. The externality issue may become more prominent with the advent of new types of high productivity vehicle, some of which will have a negative impact on third parties (e.g. motorists' concerns about overtaking B triples; NSW north coast residents' concerns about increasing numbers of large trucks).

The propositions that externalities are either too low to be worthwhile considering, or too difficult to determine are unjustifiable. While externalities are subject to substantial argument there is no argument that they occur and should be included in principle. Externalities can be included immediately at a relatively low level to avoid the arguments, but would go some way to being consistent with proper economic principles and allowing these real costs to be further refined in future. One important reason to commence at this stage it to be consistent with COAG's intention to avoid future price shocks for the road transport industry.

For this reason it is important that externality costs be introduced as soon as possible. It is anticipated that congestion and greenhouse gas emission costs will rise substantially (in real and allocatable terms) in the near future. Delay in introduction of these costs will distort the use of road transport resulting in higher impacts, and a greater barrier to rectification at some time in the future when it becomes critically necessary to governments and the community.

Impacts

Although the draft proposal will remove one of the worst anti-rail distortions, that of the B double subsidy, it will leave others. This will have a negative effect on those parts of the rail industry that compete with trucks - parts which are not earning an adequate return on capital and which will eventually decline unless returns can be improved.

The rail industry believes there is a tyranny of small decisions which accumulate to a substantial economic differential between road and rail which results in less than optimal transport system outcomes. These include government financial arrangements, governance arrangements, regulatory differences and some aspects of pricing included in this determination. Both the Productivity Commission and the NTC recognise that road charges are at the low end of the scale for a variety of reasons (including different economic principles, data inadequacies and conservative decision making).

One area of concern is interstate freight, mainly of manufactured products in containers or the equivalent which the Productivity Commission downplayed the impact of. However a submission to the Productivity Commission inquiry from economic consultants ACIL Tasman, who had worked intensively on the mode choice issue for DOTARS in the context of the North-South corridor study, suggested that the Productivity Commission had used a more generalised, high level model, and that work undertaken by ACIL Tasman at a more detailed market specific level indicated a more significant impact of changes in road pricing on rail profitability.

Another area of concern is intrastate rail freight of grain, logs, other commodities (apart from minerals) and container freight. Several jurisdictions (WA, Victoria, NSW, Tasmania) are struggling to retain sections of rail networks that are economically unviable. As a NTC Fact Sheet *Why are heavy vehicle charges being reviewed?* (June 2007) notes

> *Current charges are set by averaging road use costs by vehicle class and road type. This leads to cross subsidies from lighter loads to heavier loads [the latter of greatest competitive concern to rail operators], from low kilometre trucks to high kilometre trucks [ditto] and from using major arterials to using rural roads.*

The ARA is concerned that the potential move to a more sophisticated road charging regime, noted in the RIS, still seems so far off. There is a danger that continuing to underprice road use will continue to suppress rail prices to the extent that could lead to excessive rundown or closure of rail lines that might have survived had the road charging been economically efficient. The consequence is that the transport system as a whole operates suboptimally in terms of investment and operations.

In the context of special arrangements mooted in the draft RIS for new types of high productivity vehicle, it is especially important to eliminate remaining areas of under charging (as described above) so that the large competitive impact of those vehicles does not exceed what is economically sound from a national point of view. The ARA supports moves towards removing the averaging caused by differing vehicle utilisations as the RIS proposal commences to do.

The ARA notes the omission of rail interests in the consultation reported in section 6.1 of the RIS. We request the NTC to more openly involve the rail industry as a key stakeholder in future so its opinions and technical expertise are clearly included and reported.