

ROAD AND RAIL FREIGHT INFRASTRUCTURE PRICING

*ACCI SUBMISSION
TO THE
PRODUCTIVITY COMMISSION*

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Background

ACCI has been the peak council of Australian business associations for 105 years and traces its heritage back to Australia's first chamber of commerce in 1826.

Our motto is "Leading Australian Business."

We are also the ongoing amalgamation of the nation's leading federal business organisations – Australian Chamber of Commerce, the Associated Chamber of Manufacturers of Australia, the Australian Council of Employers Federations and the Confederation of Australian Industry.

Membership of ACCI is made up of the State and Territory Chambers of Commerce and Industry together with the major national industry associations.

Through our membership, ACCI represents over 350,000 businesses nation-wide, including over 280,000 enterprises employing less than 20 people, over 55,000 enterprises employing between 20-100 people and the top 100 companies.

Our employer network employs over 4 million people which makes ACCI the largest and most representative business organisation in Australia.

Introduction

The Council of Australian Government's Communiqué of 10 February 2006 highlighted the importance of transport infrastructure to the Australian economy and undertook to ask the Productivity Commission to investigate proposals for efficient pricing of road and rail freight infrastructure. The decision [3.1] is recorded below:

(a) COAG agreed to a Productivity Commission inquiry to be presented to COAG by end 2006 which will, inter alia:-

(i) identify the optimal methods and timeframes for introducing efficient road and rail freight infrastructure pricing in a manner that maximises net benefits to the community,

(ii) determine the full financial, economic, social and environmental costs of providing road and rail infrastructure,

(iii) identify other barriers to competition in road and rail transport, and

(iv) recognise transport operators and users and remote and rural communities will need sufficient time to transition and adjust to pricing arrangements.

Road and rail freight infrastructure pricing

The Australian land transport sector confronts challenges experienced in few other countries in the world: low population density, vast distances, a Federal structure of government, and the fragmented and often inconsistent application of laws and regulations.

Road transport plays the dominant role in Australia's domestic land transport system. However, rail has a competitive advantage in the carriage of bulk commodities and although often thought of as a nineteenth century technology, it has significant potential for greater utilization in the twenty-first century.

Few businesses produce and sell their products or services in the one place; few people live and work at the same place; and few consumers have easy access to their daily needs without some recourse to transport facilities and services. In short, everyone relies on an efficient, reliable and safe transport system to meet their needs.

From a commercial perspective, transport is a significant component of the price of all products and many services we purchase. An inefficient or distorted transport system can add to the cost of business for producers and living for consumers, and diminish our international competitiveness in key export markets.

From the perspective of an ordinary citizen, transport contributes greatly to our mobility and access, and thus our choices in housing and employment type and location, consumption, education, leisure and tourism.

Costs of providing and maintaining road and rail freight infrastructure

Economic Or Financial Costs

Given the importance of and size of expenditure on transport infrastructure in Australia and in the interests of competing projects, transport infrastructure funding must compete with myriad of other projects.

In terms of achieving economic efficiency (which includes allocative, productive and dynamic efficiency) it is economic costs that are critical. ACCI appreciates the difficulty of estimating economic costs, however, the costs from investing in data infrastructure to clarify related economic costs may well be lower than the benefits of providing Australia with efficient road and rail infrastructure. Therefore, we strongly support increased use of economic cost/benefit tools to determine efficient infrastructure investment and pricing.

Financial analysis will help provide answers to questions concerning specific groups and organisations. It will answer questions such as *does the project have a sound business case? Will returns satisfy shareholders? Are cash flows sufficient?* It will usually require detail on investments, operating costs and revenues and financing sources, from which most financial analysis can take place.

An economic analysis builds on the financial analysis to answer questions from a social perspective, such as *'does the project represent an effective use of resources for society as a whole?'* It will typically involve the recognition of:

- the difference between financial and economic costs (eg depreciation, interest);
- differences between market prices and opportunity costs (eg assets already in ownership);
- the fact that transfer payments between Governments (eg Resource Accounting and Budgeting charges) are offsetting at the societal level;
- externalities (eg environmental and social costs and benefits).¹

Given the importance of rail and road transport to the Australian economy it is necessary that the most efficient prices using economic costs be implemented in order to maximise overall welfare.

Competitive Neutrality

¹ Office of Deputy Prime Minister (2004), "Assessing The Impacts Of Spatial Interventions: The '3rs' Guidance", Creating Sustainable Communities, May.

