AUSTRALIAN LOGISTICS COUNCIL

Australian Logistics Council

Productivity Commission Submission: Review of Transport Infrastructure Pricing

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Introduction

The Australian Logistics Council (ALC) is a national partnership between all Australian Governments and senior industry leaders focused on improving the 'efficiency in delivery' of our freight logistics supply chains. ALC welcomes this opportunity to make a submission to the Commission's Review of Road and Rail Freight Infrastructure Pricing.

Setting transport infrastructure prices is a complex issue, and achieving change in this area is difficult. These difficulties have recently been demonstrated in the rejection by the Australian Transport Council of the National Transport Commission's Third Pricing Determination.

However, there is general agreement that Australia will face a very significant increase in the freight task in the coming decade. To manage this task in a way that is both economically efficient and socially and environmentally acceptable is a major challenge. We will see significant expansion of activity in both the road and rail sectors, and we need to ensure that:

- The most appropriate mode is used for each element of the transport task
- Each mode operates at maximum efficiency, using the most productive equipment and technologies
- Intermodal integration to support the complementary use of rail and road transport is encouraged.

Improved infrastructure pricing has the potential to make a contribution to the achievement of all three of these goals. To ensure that this potential is realised, the Council believes that it is vital to establish a set of key principles to guide the Commission's work on pricing issues as early as possible. The purpose of this submission is to present to the Commission the views of industry on what these key principles should be.

Primacy to economic efficiency

In its Issues Paper, the Commission correctly draws attention to the difference between financial costs and economic costs, and ask whether '*participants agree that the Commission should focus on economic costs as the relevant measure of the costs of providing transport infrastructure?'*

Our answer is yes. The ALC welcomes the clear emphasis on economic efficiency that is evident in the COAG decision establishing the terms of reference for the current inquiry. (The COAG decision requires the Commission to 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.)

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ALC is strongly of the view that the overriding objective of the review should be to develop an approach to the pricing of freight transport infrastructure that will support economically efficient freight logistics. The pricing of freight transport infrastructure should be designed to foster the efficient use of the transport infrastructure that we have, and to encourage the timely provision of the infrastructure that we need. The perspective of the review should be that of the Australian community as a whole. It is vital that the ability of prices to achieve these objectives should not be distorted by accidents of history, or by differences in institutional structures, taxation practices, and financing arrangements. All of these factors, and many others, create a divergence between financial costs and true economic costs.

This means that the focus of the Commission should be on the economic costs rather than financial costs. ALC readily acknowledges that it is much easier in practice to set prices on the basis of financial costs; as the Commission points out in the Issues Paper 'estimating economic costs in practice is not straightforward and, moreover, may be limited by data availability'. But in this case, as in many others, it is better to be approximately right than precisely wrong.

Looking Forward

The fundamental economic purpose of improved pricing is to provide better guidance for the future decisions of both transport users and transport infrastructure providers.

In the road and rail sectors, many assets have very long lives, and current system configuration and performance is heavily influenced by the decisions of the past. In the case of rail, these decisions were made under very different institutional circumstances; in the case of both road and rail, many of the decisions were guided by considerations other than the efficient and effective performance of the freight transport task.

Infrastructure pricing is unlikely to provide appropriate guidance to future decisions if it is shackled to this legacy. For this reason it is important that the Commission distinguish clearly between the issue of cost recovery (which focuses on past decisions, which can not now be changed) and the issue of pricing to encourage appropriate investment and user behaviour (which focuses on future decisions that will have important impacts on economic efficiency).

ALC believes that in framing future pricing arrangements the Commission should focus clearly on two key questions:

- What pricing arrangements will encourage transport infrastructure providers to make the investments that will be necessary to cater efficiently for the future transport task?
- What pricing arrangements will encourage freight transport service operators to make the right use of this infrastructure: that is, to use the right vehicles in the right way at the right time on the right routes?

In freight transport infrastructure as in many other infrastructure industries, the answers to these two questions may not be easily reconciled. In particular, encouraging efficient investment requires that the prices are set at a level that allows the investor to recover the full cost of its investment, including an appropriate rate of return. Pricing to encourage the efficient use of infrastructure, on the other hand, needs to focus on the marginal costs: the additional costs associated with a small increase in use of the infrastructure by infrastructure users with particular characteristics. Prices based on these marginal costs may not raise enough revenue to provide an incentive to invest in new infrastructure.

In its Issues Paper, the Commission points to a number of devices that are commonly used to minimise the impact of conflicts between the two goals, including the two-part pricing arrangements (that is, an access charge plus a usage charge) that are currently in place for both road and rail operations. ALC supports the Commission's expressed intention to explore all options that may help to reconcile the need to provide appropriate signals for efficient investment with the need to encourage efficient use of infrastructure.

Consistency between modes

The ALC supports the pursuit of greater consistency in the approach to infrastructure pricing between modes.

Ensuring that freight is carried by the most appropriate transport mode is an essential element in maximising the overall efficiency of the freight logistics system. Given the imperfections of current infrastructure investment allocation and infrastructure pricing, this is clearly not the case at present. In some instances - and in particular in the carriage of general freight between Melbourne and Brisbane - the weight of evidence suggests that rail is playing a smaller role than it should. In others it is likely that economic efficiency would be better served if road played a greater role.

Freight transport infrastructure pricing has an important role to play in ensuring that the right task is allocated to the right mode. This is not just because infrastructure prices may change the relative prices of road and rail options, and hence affect transport user choice in the short term; it is also because infrastructure pricing may influence the pattern of future investment in freight infrastructure.

