PRODUCTIVITY COMMISSION INQUIRY INTO FREIGHT INFRASTRUCTURE PRICING

Supplementary Submission - Discussion of Rural and Regional Impacts

August 2006

Prepared by

National Transport Commission

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Report Prepared by: **National Transport Commission**

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REPORT OUTLINE

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Abstract:	This paper seeks to explore how adverse impacts on rural regional areas resulting from direct pricing for heavy vehicles may be mitigated. alternative options in addressing community service obligations under a direct pricing framework for heavy vehicles. The paper discusses the current approach taken to implementing community service obligations as well as identifies three approaches under a new regime. It also considers the insitutional implications of implementing transparent community service obligations.
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FOREWORD

The National Transport Commission (NTC) is an independent body established under an Inter-Governmental Agreement, and funded jointly by the Australian Government, States and Territories. The NTC has an on-going responsibility to develop, monitor and maintain uniform or nationally consistent regulatory and operational reforms relating to road transport, rail transport and intermodal transport.

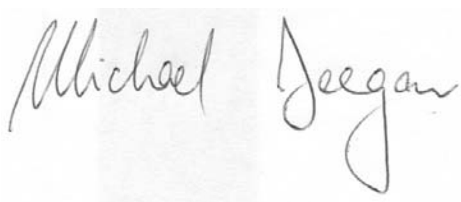
The NTC's heavy vehicle road pricing work contributes to strategies pursuing transport as a more sustainable activity, and in devising smarter approaches to regulation, provides both increased flexibility and greater certainty about results achieved.

The NTC has produced this paper to assist the Productivity Commission in its thinking on issues relating to its Inquiry on Road and Rail Infrastructure Pricing. Specifically the Productivity Commission raised the issues of impact of direct prices on rural and regional areas in its Issues Paper released in February 2006. The NTC believes this is an important issue and has therefore further developed its thinking beyond its initial submission to the Issues paper in May 2006. This paper discusses how the current pricing regime addresses subsidies for rural and regional areas and considers how adverse impacts of direct pricing on vulnerable customers could be mitigated through community service obligations and industry subsidies.

This project is critically linked to:

- the capability to implement future road pricing systems including incremental pricing and potentially a national direct pricing system;
- effective extension of Performance Based Standards to support additional productivity improvements in movement of road freight, which will require an ability to determine charges for additional mass increases based on accurate assessments of the resulting road costs; and
- the Intelligent Access project which will be effectively implemented from late 2006.

The NTC acknowledges the work of the following members of the NTC Transport Pricing Team, Meena Naidu, Fiona Calvert, Paul Sullivan and Barry Moore.



Michael Deegan
Chairman

SUMMARY

The Productivity Commission has been asked to conduct an Inquiry into road and rail infrastructure pricing. Its terms of reference has specifically asked it to consider the rural and regional impact of a movement towards a form of direct pricing.

As discussed in the NTC main submission, direct pricing can deliver a number of productivity benefits in providing the correct signals for optimising road use and investment. However, the individual nature of direct pricing coupled with the extreme diversity inherent in the road sector (in terms of trip distances, road type, vehicle type and payload), means that there could be considerable differentiation in prices. Rural and regional areas are most likely to feel the effects of this price differentiation due to the considerable distances involved and the low levels of traffic which would be expected to recover the cost of the road. Ultimately this may lead to the cost of some freight goods increasing (although it also possible that some costs could decrease with vehicles that are not used year round not paying as high an annual cost). In a worst case scenario, this could make the cost of living in some communities higher.

In essence, direct pricing may deliver considerable benefits but it does not necessarily adequately take social benefits into account. It is in this situation, the market is said to have failed to adequately provide for the community. This does not mean that direct pricing should not be considered. Instead it requires further thought as to how undesirable outcomes may be mitigated.

Historically governments have addressed this problem though the application of community service obligations. Community service obligations are a required minimum level of service the government requires from service providers. The obligation may not necessarily be commercially viable but is deemed important to meet a social policy objective. Where it is not commercially viable, the government provides funding support through subsidies, grants and rebates (either explicitly or implicitly). The concept was primarily developed as a result of privatisation, where the private sector did not always have adequate financial incentives to provide a universal minimum level of service at a price which particularly vulnerable members of the community were able to afford.