ACCI supports the notion of competitive neutrality. The goal of competitive neutrality is to set infrastructure access at a set of charges that delivers ‘economic efficiency’. Economic efficiency is dependent on the market delivering allocation, production and dynamic efficiencies. These three efficiencies are broadly outlined below:

- allocative efficiency: the degree to which resources available to society are allocated to their most valuable use
- technical (productive) efficiency: the creation of a given volume of output at the lowest possible resource cost
- dynamic efficiency: the optimal introduction of new products and production processes over time².

Definition of competitive neutrality

Giving a competitive advantage to one sector over another sector distorts the allocation of resources away from the most valued use. National Competition Policy states *neutrality principles aim to remove this unfair advantage. The principles also remove the impediment to efficient resource allocation that had arisen from the regulatory advantage of government owned businesses. They ensure these businesses face the same costs and commercial pressures that face their private sector competitors.*³

In the above context competitive neutrality is directed toward competition between public and private enterprises, however the same applies to competitors in the private sector. The Productivity Commission preliminary view on competitive neutrality is outlined below:

“The commission’s preliminary view is that competitively neutral pricing implies an absence of *differential* subsidies (implicit or explicit) between transport modes or within them. Full user cost recovery would require that there be *no* subsidies at all related to freight infrastructure use. (This interpretation would not necessarily preclude different levels of recovery of common costs from different users or services).”⁴

² <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=1724&lg=e>

³ National Competition Council, “*Government Business: Competitive Neutrality*” <http://www.ncc.gov.au/sector.asp?sectorID=16> accessed May 10 2006

⁴ Productivity Commission (2006), “Road and Rail Freight Infrastructure Pricing”, Options for pricing reform, Issues Paper, March, p 21.

ACCI preferred option remains full cost recovery without subsidies and with transparency in pricing. ACCI also supports equal treatment between different modes of transport. However, as noted later there may be, given the final access pricing regime, reason for price discrimination to occur.

Full economic and social costs of road and rail freight

Persistent characteristics of land transport policy have included the lack of transparency, the presence of unclear cross-subsidies and inadequate cost recovery in user charging and pricing. These characteristics result in distortions and inefficiencies in the use of land transport facilities and services.

ACCI's user's charging and pricing policy notes that pricing of externalities, such as pollution and congestion, must be assessed against positive externalities and adjusted for the causal and contributory effects of government policy and regulatory failure.

Marginal Social Cost

ACCI prefers both rail and road transport sectors to operate without subsidies, with user charging and pricing being based on full cost recovery and applied in a competitively neutral and transparent manner. Full cost recovery sends clear signals to current and future infrastructures users and providers.

A fair pricing of the use of railway infrastructure would allow a continuous increase in the capacity utilisation of railway infrastructure. This would make rail transport more attractive and accessible and rail service output higher. In general, it will assist infrastructure managers in reaching their financial goals and establishing useful infrastructure parameters for benchmarking.⁵

However, there are a numbers of issues that need discussion when considering full cost recovery. One such pricing methodology for implementing full cost recovery is a two-part tariff. A two-part tariff, which has a high cost recovery where the fixed component is high, can adversely affect the incentive of operators and competition. For example, a high fixed cost component impedes market entry, in maximizing infrastructure use there is a competitive advantage to large firms and given the relatively inelastic nature of revenue there is little incentive to invest in

⁵ <http://www.unece.org/trans/main/ter/terdocs/ter-seminar-may2001.pdf> (accessed May 11, 2006)

additional capacity⁶. Bureau of Transport and Regional Economics report goes on to state that Ramsey pricing⁷ applied to the fixed price component of a two-part tariff could be used to improve cost recovery.

Most experts agree that charging for the use of transport infrastructure should be based on the marginal social cost principle (marginal cost of use, plus marginal cost of the corresponding environmental damage). This principle should be applied to all modes of transport to avoid distortion of competition.⁸

While pricing must account for externalities there are alternative mechanisms by which social objectives can be achieved. Regulation of emissions and fuels standards are examples of government regulated mechanisms rather than priced-based market mechanisms.

Government regulations prescribing maximum allowable emissions from new heavy vehicle engines act more as a fixed cost rather than a variable cost. The price of a new truck will be higher, and unavoidable, because of the new standard. These regulations have many problems which make them less desirable, because higher fixed costs lead to:

- higher costs of entry for new participants through higher fixed costs;
- a lack of differentiation between marginal social costs, such as city or country driving or time of day;
- cost advantages to large firms;
- less incentive to innovate beyond the minimum emissions regulated, that is, reducing emissions no longer creates a competitive advantage; and
- regulations are generally inputs based rather than outcomes based.

