



SUBMISSION

Productivity Commission Inquiry: Road and Rail Freight Infrastructure Pricing

May 2006

Introduction

The National Association of Forest Industries (NAFI) appreciates the opportunity to make a submission to this important inquiry. This brief submission highlights some of the key issues that NAFI believes the Commission needs to consider in undertaking this review.

These issues include:

- The encouragement of an infrastructure pricing regime that does not impact on decisions which allow industry to minimise its costs (i.e. the choice between road and rail).
- Infrastructure pricing proposals must allow each mode to operate at maximum efficiency, ensuring that the most appropriate mode is chosen for each element of the transport task. and
- Ensuring recognition of equity between the major roads and highways, and rural and regional roads through any infrastructure pricing proposals.

NAFI acknowledges the aim of this inquiry, which is, ‘to assist COAG in implementing efficient pricing of road and rail freight infrastructure through competitively neutral pricing regimes, in a manner that optimises efficiency and productivity in the freight transport task and maximises net benefits to the community.’

The transport of timber and timber products by both road and rail is a major cost component for Australia’s forest industry. Therefore, any proposed changes in infrastructure pricing for either mode of transport, resulting from this inquiry, would be of particular relevance to industry in its efforts to remain competitive in both domestic and export markets.

The forest industry supports any transport infrastructure pricing regime where there is a direct link between the cost recovered from a particular transport sector and the expenditure on infrastructure allocated for that particular sector. The process to determine such cost allocation should be transparent and should not include additional and unwarranted taxation or other cost impediments of either the road or rail transport sectors.

Road, Rail and the forest industry

Australia’s forest industry relies heavily on both the road and rail freight systems for the transport of its timber and timber products. Freight is a pivotal cost and profit driver for the

industry in transporting logs from the forest to the processing site, and transporting processed timber products to the market.

The haulage of logs from the forest to the processing site constitutes the majority of the transport task and therefore cost. This task involves a much higher proportion of travel on rural and local roads as compared to the transportation of processed timber products to the market, where travel is more confined to the established state and federal roading networks.

It is clearly apparent that the current sharing of funding raised for road funding is not equitably shared between the three tiers of Government. In particular, the local government sector appears to be under resourced, whilst this is not specifically the subject of this review, we believe any on-going failure to fairly address this issue could have serious ramifications.

The forest industry is currently far more dependent on road infrastructure than rail. Statistics show that 94.5% of round logs transported in Australia is by road, 4.8% is by rail, and the remaining 0.7% is transported by coastal shipping.¹

This high level of dependence on road is mainly due to the strong primary production aspect of the industry, which usually involves the sourcing of timber from forests that are remotely located and generally inaccessible to suitable rail networks. As such, it is often impractical and uneconomical to transport timber solely, or mostly, by rail from the forest to the processing site.

In the cases where rail is used to transport timber to the processing site it is often for the 'last leg' of the journey, where rail networks, near regional centres, are more established and readily accessible. This assists in reducing the volume of truck movements through the more traffic congested and higher populated areas.

Over time, the utilisation of rail infrastructure by the forest industry is expected to increase, due to an increase in activities such as the expansion of Australia's export woodchip industry and the various proposals for new pulp mills throughout southern Australia. As a result, many of Australia's forestry organisations are examining the practicalities of greater use of rail infrastructure for the transport of timber and timber products to processing facilities, markets and ports.

The industry is aware of a number of issues which require attention before an efficient and effective transfer of freight from road to rail can be achieved. These issues include the lack of standard gauge rail throughout Australia, resulting in a need to transfer loads. There is also the inability to achieve 'door to door' delivery, resulting in a split haul penalty, double handling costs and a higher level of product damage. Also, as mentioned previously, there are too few rail lines on some routes, or limited opportunities where freight can be moved in the required time frames, when compared with road transport.

There is also the issue of the long term neglect of certain rail networks, which often effects decision-making when it comes to choosing between road and rail as an appropriate and reliable means of transport. Reduced levels of freight on neglected rail networks, insufficient charges to cover operational costs and poor revenue generation often combine to prevent an adequate level of maintenance and upgrading of rail infrastructure. This may compromise the overall integrity of certain rail networks, often making road transport a more attractive and viable alternative.

¹ Australian Bureau of Statistics (2002). *Freight Movements: Australia Summary*.

Implications for the forest industry

While there is some scope for the forest industry to move towards a greater integration of road and rail freight systems, there are clearly a number of issues which need to be resolved in order for this transition to be carried out effectively and without unfairly disadvantaging either mode of transport. For instance, the improvement of rail infrastructure may, in part, require a significant commitment of government expenditure, but this should in no way compromise the equivalent expenditure on road infrastructure.

The National Transport Commission's (NTC) recent process for determining heavy road vehicle charges, 'Third Heavy Vehicle Road Pricing Determination', highlighted some key concerns for the heavy vehicle transport sector and the many industries that it supports, including the forest industry.

Paramount among these concerns was the notion put forward by the NTC during the review that 'heavy vehicle charges no longer reflected their costs of using the road network.' In countering this argument, the Australian Trucking Association (ATA) estimated that \$1.65 to \$1.8 billion is currently collected from fuel excise and heavy vehicle registration charges annually in Australia, which is well above the revenue target of \$1.62 billion proposed by the NTC during the review.

