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Freight Inquiry
Productivity Commission
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Dear Commissioner

Road and rail competitive neutrality: some core issues

The purpose of this brief submission is to focus on the core issues relating to road and rail competitive neutrality which the Productivity Commission is required to examine in its inquiry into Road and Rail Freight Infrastructure Pricing.

This submission has been prepared in the expectation that, for a variety of reasons, it is unlikely that the Productivity Commission will receive any overt trucking industry submissions that effectively focus on the core issue of "competitive neutrality" which is central to the inquiry. In this regard we note that the first substantive term of reference for the review is that:

“The review will estimate the full financial costs of providing and maintaining freight transport infrastructure on major road and rail networks. It should be based on the principle that prices charged should reflect all costs in each mode and that there are benefits in a national pricing regime. In estimating these financial costs, the review will take account of the extensive research and studies on this issue, including by the National Transport Commission and the Bureau of Transport and Regional Economics”

This submission could reasonably be characterised as a pro-trucking submission which seeks to defend the industry from poorly-based assertions regarding competitive neutrality. These assertions are mostly made by interests associated with the public rail system in Australia.

Ultimately this submission recognises that the Productivity Commission will find that both road and rail have a role to play and each has some positives and negatives in the competitive neutrality balance. But in our view public policy is showing signs of swinging too far in the wrong direction. It will ultimately damage the prosperity and well being of all Australians if policy is formed on misguided basis that publicly rail infrastructure is suffering from an imbalance in competitive neutrality.

This submission argues that on a narrow view of market costs rail infrastructure is significantly underpriced compared to trucking. Moreover, extending the cost boundaries to include “externalities” does not change the overall picture.

Aggregate Cost Recovery

At the broad aggregate level, the Productivity Commission will receive plenty of information about the way in which the Australian trucking industry, in aggregate, on any reasonable assessment, more than pays its way. This information will no doubt include assessments made by the National Transport Commission, which is a national body established by Federal and State Governments for the very purpose of assessing the level of cost recovery and making recommendations on the charges which should apply.

A more sophisticated argument is that while trucking pays its way as an industry, one particular sector does not; namely long distance high volume multi-combination trucks, mainly running on major roads in competition with rail. This particular sector is discussed below.

However, while it is relatively easy to sustain the view that the trucking industry pays its way, the same is not true of the rail sector where:

- Reliable information is difficult to obtain
- Assertions of rail being competitively disadvantaged are confidently made and accepted by key interest groups including the dominant media and most Federal and State governments most of the time
- What information that is available is often suppressed or overlooked as part of an effective program to conceal some inconvenient facts.

However, while the cost recovery outcomes from the publicly provided rail network are substantially concealed, it is clear that, on any reasonable basis, the publicly provided rail freight network currently operating in Australia significantly fails to pay its way or make any reasonable contribution to covering infrastructure cost, unlike every other commercial sector including the trucking industry.

The public network can be broadly divided into four main classes; namely:

- The capital city freight mainline
- Regional branch lines and associated main lines
- Urban commuter networks which also carry in some cases significant freight traffic, and
- Sectors of rail track which carry bulk commodities – mainly coal

Inter capital city freight

As a broad generalisation, the East West capital city route connecting Melbourne, Adelaide and Perth appears to be recovering something in the order of 30% of infrastructure costs.

By contrast the North-South rail route connecting Melbourne, Sydney and Brisbane currently only recovers something in the order of 15% of rail infrastructure costs, on an optimistic assessment. As with the capital city network generally, the above rail freight providers cover their commercial costs including a profit component.

Regional branch lines

Regional branch lines generally carry so little traffic that they are grossly uneconomical. Small branch lines in particular only meet around 3% of their infrastructure costs and contribute traffic to regional mainlines which struggle to cover 30% of infrastructure costs.

Urban commuter networks

Like so much of the rail sector, the urban commuter networks are massively under recovered. They provide a mechanism for governments to ostensibly subsidise transport deprived groups such as students, pensioners and welfare dependant people. At least as importantly, rail subsidies also offer a mechanism to fund providers who in turn are expected to offer support to Governments.