Price based market solutions to externalities, which are related to marginal costs, are more efficient at providing price signals than

⁶ Department of Transport and Regional Services (2003), "Rail Infrastructure Pricing: Principles and Practice", Report 109, Bureau of Transport and Regional Economics.

⁷ Prices vary in inverse proportion to the users' demand elasticities

⁸ <http://www.unece.org/trans/main/ter/terdocs/ter-seminar-may2001.pdf> (accessed May 11, 2006)

government regulation. If externalities were to be captured using price signals the validity of current government based solutions would need to be reviewed.

Pricing through fuel excise

Governments have traditionally placed large taxes on fuel use, for a number of reasons, the most significant one being revenue raising. The taxes on fuel (excise and GST) impose a heavy burden – equivalent to a tax rate of 63% at a pump price of 130 cpl (cents per litre). This tax generally does not provide for the correct costing of infrastructure use. In particular economists have argued:

- Tax (currently) applies to a whole range of activities that don't use a road, such as construction⁹;
- The same tax rate applies to fuel use in vehicles causing little congestion (travelling at midnight) and vehicles that cause much more congestion (travelling at peak hour);
- The same tax rate applies to fuel use in vehicles causing little pollution (older vehicles) and vehicles that cause much more pollution (newer vehicles);
- Due to the onroad fuel grant, the tax rate applying to vehicles causing less road damage (cars) is actually *higher* than the tax rate applying to vehicles causing more road damage (trucks);
- Australia does not have a carbon tax, so the fuel tax cannot be seen as appropriate charging for greenhouse emissions; and
- The revenue raised from fuel taxes is *greatly* above the amount spent on roads.

ACCI supports reform of fuel taxes to enable better charging for infrastructure use. In particular, ACCI supports the following principles for the taxation of fuel:

- The number of distortions in the tax treatment of different fuels and in their uses should be minimised. Environmental or regional considerations provide possibilities where a differential treatment may be appropriate. These, however, need to be explicit and transparent;

9. The Government is planning to broaden the fuel excise exemption for a large number of business uses of fuel offroad.

- Market failure as a justification for higher taxation has to be very carefully justified. Attempts to remedy alleged market failures often merely add to economic distortions, reduce overall growth and create additional inefficiencies;
- There should be no advantage provided to one form of fuel relative to another unless there are specific additional public policy considerations that need to be addressed and these are clearly articulated;
- Taxes should be broadly based so as to allow lower taxes on each taxed item, rather than applying large distorting taxes to fewer items;
- Care must be taken to minimise the risk of unintended technological consequences of the adoption of differential fuel taxation. Fuel taxes should be long-term technology neutral;
- No taxes should be applied to non-transport uses such as power generation as there ought to be no taxation of business inputs; and
- Indexation of fuel taxes should not be reintroduced. Increases in excise should be subject to the explicit approval of Parliament rather than occurring automatically due to increases in the general price level;

Infrastructure provision and financing

There are clearly major infrastructure needs for Australia. ACCI considers that:

- Infrastructure needs should be primarily addressed by the private sector, because it is generally more efficient at developing and operating infrastructure. The Government should assist private investment through facilitative tax and regulatory systems;
- Government investment should only be used when there is clear and demonstrated market failure and after a thorough cost benefit analysis has been undertaken. Where government involvement in infrastructure is required, governments should make full use of partnerships with the private sector to reduce costs;
- Consistent with proposals to reduce business regulation, the regulations applying to infrastructure planning, development

and use should be examined and removed if they do not meet cost-benefit tests;

- ACCI does not support proposals to have a national takeover of infrastructure investment decisions. States retain an important role; and
- However, we do support proposals for greater coordination in infrastructure regulation and planning;

ACCI's policy on land transport is attached.

Summary

ACCI supports the Productivity Commission's enquiry into Road and Rail Freight Infrastructure Pricing and the objectives laid out in the Council of Australian Government's (CoAG) Meeting on Transport.

Depending on the government's objective with regard to infrastructure development each pricing regime will deliver its own set of trade offs. ACCI's primary objective is to ensure competition between and within various modes of transports is encouraged while barriers to investment and new entrants are removed.

Transport should generally be delivered by dedicated, corporatised or preferably privatised agencies, with charging and pricing set against criteria of full cost recovery and reflecting market forces (which would permit differential charging and pricing based on time-of-day usage).