Whilst the term “community service obligation” is often bandied around as a solution for meeting governments social obligations, it is important to note that they can have a distortionary effect if not implemented properly – they can do more damage than good and not benefit the intended recipient. A community service obligation is also often incorrectly referred to in terms of an industry subsidy. An industry subsidy is provided by government to selected industries which government has identified for assistance. This maybe for a number of reasons, the most obvious for Australia being security of supply. This may be the case for agricultural products for example. Whilst these subsidies may be important, they are not strictly a community service obligation as they do not strictly service a particular community.

The current regime implicitly deals with community service obligations and industry subsidies through the averaging process within the pricing regime. Prices are currently based on average costs across four road types and usage within the various vehicle categories. This means that vehicles that operate below the average (low cost roads and low annual kilometres) are subsiding those that operate above the average (high cost roads and annual kilometres). The problem with the current approach is that the cross subsidy is non-transparent and very indiscriminate. Recipients of the benefit may not be targeted beneficiaries.

Going forward it is expected that community service obligations will become more transparent. This is always preferable as it is clearer who is being targeted and whether the approach taken is being successful in achieving the objective. There are three ways in which a community service obligation may be implemented in the road sector. They are summarised in the table below:

Approach	**Features**
Adjusting the cost base	• Similar to the approach taken now • Blunt approach • Treatment of historical costs under a WOLC approach complex • Although transparent in identifying exact Community service obligations costs, achievement of policy objective highly dependent on cost classification categories and structure of charges.
Adjusting prices on Community Service Obligation roads	• Relatively simple • Community Service Obligation is explicit • Better when targeting vulnerable communities • Others may benefit other than the intended recipients
Offering a rebate	• Better when targeting industry • End customer may not receive the full benefit if it is offered to other parties • Could be administratively complex

Whatever the approach adopted there will be a number of issues which will need to be resolved. These include how the community service obligation is valued, who should have responsibility for declaring and paying for a community service obligation and what institutional framework will be required to support them given the three levels of government and multi-jurisdiction. It is expected that the first step will be to establish a national social policy for the provision of roads services, which will need to address service provisions for both heavy and light vehicles.

It is important to note that each of the approaches identified above are best not universally applied. They each work well in different circumstances and each have their challenges implementation. It is also important to note that it is not essential to only adopt one approach. The adjustment of prices option can work side-by-side with the offering of a rebate. Whatever approach is taken the benefit will only be achieved if the obligation is clearly articulated and can be justified on a social basis.

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1. INTRODUCTION

The Council of Australian Governments (COAG) has requested the Productivity Commission undertake an inquiry into road and rail freight infrastructure pricing. The Productivity Commission sought submissions from key stakeholders and interested parties in response to its Issues Paper, which it published in March 2006.

The NTC made a main submission responding to the issues raised by the Productivity Commission in its paper. However, there were a number of issues which the NTC believed required further consideration. This supplementary submission seeks to further examine the issues surrounding the impact of direct pricing on rural and regional areas and the application of community service obligations.

In calculating national heavy vehicle charges the current pricing regime is based on averaging across vehicles (within each vehicle class), road types and traffic densities. More direct pricing arrangements could allow pricing based on other characteristics and features such as mass and distance of individual vehicles , road types and (in effect) traffic densities. A movement to this form of pricing regime is expected to have considerable benefits in terms of optimising the use of the existing network as well as optimising future investment (making the right investment at the right time). In effect, this type of regime is expected to result in considerable productivity gains.

However, some communities may face greater differential pricing. Rural and regional areas are particularly susceptible to this due to the associated long distances, road types and lack of scale economies associated with low traffic density. A movement away from the current approach of average prices across road types and within vehicle classes is likely to result in a considerable price decreases in transport for some locations and considerable increases in others. The impact is heightened by the general lack of an alternative form of transport. Normally higher prices would provide an incentive for modal shift – i.e. movement of freight from road to rail. However, most rural and regional areas have only limited, if any, access to the rail network. Therefore the ability to mitigate the increased transport costs is limited. The choices for freight users in some locations in response to higher prices that reflect the true cost of using the relevant roads are therefore to reduce road use, relocate or accept lower profit levels. Thus, a move to direct pricing may have significant distributional and transitional implications, which would need to be managed in some way.

This result may be contrary to government policy, in particular social and economic development policies associated with rural and regional areas. For example, higher community transport costs may influence investment decisions in government support services such as health and education. The extent to which this may occur under a partial pricing approach (i.e. increased costs of only heavy vehicle transport) is uncertain, but clearly less than if direct pricing arrangements were also to apply to light vehicle traffic.