Coal Lines

The principal reason for most of the public rail network being so uneconomic is that Australia often fails to generate the huge volumes of point to point traffic which are necessary for rail to be the economically dominant transport system. However, in a number of cases publicly provided rail does carry bulk commodities, principally coal in the Hunter Valley of NSW and coal in Queensland. In both case the traffic currently meets its costs. The Queensland coal lines in particular continue to generate large supernormal profits which enable Queensland Rail (QR) to sustain its wider grossly uneconomic general rail network and even – more recently – to acquire businesses outside Queensland.

The NSW coal lines are now reaching a similar profitable operational phase, having been transferred from the former dead hand of the NSW State to the Australian Rail Track Corporation.

These limited areas of economically justified infrastructure do not change the overall picture where grossly uneconomic rail lines compete with a limited part of the trucking industry for contestable traffic.

Multi-combination trucks: the B-Double

We mentioned above that, in aggregate, the road trucking industry is fully cost recovered and the publicly owned rail sector falls far short of that commercial goal. However, a more finely grained argument made on some occasions by commercial rail interests is that while trucking pays its way a particular type of truck – the "B-Double" which competes with rail especially on capital city routes – is cross-subsidised as a result of averaging in the charging system. This criticism reflects the fact that the existing pricing mechanisms rely entirely on a fuel charge

and an annual truck registration charge. (The same arguments are also made on occasion about some other classes of intensively worked multi-combination truck.)

The National Transport Commission has also produced estimates that B-Doubles recover some 90% of properly attributed costs. Our first point would be that this cost recovery level – even if taken as accurate – far exceeds the equivalent rail figure. Secondly, the National Transport Commission estimates themselves reflect pressure from rail interests to produce such a result – the principal method used to over attribute costs to B-doubles has been to overestimate the road wear impacts of this truck type.

However, it is also the case that the averaging process over attributes costs to trucks travelling on inter-capital city routes. This happens because the capital city routes tend to be Australia's best constructed roads and these roads would be the least affected by the passage of a truck. For example the extensive sections of road on the Hume Highway which are constructed with concrete appear to show very little road wear from the passage of a truck.

The other significant area of competition between road and rail arises in the use of regional branch rail lines where rail is even more differentially subsidised than elsewhere. In addition, the roads used to transport grain are most often travelled during Australia's typically hot dry summers. Dry roads generally incur far less road wear than roads where the ground is either wet or moist.

A Road Rail Competitive Neutrality Comparison

There is a very substantial imbalance in the relative rates of cost recovery achieved between trucking and rail where they compete. The trucking sector as a whole more than pays its way and the rail freight network which competes with road meets only around 20% to 30% of infrastructure costs.

Transparency: Concealing Facts

It is fairly broadly understood amongst those with an interest in rail that the assessment outlined above are about right. Nonetheless such assessments rarely find their way into the public arena. It is especially difficult to get any recognition of these realities in the face of a concerted effort by well funded rail interest and governments to suppress the true figures about cost recovery levels. There are a variety of reasons for this.

First "everybody knows", in a way that dominates public debate, that rail is always better than road.

Secondly government transport agencies and rail interests, despite what they publicly proclaim, have a shared interest in suppressing the real information so that they can pump additional subsidies into the rail network while asserting that this is being done for good economic reasons.

At this point it might be useful to quickly cite some of the evidence which is available on the public record which points in this direction

Firstly in authorising the access arrangements lodged by the Australian Railtrack Corporation, the Australian Competition and Consumer Commission noted that the rates being charged for “below the rail services” were well below the rates required to meet long run marginal costs.

Secondly, governments continue to provide grants to the rail system which are substantially hidden from view. For example the recent Federal Government budget adds yet more subsidies to the already substantial subsidies provided for the upgrading of the inter-capital city rail network.

Thirdly, a recent major report commissioned by rail interests (the Port Jackson Partners report) made considerable efforts to incorporate certain revealing recommendations. These suggested that when rail interests achieved their goal of pushing up government charges on the trucking industry, and as a consequence rail freight rates could rise, it was desirable that the “below the rail” track provider not be able to raise their charges to an economic level. Rather, all the benefits of any increased charges going to the rail sector should be appropriated by the above rail operator.