Given the importance of rail and road transport to the Australian economy it is necessary that the most efficient prices using economic costs be implemented in order to maximise overall welfare.

ACCI's user's charging and pricing policy notes that pricing of externalities, such as pollution and congestion, must be assessed against positive externalities and adjusted for the causal and contributory effects of government policy and regulatory failure.

Appendix A

AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

TRANSPORT - LAND

PRINCIPLES OF LAND TRANSPORT POLICY

Transport is the essential backbone of modern economies and societies.

Few businesses produce and sell their products or services in the one place; few people live and work at the same place; and few consumers have easy access to their daily needs without some recourse to transport facilities and services.

In short, everyone relies on an efficient, reliable and safe transport system to meet their needs.

From a commercial perspective, transport is a significant component of the price of all products and many services we purchase. An inefficient or distorted transport system can add to the cost of business for producers and living for consumers, and diminish our international competitiveness in key export markets.

From the perspective of an ordinary citizen, transport contributes greatly to our mobility and access and thus our choices in housing and employment type and location, consumption/ shopping, education, leisure and tourism.

POLICY OBJECTIVES

ACCI's over-arching policy objectives include:

- competitive neutrality between land transport modes;
- more comprehensive and integrated national land transport use/planning;
- the orientation of Federal, State and Local Government land transport expenditure toward investments of national economic significance; and
- land transport user charging and pricing being determined on the basis of full cost recovery and market forces, with any community service obligations funded from consolidated public revenue

- land transport policies be developed and implemented within the broader context of integrated and intelligent (utilising electronic commerce) transport systems.

Specific, immediate policy objectives include:

- the creation of an Australian Land Transport Corporation to ensure greater analytical rigour and transparency in land transport infrastructure decision-making; and
- the publication by the Australian Government of a Ministerial National Transport Planning Policy Statement within the life of each Parliament, with complementary documents from the State and Territory Governments.

THE POLICY FRAMEWORK

The Australian land transport sector confronts challenges experienced in few other countries in the world: low population density; vast distances; the federal structure of government; and the fragmented and often inconsistent application of laws and regulations.

Government policy, evident in the levels and allocation of funding for rail and road, has strongly favoured the latter. Since the early 1980s, federal funding for roads has been some eight times that for rail - for infrastructure (that is, taking out funding for the operating deficits of rail), the disparity increases to a factor of 20 times.

The perception remains that rail is a nineteenth century technology and generally lacks the narrow electoral benefits which come from higher and targeted road spending.

Commerce and industry recognises road transport plays the dominant role in Australia's domestic land transport system, accounting for two-thirds of the domestic land transport task. Road is regarded as having a competitive advantage in intra-urban movements and the carriage of break-bulk and small-bulk manufactures.

However, this does not diminish the important role played by rail which accounts for a still substantial one-third of the domestic land transport task. Rail has a competitive advantage in the carriage of bulk commodities (both minerals and primary products), although it has lost market share to road in the movement of non-bulk freight.

National Transport Planning

Comprehensive, integrated and market-oriented national transport planning is essential to the efficiency and competitiveness of land transport providers and users and the optimum allocation of scarce infrastructure development funds.

While commerce and industry acknowledges there have been improvements in the co-ordination of land transport initiatives between and within Federal, State/Territory and Local Governments, much more remains to be done.

To maximise co-ordination and transparency in national land transport planning, commerce and industry calls upon the Australian Government to publish in the life of each Parliament a comprehensive National Transport Planning Policy Statement, with each State and Territory Government producing complementary documents along similar time frames.

Such statements would outline, inter alia, the relevant Government's land transport: objectives and strategies for the following three years; priorities for infrastructure asset management, spending and charging; operational and safety regulation reform; application of competition policy principles to land transport; and any changes to the criteria for key decision-making on land transport matters.

Competition Law, Policy and Regulatory Frameworks

Land transport, and rail transport in particular, has undergone major reform over the past decade. However, much still remains to be done.

Important changes in the rail area include reform of the structural arrangements of some State-owned railways, the corporatisation or privatisation of certain rail operations, improved consistency between operating and safety standards in the different jurisdictions and the implementation of competition policy reforms (most notably rail access regimes).

Nevertheless, the Australian land transport sector continues to operate under a mixed framework of operational and safety regulations, imposed by the Federal, State and even local Governments, many of which impair effective competition between road and rail transport.