Another example is the contribution a particular community may have on the broader economy. A good example of this is an agricultural area. If the cost of transport and living in such an area increases significantly, it may lessen the competitiveness of the agricultural sector and have subsequent macro effects on the economy. Although this might economically be justified at a local level, it may result in a high transitional cost in the short term which may be contrary to government policy. Social impacts may also be significant, with the potential for regional populations and remote communities to become unviable, if living costs increase substantially or transport services are withdrawn.

In circumstances such as these governments may decide to apply a community service obligation . A community service obligation is a service which would otherwise not be provided by an organisation as it fails to deliver sufficient financial returns. However it is deemed by government as the least cost option for fulfilling an important policy objective. Government funds any gap between revenues received for service provision and costs associated with provision. The concept was originally introduced as a means of ensuring that a minimum level of public services were still provided under a privatised environment. It ensures that vulnerable communities continue to have access to essential services regardless of cost. A community service obligation is an important instrument in addressing rural and regional impacts. However its application is not limited to only these areas but to any situation where commercial returns of a service are not sufficient to achieve a government policy objective.

In addition to providing support for vulnerable communities Government may want to support specific industries. This may be for a number of reasons including security of supply[1]. This is less of a community service obligation and more of an industry subsidy. Both industry subsidies and community service obligations can be applied in a number of forms – through a transparent direct subsidy or grant or through less transparent cross subsidies within pricing arrangements.

However, it must be recognised than any community service obligation and any industry subsidy will lead to a distortion away from the economically efficient outcome. That is, the amount of road use by heavy vehicles, location of businesses and so on will not reflect the lowest total cost to the nation as a whole. Consequently, road use patterns will be distorted from the optimal in some way. That said, these distortions would be explicitly agreed as necessary to meet other social and economic objectives.

It is important to note that the cost of a community service obligation is the cost over and above the commercially viable cost and includes both capital and maintenance costs. As will be discussed in the paper, different approaches to applying community service obligations vary the potential cost of providing the community service obligation. This is because different approaches have varying distortionary effects which may accelerate deterioration of the road and increase maintenance costs.

The current PAYGO regime incorporates a very blunt and non-transparent approach to addressing community service obligations. Any movement away from this approach will almost certainly be an improvement with community service obligations and industry subsidies being more targeted and transparent. It is important to note, however, that even with direct pricing there will still be an element of averaging and therefore cost subsidies will be an inherent feature of any pricing regime. The transaction costs of calculating exact costs of usage for individual vehicles and individual road links are prohibitively high due to the near infinite combinations of usage. A movement to direct pricing will reduce the level of cross subsidy. However as this paper will discuss, the inherent inefficiency of a community service obligation as well as the complexity of the road sector means that any approach taken will have it own problems.

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[1] Governments may support an industry to ensure there is local production of essential items (such as food) in case there is a disruption to international supply.

The remainder of this paper discusses the treatment of community service obligations and industry subsidies in the current heavy vehicle road charges environment and the options for the application of these subsidies under a direct pricing regime. The paper does not discuss where it may be appropriate to apply a community service obligation or industry subsidy as this is an issue of government policy. It does however distinguish between a community service obligation and an industry subsidy. A community service obligation is deemed to enable the provision of a minimum level of service expected to be provided by Government. An industry subsidy supports particularly industries deemed important by government.

2. TREATMENT OF COMMUNITY SERVICE OBLIGATIONS

2.1 Community service obligations and industry subsidies under the current heavy vehicle charging environment

The current heavy vehicle pricing regime averages costs across four road categories (urban and rural local roads and urban and rural arterial roads) and usage within each vehicle class. As a result there is a considerable level of cross subsidisation across and within vehicle classes. In essence this means that some transport operators pay more than the cost they incur on the road network whilst others pay less. Despite the fact that operators pay a fuel charge which is strongly related to the distance they travel, it is thought that operators on rural and regional roads often pay less than the cost they incur on the roads they operate on.

This is for three primary reasons. First, they travel distances greater than the average distance within their vehicle class. This means the additional distance they travel is in effect paid for those who do less mileage. Second, the cost of maintaining rural and regional roads are often greater than the average cost in a road category and therefore those operating on better quality roads within a given category are cross subsidising higher cost roads. Third, travel on long distances is generally more fuel efficient (as vehicles are more likely to be able to travel at free or uncongested speeds, with less acceleration and braking, and the most fuel efficient vehicles are more likely to be used on these long distance trips as fuel is a higher proportion of total operating costs). The fuel charge is not a perfect proxy for a distance charge and those that operate in urban areas (with more stop/starts), do shorter trips or use vehicles which are less fuel efficient subsidise others.

