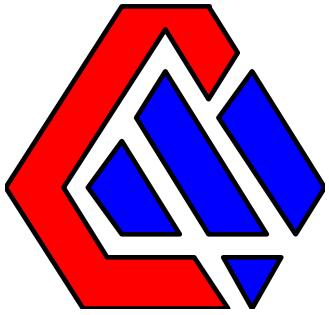

Coles Myer Ltd.

A.C.N. 004 089 936

Submission to the Productivity Commission's Review of the Economic Costs of Freight Infrastructure and Efficient Approaches to Transport Pricing

Introduction

Coles Myer Ltd is one of Australia's largest customers of freight into and around Australia. The shape, health and cost-effectiveness of the nation's transport infrastructure are vitally important to our business, our customers, and the national economy in which we operate.

CML is currently undertaking a major investment in its supply chain because the efficient movement of goods into our stores is central to the company's success. Recommendations by the Productivity Commission that will affect transport costs will affect the company's business.

It is important that CML is able to gain a clear view of where Governments are heading with transport reform so it can plan effectively. Conversely it is important that freight customers participate in these deliberations so that Governments, and their organisations, can better appreciate the implications of their decisions. Consequently, CML welcomes the opportunity to engage with the Productivity Commission on the nation's freight transport infrastructure.

CML is concerned about the long-term health of the freight infrastructure, and its ability to cope with the doubling of the freight task expected over the next 25 years. Unless addressed, increased traffic congestion, poor inter-modal connections and poor performing rail freight could impact on the company's ability to deliver fresh foods and consumer goods to our customers quickly and cheaply – with significant roll on effects.

> **Australia needs a freight transport network that is quick, inexpensive, efficient, safe and sustainable. Pricing structures and charges should be tested against these desired outcomes.**

Such an infrastructure requires considerable investment. Freight pricing structures and charges are one means of encouraging efficiencies and recouping part of these investment costs. However, given the greater national benefit derived from freight movement, Governments rightly invest considerable amounts from the broader public funds to improve freight infrastructure. The AusLink initiatives, with their significant investments in road and rail infrastructure, are testament to this.

CML supports these initiatives, particularly the development of the South Sydney Rail Freight line and consideration of a new inland Melbourne-Brisbane link. Delays to rail traffic entering and leaving Sydney undermine rail's competitiveness and retard the movement of rail freight between Melbourne and Brisbane.

While CML welcomes a review of price structure that will encourage efficiencies, it believes externalities such as environmental, safety and security concerns should be addressed through regulation and standards that are consistent across Australia, not through additional charges and certainly not through varying charges by individual jurisdictions.

Further, while recognising the arguments from the rail sector that road operations do not pay for all their costs, CML is strongly of the view that rail's future lies in capitalising on the strengths of road transport and integrating it into rail freight movement. Arguing for increasing the cost of road freight purely to encourage more people on to rail, or place greater impost on larger vehicles - will only cover up and perpetuate inefficiencies in the rail system.

CML's freight task is an integrated one involving international, national, state and local freight movements by sea, rail, road and, to a lesser extent, air. CML sees this activity as one task and, as such, one that needs a consistent national approach and vision to generate the greatest benefit for the economy and the community. It seeks a framework that enables the various jurisdictions to have consistent and complementary regulations.

> **Similarly, CML encourages Governments to adopt a holistic approach to the nation's freight infrastructure; an approach that recognises the contribution that each mode makes to the whole and capitalises on the advantages of each to deliver the fully integrated and efficient freight transport vital to the nation's prosperity.**

CML believes informed decision making in this context must be supported by the development of nationally consistent metrics.

CML and its freight task

Coles Myer Ltd, is one of Australia's largest employers and largest retail chains. It has over 2,600 stores across Australia, stocked with some 10 million items, from 9,000 suppliers, processing 21 million customer transactions a week. Total annual sales recorded last year were $36 billion.

More particularly, supermarkets stock 25,000+ items on high rotation, with fresh food replenished daily and most other items replenished at least every week.

CML operates in a highly competitive environment. Customers have complete freedom to change where they shop at any time; they are not bound by any entry or exit fees. As a consequence the company must continually strive to delight customers with quality, range, price and service.