ALC agrees with the view expressed by the Commission in its Issues Paper that the appropriate allocation of freight is most likely to be achieved if common pricing principles are adopted across the two main land transport modes. ALC also notes, however, that these principles should also be consistent with those that apply to the infrastructure serving sea and (less importantly) air transport, since there are certain markets in which there is a significant element of competition between these modes and land transport.

In its Issues Paper, the Commission proposes that 'competitive neutrality', which has its origins in the efforts of National Competition Policy to ensure that competition between government-owned and privately owned enterprise takes place on equal terms, need to be understand somewhat differently in the current context. The ALC endorses this view. However, it is less comfortable with the proposed definition of 'competitive neutrality' as the absence of 'differential subsidies'.

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The problem here lies generally with concept of subsidy, which is closely related to the idea of 'cost recovery'. There is a risk that the use of this concept will drag us back to a fruitless discussion of historical decisions that cannot now be changed, and undermine the forward-looking focus that (as we argued in the preceding section) is essential to the review.

From the perspective of economic efficiency, what matters is that the principles adopted for infrastructure pricing in the competing modes are non-distorting; that is, they do not result in an allocation of freight between the modes that is substantially different from that which would minimise total transport system costs. But while the goal to which the pricing principles should be directed is clear, neither the articulation of appropriate principles not their application is a trivial task. There are important and relevant differences between rail and road that will have an important bearing on the development of appropriate principles, and add to the complexity of the task of doing so.

Flow of funds and institutional issues

We have argued earlier that one of the most important functions of improved infrastructure pricing is to encourage and reward investment in infrastructure. But improved pricing will only do this if it is supported by an appropriate fiscal framework and institutional structures. In the rail sector, these requirements are in place: institutional arrangements allow charges levied on the users of infrastructure to flow to the supplier of the infrastructure, providing both the incentive and the ability to fund further infrastructure improvements. But at present this connection does not exist in the road sector. The circle that characterises typical commercial relationships is broken. Revenue that is derived from road user charges flows into general revenue, and there is no systematic relationship, even at the aggregate level, between the funds made available for investment in roads and the revenues that are gathered from road users.

While formally these payments are described as a road user charges, in practice they are treated as a tax.

For as long as this continues to be the case, one of the two main benefits of improved infrastructure pricing - better signals on what investment is justified and where - cannot be realised in the road sector. As a result, pricing improvement may lead to improved *road use* behaviour (the demand side response to improved pricing) but there is no mechanism by which it can lead to improved *investment* behaviour (the supply side response to improved pricing). This is particularly important as there is some reason to believe that the economic returns from the supply side response are likely to be very much higher than the economic returns from the demand side response.

There are other important consequences of this 'broken circle'. One is that road transport operators - understandably and at least arguably correctly - tend to regard road user charges as a form of taxation, rather than a payment for services rendered. This increases resistance to any change that may lead to higher charges, since those who pay the charge have no certainty that the additional payments will be used to provide and maintain infrastructure from which they will benefit.

Another harmful consequence is the generation of an 'asset preservation' rather than a 'service provision' attitude in road agencies. Since the agencies are effectively rewarded for reducing internal costs rather than for maximising the net value of services provided, they have an incentive to limit the service capabilities of the assets provided and impose prescriptive regulations on the way in which roads can be used. In addition, current funding arrangements mean that commercial pressures to invest and operate efficiently are muted or absent and there are limited incentives to be efficient in allocation of investment funds in the road sector.

A minimum requirement for resolving these issues is the revenue raised through heavy vehicle road user charges should be returned to the owner of the road asset.

There is a strong case also for introducing a specific charge for road use by light vehicles, which would also then be hypothecated to the road agency. In arguing for such a charge, the ALC is not advocating an increase in the total burden on light vehicles. Any road user charge should be fully offset by a corresponding reduction in the level of fuel taxation.

The ALC recognises that road user charges for light vehicles lie outside of the terms of reference of the Commission. However, because roads are generally shared between private vehicles and freight operators, the issue of how much heavy vehicles should pay for road use cannot be satisfactorily resolved without also addressing the question of how much light vehicles should pay for road use. The introduction of an explicit road use charges for light vehicles would force the question into the open; require that a transparent response be developed to the question of the proper allocation of road costs between heavy and light vehicles; and provide an adequate revenue stream to fund future road investment.

Externalities

ALC accepts in principle the arguments for the inclusion of external costs in the pricing of transport infrastructure. However, we are concerned that currently available estimates of externality costs are not sufficiently robust or disaggregated to allow the implementation of externality charges that will allow transport infrastructure pricing to make a genuine contribution to the efficient reduction of these costs in freight transport. We therefore urges caution in the introduction of an externality component into infrastructure charges, and suggests that, initially at least; externality charges should be set at the lower end of the range defined by informed and impartial opinion. We also believe that the introduction of externality charges should proceed only if:

- The mechanisms used to implement externality charges are sufficiently disaggregated to reflect the very large differences that exist in different operating environments. As a minimum, this would require the application of different externality charges in urban and rural environments
- Charges for externalities are introduced simultaneously and on a consistent basis across all modes and vehicle classes.

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Conclusion

This brief submission highlights some of the key issues that, in the view of the ALC, the Commission needs to address in undertaking the review. We note that the Commission is willing to receive further submissions throughout the course of the review, and in particular that there will be an opportunity to comment on the Draft Report scheduled for release in September.