Further supporting this stance that the heavy vehicle sector is 'paying its way', in the NTC's second charges Determination in 2000, it was estimated that the heavy vehicle sector paid \$1.39 billion in road user and registration charges. This was 9% over and above the estimated road expenditure (\$1.28 billion) attributable to heavy vehicle use.

The forest industry was concerned with the assumption made by the NTC in their charging methodology, that the costs of constructing and maintaining the road network, is equal to the overall expenditure from governments. For instance, the forestry industry is already required to pay significant additional and direct costs to upgrade and maintain local government roads, in order for timber haulage operations to proceed.

The current recovery of heavy vehicle fuel taxes and registration charges has a greater impact on the regionally based forest industry than many other sectors. While the industry more than pays its share in fuel excise and registration charges, it is less exposed to the benefits of government road funding. This is because the haulage of timber and timber products constitutes a high proportion of the cost of getting the product to the market, however transport in the industry is concentrated on local and rural roads which unfortunately attract the least amount of government investment. As noted earlier this is an issue in need of urgent attention.

If funds are collected on the basis of heavy vehicle damage to our roads, then surely those funds should be used to upgrade and improve the road network on an equitable basis between major arterial and secondary road networks. It is quite unreasonable for industry to pay the higher road user charges and, in addition, continue to pay for the repair of the local road network, due to the long-term under-funding of road and bridge upgrading in rural areas.

The Australian Transport Council's rejection of the NTC's recommended charge increases highlighted the recognition that the heavy vehicle sector is 'paying its way' and the timeliness of increased charges was not appropriate in the current environment with issues such as significant increases in fuel costs.

Infrastructure Pricing

NAFI supports COAG's objective of 'implementing efficient pricing of road and rail freight infrastructurein a manner that optimises efficiency and productivity in the freight transport task and maximises net benefits to the community.' However, 'consistent and competitively neutral pricing reform' may not necessarily be the best way to achieve this objective, particularly where there are fundamental differences in the characteristics between the road and rail transport sectors.

Competitive neutrality in the context of road and rail should be considered separately to previous cases in Australia's microeconomic reform agenda, where intervention promoting competitive neutrality has been successful. It is important to remember the context and the specifics of the previous cases where the promotion of competitive neutrality was a success.

In these previous cases, public utilities competed with the private sector, as both provided a relatively homogenous and highly substitutable product or service. They were also part of a large market that was responsive to price fluctuations and contained a large number of customers all intent on maximising their utility for a product or service. The fact that the product or service was highly substitutable encouraged competition and promoted incentives for improvement and innovation as well as delivering lower costs.

Intervention to promote competitive neutrality made sense in these cases. However, its application to road and rail may be quite different to these cases, and as such, may fail to deliver the same level of benefits.

It is important to note that road and rail freight transport systems contain some fundamental differences which complicate the objective of 'consistent and competitively neutral pricing reform' between the two modes. These include differences in available markets, which are determined by the highly variable nature of the freight, and differences in haulage lengths and available access to infrastructure. There are also large variations in client expectations and the common use of infrastructure with both private and non-freight users.

Importantly, consideration must be given to the fact that only a small proportion of the road and rail freight market is substitutable, as only around 10% of land freight is contestable between the two transport sectors. Also, road and rail are increasingly not providing a highly substitutable product or service and cost is not the sole consideration for a freight customer when choosing an alternative mode of transport.

Therefore, it may be counter productive to seek competitive neutrality between road and rail infrastructure pricing as its application will be very limited and more than likely ineffective. Any such intervention in pricing may inadvertently cause an increase in freight costs resulting in negative implications for reliant industries and the broader Australian community.

While some degree of government intervention in the road and rail transport sectors is inevitable, it should be in limited areas to allow modes to compete on their individual merits to drive efficiencies. There is an argument that in recovering infrastructure costs and imposing price controls, government may in fact cause an anti-competitive environment within those freight markets where road and rail are possible substitutes.

Additional government intervention will do little to enhance the free and unhindered operation of markets to encourage the most efficient economic outcomes. Therefore, there is a

strong argument that government intervention should be kept to a minimum, and where it is considered necessary, should be applied using best practice regulatory principles.

A more viable solution would be to optimise the efficiency and functioning of both the road and rail transport sectors prior to introducing a further and potentially distortionary pricing adjustment for both modes, which may disadvantage either sector.

Conclusion

In line with other Australian industries which depend heavily on freight, the forest industry is likely to experience a significant increase in its freight task over the next decade. To ensure an efficient expansion of this activity, it is critical that both road and rail transport modes operate at optimal efficiency, both in isolation and through the encouragement of complementary inter-modal integration.

Therefore, caution must be taken to avoid any form of government intervention which would cause an anti-competitive environment between road and rail. This could result in sharp rises in transport costs for either mode, impacting on the international competitiveness and domestic viability of freight reliant industries, such as the forest industry.

It is important to maintain the current effort, through the NTC and COAG processes to advance road and rail regulatory harmonisation, and increase investment in transport infrastructure, across both modes.

The forest industry advocates an infrastructure pricing regime that encourages a more efficient use of road and rail infrastructure by promoting improvements in productivity, safety and environmental sustainability and recognises equity between major arterial and secondary road network funding.