The Coles Myer Group is comprised predominately of 'volume' businesses. For example, Coles supermarkets is a 'low-margin high-turnover' business that requires scale to be effective in delivering a wide range of food and groceries to customers across a vast land mass at the lowest possible retail prices. Like most retailers in Australia, CML operates on a margin between 3 to 4 cents in the dollar.

Given the points above, the company has little ability to absorb increased transport costs or tolerate slow or unreliable freight networks. The company is continually striving to reduce freight costs, cut delivery times and increase reliability.

As part of this effort, it has embarked on an exercise to rationalise its distribution network from 41 to 24 distribution centres - the first of the new centres is due to open later this year. New distribution centres servicing interstate freight are located within 30 minutes of interstate rail terminals. The Distribution Centre in Melbourne will be located at the new Somerton intermodal terminal. A new packing and display system has been introduced to reduce handling and transit times for fresh produce, and the company is taking control of freight movements into its distribution centres.

Most stores are situated in or near residential areas while suppliers of fresh produce are in regional areas. Much of our general merchandise is imported in shipping containers through the Melbourne port and transported by rail and road to our distribution centres and then dispatched to stores. Consequently the company's freight task involves road and rail on long haul movement and road freight on interstate, intra state and local roads.

Currently there are in the order of 2,700 truck movements a day from existing distribution centres to stores. Eighty percent of this traffic is in metropolitan areas and the average distance travelled each trip is 150 kilometres. This freight could not be carried by rail. Truck movements are likely to increase as the number of distribution centres is reduced and demand grows unless more efficient vehicles are employed.

Coles Myer Ltd Freight Statistics

70,000 containers imported pa (20 foot equivalent units TUEs)

8.3 million shipping pallets freighted around Australia pa

450 containers (TUEs**)** transported by rail a week

- **250 containers** TUEs**)** by rail from Melbourne to Brisbane a week
- **200 containers** (TUEs) from Melbourne to Perth a week

100 B-Double trips from Melbourne to Sydney a week

2,700 truck movements from distribution centres to stores a day

$1 billion is being invested in a new distribution centre network

Significantly, CML road freight loads tend to be considerably lighter than the vehicles' maximum load limits. The nature of the goods transported invariably results in maximum volume being met before weight limits are reached. The net result is vehicles operating well under axle-weight limits.

An efficient supply chain to retail outlets, coupled with a highly competitive industry has provided the community with a ready supply of high quality foods and merchandise, many regional communities have greater access to their markets, and the economy benefits from lower prices than would otherwise be the case.

What should the freight Infrastructure look like?

As indicated CML seeks a freight network that is fast, cheap, safe and sustainable.

CML's vision is for an integrated freight network that involves reliable fast rail freight between state capitals, fast modal transfer and shuttle operations to distribution centres, overnight road freight for fresh produce into distribution centres, larger interstate road freight vehicles to increase efficiency and more efficient use of B-doubles for intrastate and some local deliveries where the latter is possible and effective.

We see the long haul task as both rail and road. We seek a rail service for general merchandise that is competitive for distances as low as 600km and a purpose built inland rail connection between Melbourne and Brisbane with extensive sections of dual track (to reduce congestion and maximise schedule flexibility) and capable of double stacking containers. We believe larger vehicles, possibly B-triples should be encouraged on the long-haul road task, particularly for transporting perishable foods.

As part of this process, we expect government charges and regulation to accurately reflect cost recovery and encourage efficiency and innovation in the market. We also seek consistent regulation across jurisdictions, including local government.

Specific Questions

This submission does not seek to address all the questions posed by the Productivity Commission's Issues paper only those that CML believes it can add value to the Commission's deliberations.

Scope of the Inquiry

CML believes that the Commission can make a valued contribution by establishing a framework and principles for pricing road and rail infrastructure, and more particularly by recommending implementation paths and time timetables for any proposed changes. CML is making a major investment in logistics management processes. It needs clarity on the manner, direction and timetable of change to ensure it can maximise any efficiencies offered by any proposed changes, and avoid or minimise any detrimental impacts.