(A reality: The principal impact – for rail – of any increase in the costs of trucking would be to provide scope to increase rail freight rates for freight contestable with road. In general, each dollar by which trucking costs were artificially boosted would enable rail to increase its profits \$ for \$. It is therefore not surprising that the incumbent commercially driven above rail operator not only plays a key role within the principal rail interest group, the Australasian Railway Association, but also provided by far the greatest portion of the funding for the Port Jackson Partners report. It's a simple and worthwhile commercial proposition to bend the regulatory environment towards a particular interest, and then to ensure that that tilted “competitively neutral” commercial environment is further tilted so that all the benefits accrue to a particular operator.)

Fourthly, under pressure of fiscal imbalances the New South Wales Government commissioned some 18 months ago a targeted review of selected economically marginal branch lines. The information contained in this review confirms that many branch lines are grossly uneconomic. (Report of the NSW Grain Infrastructure Advisory Committee, 2004).

Finally it's interesting to note the progress with the operation of the Alice Springs to Darwin railway line where reports in the financial press continue to indicate that the new service is not operating commercially. Presumably the \$350 million contributed to this project by the Federal and South Australian governments is now completely lost, but there has not been and generally will not be any acknowledgement of the economic character of this massive investment.

A standard approach used by Federal and State Governments has been to claim at the time of infrastructure investment that an obviously uneconomic investment is economic, suppress all real information, and subsequently write off the expense after the public focus has shifted

elsewhere. The shortness of this cycle for the Darwin Alice Springs line will probably only be exceeded by that of the Perth Mandurah passenger rail line.

Externalities

As it is extremely difficult to sustain any objective argument that rail is disadvantaged in any competitive neutrality analysis of market costs, interest often turns to "externalities" as a way of redressing the balance. The principal externalities examined are typically safety, pollution and greenhouse gas effects

Safety

It is often not recognised that rail, like road, has safety consequences. And the safety consequences of the rail sector are not trivial. Like road, the rail sector suffers from a significant number of accidents and fatalities caused by either suicide or by other persons who are at fault.

However in the road sector the level of accidents is well recognised, whatever the causation. By contrast, it is only been recently that the Australian Transport Safety Bureau has started to collect and publish rail accident information on a similar basis. The usual pattern has been to ignore or overlook rail accidents involving suicide or inebriated pedestrians killed or injured at level crossings. When these sorts of incidents are taken into account, the safety difference between road and rail is nowhere near as large as often cited.

It is for example quite easy to derive the fact that the rail fatality rate per train kilometre is significantly higher than the fatality rate per truck kilometre.

While the costs of accident should not be underestimated, they are not entirely "externalities" a significant proportion of accident costs for both road and rail are covered by insurance arrangements. In short, accident costs are significant for both sectors and not properly characterised as creating a substantial imbalance in "competitive neutrality".

Atmospheric and Noise Pollution

Both road and rail also have side consequences of generating atmospheric pollution. Both sectors have regulatory arrangements in place which are making differences to the rate and volume of atmospheric pollution. Road in particular has been subject to much more stringent regulatory requirements for both atmospheric and noise pollution. By contrast, until recently the rail sector has been largely exempt from regulation in this area and many of the passenger trains operating in urban areas are still highly polluting. Some surveys in Sydney, for example, have suggested that train noise is more a problem than road noise

Greenhouse gas effects

While it is the case that a train carrying a full load of freight produces less greenhouse gases per tonne than a truck carrying a full load of freight, often trains do not operate at capacity so the relative impact may be quite different. In addition, a whole of life cycle approach needs to be considered. For example, a whole of life cycle analysis of the Alice Springs to Darwin railway which took into account the "congealed energy" embodied in the rail track would almost certainly reveal that the greenhouse preferable option would be to continue to use trucks on that route.

Summary

The focus of this submission has been to redress the balance of submissions which the Productivity Commission is likely to receive on the key issue of competitive neutrality.

There is a strong case that far from being disadvantaged in competing for contestable freight, publicly provided rail is in fact substantially advantaged by an in-built "competitive neutrality" bias.

I would be happy to answer any questions you may have.

Yours sincerely

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