Insofar as governments and their agencies impose regulations upon the land transport sector, these should be minimal, light-handed and transparent, and sensitive to the commercial circumstances of transport service providers and users. National uniform access and regulatory standards should be pursued within each of rail and road transport.

They should also be competitively neutral between the land transport modes, with necessarily high standards of safety regulation not being used to achieve commercially or competitively discriminatory outcomes.

Asset Management

Past initiatives in the application of national competition principles and the corporatisation and privatisation of important components of the rail transport system are welcomed, although more remains to be achieved.

An important priority is the clear and distinct structural separation of government-owned land transport players into commercial players and regulatory agencies, where this has not already been done.

In particular, commerce and industry supports the full privatisation of all 'above the rail' operations at all tiers of government, with the remaining 'below the rail' assets being

consolidated into corporatised entities operating in conformity with national competition principles.

Ideally, all ‘below-the-rail’ assets should be transferred to a single, national Australian Land Transport Corporation, as a focal point for rail operators looking to provide rail transport services within Australia. Such an approach would greatly assist in overcoming the duplication and inefficiencies of administration and regulation which exist under the current multiple jurisdiction model.

Infrastructure Decision Making

Investment spending on key land transport infrastructure has barely kept up with the depreciation of existing rail and road capital assets. In short, Australia has been engaged in running-down its land transport capital stock for at least the past 20 years, a situation which is unsustainable.

This condition reflects the tendency for decision-making in land transport infrastructure spending to be fragmented and lacking transparency, with political considerations receiving undue emphasis in the allocation of scarce public funds for major capital projects.

Commerce and industry supports a transparent decision-making regime, based on a joint ‘investments of national economic significance’/national competition policy approach to the development and maintenance of land transport infrastructure and services.

Key criteria for determining ‘investments of national economic significance’ include the economic benefit/costs of the project, its place within a national infrastructure or services system and alternative use of funds for land transport infrastructure development.

Nevertheless, commerce and industry recognises there are legitimate arguments for focusing public funds on ‘black spots’ and ‘bottlenecks’ in both rail and road transport, for genuine public safety and user-efficiency reasons and community service purposes, such as national defence and providing land transport access to remote areas.

Commerce and industry supports the creation of a single Australian Land Transport Corporation (ALTC) to better co-ordinate and ensure transparency within land transport infrastructure decision-making (especially the allocation of public funds) and deal with modal interface and broader, related land-use issues.

The ALTC would be expected to make decisions on the allocation of public infrastructure expenditure within a market environment against ‘investments of national economic significance’/national competition policy criteria. The Corporation would be informed, but not bound, by government policies in its decision-making.

An early policy priority for the ALTC would be determining a single, uniform set of transparent criteria for decision-making on the allocation of funds for each of road and rail infrastructure, including the relative responsibilities of the different tiers of government.

Monumental land transport projects, such as the mooted rail connection between Darwin-Toowoomba, insofar as they make calls upon public funds, should meet the ‘investments of national economic significance’/competitive neutrality tests.

While commerce and industry welcomes private sector provision of land transport infrastructure, this should be done without public sector guarantees or subsidies and proceed on the basis of the inherent commercial viability of the project and within national competition principles.

User Charging and Pricing

Sustained characteristics of land transport policy have included the lack of transparency, the presence of unclear cross-subsidies and inadequate cost recovery in user charging and pricing, which result in distortions and inefficiencies in the use of land transport facilities and services.

Ongoing public debate has seen the rail sector arguing road charges do not cover the full cost of road use, while the road sector argues rail operators benefit from cross- and direct-subsidies.

Commerce and industry expects both rail and road transport sectors to operate without subsidies, with user charging and pricing being based on full cost recovery and applied in a competitively neutral and transparent manner.

Where governments seek to recover costs associated with perceived negative externalities, such as congestion and pollution, these should be assessed against positive externalities and adjusted for the causal and contributory effects of government policy and regulatory failure.

Further, where governments wish to provide incentives or subsidies for broader policy objectives, for which they are held electorally accountable, these should be done transparently and funded solely from the public account.

Public transport should be delivered by dedicated, corporatised or preferably privatised agencies, with charging and pricing set against criteria of full cost recovery and reflecting market forces (which would permit differential charging and pricing based on time-of-day usage).

Where governments impose specific purpose taxes or charges (for example, fuel taxes for road infrastructure development) these taxes or charges should be used exclusively for that designated purpose and not diverted in any way to other purposes or general public revenue.

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