A fundamental tenet should be that pricing structures should promote efficiency across the system, not seek to advantage one mode at the expense of another.

Inquiry focus

While the focus on the inquiry is naturally on the economic costs of providing freight transport infrastructure, it must also be cognisant of the capacity and capability of various modes to meet the service requirements of customers and the cost savings that may flow to the broader community as a result – in CML's case, in the provision of high quality fresh food, processed food and merchandise at relatively low prices.

Additionally, while CML is advocating an integrated national approach to freight transport, it is concerned that the delivery of such an approach may be compromised by the lack of sufficient or incomplete information on the size and scope of the logistics industry in Australia.

Data on Transport and Logistics is currently patchy. It is collected against different definitions and metrics to answer different questions. Much of this relates to a single transport mode and is not able to be aggregated to get a full industry picture. Specifically relevant data is collected by industry peak bodies such as SAL, ASA, ARA, ICHCA, CBFCA, AFIF, AAPMA, TALC, TDT and ATA, the State Governments and Freight Councils as well as government agencies such as ABS and BTRE. The SCOT National Data Group, has also completed important, relevant work in this area. The best and most recent information is the Bureau of Transport and Regional Economics Paper 49. This document makes it clear that figures are estimates only.

The absence of complete and reliable data is an issue with which the Commission and all involved in the national freight task need to grapple.

CML is not in a position to determine how well the PAYGO approach captures the capital cost of providing the road network. However it does seem to penalise larger vehicles that are more efficient. Additionally, CML struggles with a concept advanced by the National Transport Commission, of variable costs depending on roads travelled, as a means of improving the efficiency of the system.

CML deals directly with its fresh food suppliers, rather than wholesalers, and must arrange transport over regional and local roads to collect the produce. Additionally regional and local roads must be used to deliver goods to stores, which are usually located in shopping strips or centres close to residential areas and well removed from railheads. It is difficult to see how a payment structure that increases the cost of larger vehicles and the use of local roads will lead to the use of more efficient vehicles or a choice of different roads when no alternative is available. The administrative impost and process for setting and reviewing local road charges are also issues that need to be clarified.

Full economic and social costs of road and rail

Many, if not all, of the external costs such as environmental and safety costs are already internalised both in rail and road through compliance regulation, laws, and by-laws.

This approach seems appropriate because of the inexact and complex nature of determining the costs to the community and the contribution made by freight traffic. The subjective nature of some elements is also an additional complexity. For example how much of the noise from a major metropolitan arterial road is generated by a freight transport? Is the sound of an individual truck more of an issue on a metropolitan arterial road running through a high-density residential area or on a regional road in a sparsely populated area? If so what is the price differential?

If road freight were charged a congestion tax, would smaller vehicles be charged more than larger vehicles, would private motorists also be charged a congestion tax?

Conversely there are difficulties in quantifying the economic and social benefit of improvements in freight. There is no doubt that the community enjoys produce that is cheaper in relative terms, fresher and higher quality fresh foods than ever before. Container transport by road and rail has also delivered efficiencies and economies of scale. Over the last 30 years the cost of food to the customer has dropped in relative terms about 1% a year. Produce harvested in Atherton, Queensland, can be in Melbourne in a matter of days. In many instances produce harvested one day is in stores the next.

The ability of the freight network to move quickly and reliably has contributed to the success of consolidation of production, resulting in economies of scale, provided greater market opportunities for producers, more market competition and longer life for food in homes. The diesel rebate is one means of, in part, internalising these benefits, however the extent to which it covers these benefits is unclear.

CML views with concern calls for the State Government's to impose levies on road freight container movement to deal with local congestion issues. Such an approach must build in inefficiencies into the freight task, rather than improve efficiency, and continue a piece meal approach to freight management. Levies are a disincentive to the Australia's manufacturing and trading activities. Trade is the nation's lifeblood so transport levies will send a negative message to industry and dampen productivity growth.

Supply chain security is emerging as another externality that is impacting on the efficiency and cost of freight movements. It has already resulted in the introduction of fees on importing shipping containers through ports and has the potential to overlay another range of user fees, and other compliance costs, on the domestic freight and logistics sector.

Overseas experience suggests increased costs across the range of transport modes: air, sea, rail and road. In Australia we have already introduced new security measures in the air and international sea cargo environments.

Supply chain security costs are a potential inhibitor to flexibility and efficiency depending on how the costs are recovered, administered and implemented.

It could be legitimately argued that the cost of increased security is a general public good similar to community protection and should not be a cost recovered solely from the freight industry.

Options for pricing reform – competitive neutrality

The issue of competitive neutrality suggests that there is an inequity between the charges for rail and road, and that this issue is significant because road and rail compete with each other for freight. There is an opinion, largely advanced by the rail sector, that road transport is not paying its way and should pay more; that in doing so, rail may become more competitive.

As indicated, CML uses a combination of road and rail for its freight task. From CML's perspective, there are very few instances where road and rail freight options compete purely on the basis of price and more instances where they are complementary elements of the same supply chain. Everything transported by rail for CML eventually is transported by road. Even on the Brisbane-Melbourne corridor, where competition between the two modes is considered to be its most direct, rail's freight task is primarily dry foods and goods while road's is primarily fresh produce. Rail simply cannot hope to duplicate road's reach and flexibility.

Charges for heavy vehicles

CML is concerned that the current charging arrangements discourage the use of large trucks and the introduction of the larger technologically advanced trucks.

CML believes there could be considerable benefit in the introduction of larger vehicles on interstate routes and where possible for local distribution. These benefits would include increased transport efficiency and fewer vehicles on the road for the same freight task. This process is also retarded by local regulations restricting the size of vehicles and their hours of operations on some local roads. In this instance a more effective approach could involve by-laws relating to noise, and actual axle weights rather than vehicle size or hours of operation.

Moving to a location pricing modal, would seriously disadvantage many retailers, who by necessity must be located in or near residential areas. Additionally road user charges related to distance travelled and marginal road damage would disadvantage regional communities competing for local and international markets and relying on road transport for all items brought into the region.

Similar concerns are held for mass-distance models, which again may disadvantage regional communities for the reasons stated above. It is unclear whether such a system would encourage a proliferation of lighter small vehicles, increasing costs, congestion, fuel consumption, pollution and inefficiencies or larger vehicles on the local freight task. As indicated CML manages some 2,700 trips a day from its distribution centre, averaging of 150km each – that is almost 3 million kilometres a week. Any small increase per kilometre, translates into a considerable cost impost which most be passed on to the consumer through increased prices.

CML is concerned that the incremental charging as outlined by the NTC seems predicated on assumptions that need to be examined further. The first assumption is that road freight does not already seek the most efficient route. There seems little need to encourage freight operators to use higher quality, faster routes given the time, fuel consumption and cost sensitivity of the freight task. The second assumption is that pick-up and delivery for freight operations need not be on local roads. While CML is naturally locating its major distribution centres adjacent to major roads and as close as possible to rail facilities, it must locate its stores near its markets; for the most part in shopping centres or near residential areas. At best these are sighted on arterial roads. Industry flexibility further is restricted by zoning and planning laws that influence the location of distribution centres, stores and rail hubs. It is difficult to see how such a pricing approach would encourage a relocation of suppliers and stores.

Neither the current system nor that proposed by the NTC acknowledge the inherent difference between road freight for retail and other purposes. As indicated earlier, CML transports are loaded by volume rather than weight. This makes them consistently lighter than similar vehicles hauling for other industries. While a 14-metre trailer would normally carry 18 tonnes, carrying general retail merchandise it averages 10 to 12 tonnes. Consequently axle weight and impact of the road surface is considerably less than what would normally be expected, yet these vehicles pay the same registration fee and receive the same fuel rebate as their heavier counterparts. CML believes pricing structures should recognise or offer incentives for reducing axle-weight.

Price sensitivity

Freight customers are perhaps more sensitive to freight costs then freight movers. The latter have the ability to pass on costs to customers, particularly when they are uniform government charges across the freight industry. Customers on the other hand must consider their ability to pass on costs in the context of their competitiveness with others who may not incur the same costs because of a different product mix.

Supermarket retailing is a 'low-margin high-volume' business measuring costs in 0.001 cents. It is very sensitive to freight price movement. An increase of 0.01 cent per carton can increase costs by hundreds of thousands of dollars a year.

Modal Choice

CML seeks to capitalise on the economies of scale offered by rail, as much as possible. However, a major impediment is the cost of pick up and delivery from rail, the inherent delays in transit due to poor infrastructure, rail congestion in metropolitan areas and infrequent services. Under current arrangements this makes rail struggle to be an attractive option for distances less than 1500km.

CML rail freights 250 containers from Melbourne to Brisbane a week and virtually none between Melbourne and Sydney and Sydney and Brisbane.

Currently rail is 10% cheaper than road on the Melbourne - Brisbane route, but about 20% dearer than road between Melbourne and Sydney. However price is only part of the picture. Sixty percent of the freight from Melbourne to Brisbane is general merchandise. However, virtually all the perishable food transported from and to Queensland is by road, because it is quicker and more reliable.

Generally, rail suffers because of its inefficient infrastructure on the Eastern north south corridor. The Melbourne-Brisbane rail access path through Sydney, which gives priority to passenger rail services, retards this traffic. Additionally Sydney-Melbourne and Sydney-Brisbane traffic are similarly affected. This will in part be addressed by the development of the new dedicated freight line into Sydney, but not completely.

Melbourne to Perth trains can be 1.8km long compared with 1.5km travelling north to Sydney; a 20% productivity loss on the Melbourne – Sydney line due to shorter passing loops and the need to haul over mountains into and out of Sydney. While the current line upgrades include new bridges and track improvements to raise transit speeds, it is disappointing that the new passing loops being built are 1.5km in length; limiting the size of the trains on the existing north south route. CML believes this may have been an opportunity to begin the upgrading of the line to cater for longer trains.

Currently virtually all the freight task between Melbourne and Sydney is handled by road. This involves in the order of 100 B-Doubles from Melbourne to Sydney each week.

The Adelaide-Darwin rail service, which has the advantages of long trains and double stacking, has yet to prove itself a strong competitor for road because of the flexibility of the road service compared to rail and rail's low frequency (three services a week) while, additionally, rail charges have nearly doubled on the route since its introduction. On this corridor, CML is seeking to dispatch items from its distribution centre in Adelaide direct to the stores in Darwin, at a time that meets the stores' and customers' requirements.

Rail cannot compete on the intrastate and local freight task, because of its limited network, relative to road, its service inflexibility, the amount of time and cost involved in the pick-up and drop-off process relative to the transit time.

Rail can improve its competitiveness in interstate travel through improved infrastructure to increase its integration with road, improved service and reliability and further reduce costs.

Other impediments

As discussed the major impediments to efficient freight movement are:

- Inefficient rail infrastructure on the North-South Eastern freight corridor, particularly
    - Congestion into and out of Sydney
    - No ability to by-pass Sydney on the Melbourne-Brisbane route
    - Height and length restrictions on trains.
    - Inefficient inter modal transfers
    - Scheduling inflexibility and unreliability
- Differing road transport regulations and policies between States.
    - Eg different load limits on B doubles between Victoria and NSW result in B-doubles not operating at optimum levels.
    - Different driver operator hours complicating scheduling
    - The prospect of congestion charges/regulations inconsistent with efficient freight movement.
- Local limitations on heavy vehicle operating hours
    - Limits the window of deliveries to stores impacting on scheduling
    - Increases inefficiencies and complicates delivery scheduling
    - Restricts the ability to work around/avoid traffic congestion peak periods.

Removing the impediments

There is no doubt that State and Federal Governments invest heavily in road and rail infrastructure, as does the private sector. This investment is crucial. However to remove impediments and enable Governments and private sector to invest with greatest effect, a clear agreed national freight strategy is needed. Such a strategy would recognise the freight task as a total interconnected activity, requiring consistent national regulatory and policy approach that rewards efficiency and innovation.

Under this umbrella, State and Local governments could develop freight charges and traffic regulations that are more consistent and supportive.

In developing such an approach, Governments will need to have a clear understanding of the broader community implications that flow from any changes.