Figure 1 shows the level of cross subsidisation within vehicle classes (excluding cross subsidies between road types). The graph shows that those vehicles travelling high distances and high masses incur a greater cost than the average, yet recover a little less than a third of that cost.

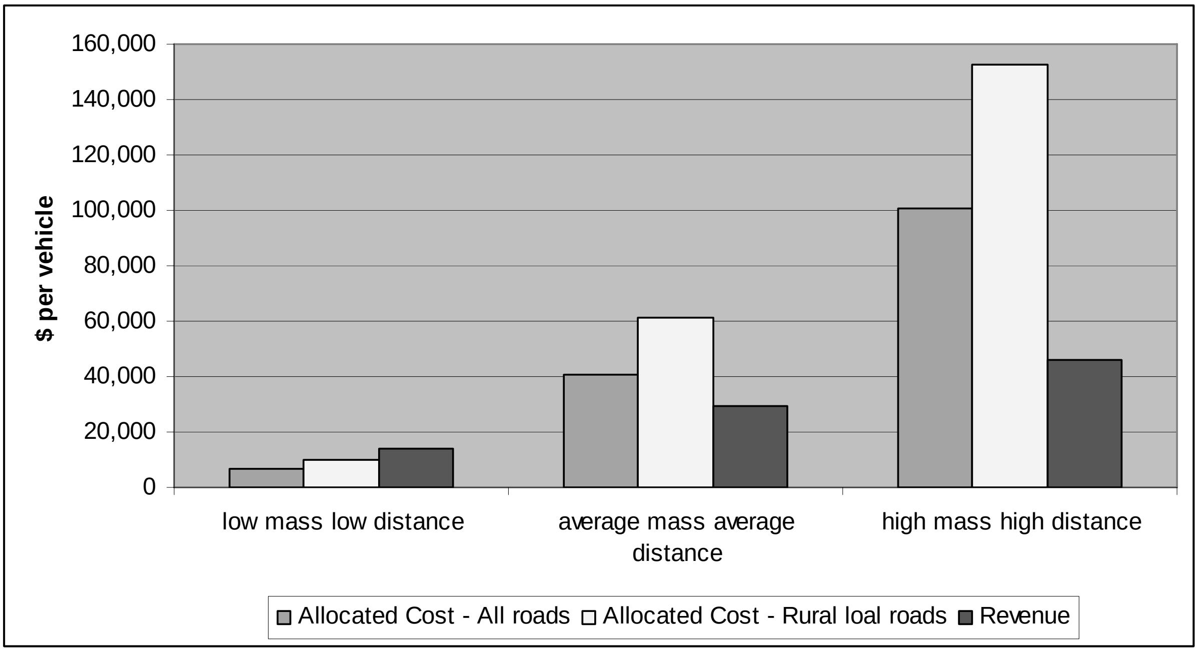

Figure 1. Cross subsidies within the current costing system

It should be noted that some road freight operators in rural or regional areas do not travel high annual distances. This is because the size of the local freight market or task that they serve is relatively small. These operators will not be cross subsidised in the way shown in Figure 1, but would over recover road costs averaged across vehicles within a class. Once averaging across road types is removed, the unit costs on the roads they use may increase. That is, they may currently under recover road costs averaged across road types. It is not possible to judge how these effects will balance out at this stage.

However, in most areas where there is a mix of road use and road types, the under and over recovery of operators may net out so the impact on transport costs for a community may be reduced. However in areas where there is not an infrastructure and usage mix, communities may be paying more or less for freight transport through the price of the goods they purchase. This is the situation in those rural and regional areas where the two factors of distance and scale mean that not only do operators benefit from subsidised operating costs but so do the communities they service. In this way a community service obligation has effectively been provided through the cross subsidies inherent in the current regime.

A number of points should be noted about the application of community service obligations in the current pricing regime. Whilst the community service obligation is provided, it is not explicit, it has not been quantified and does not respond to any specific government policy. It is, in effect, indiscriminate. In that regard it could be seen more as a coincidence that communities that may have been targeted for a community service obligation receive one under the regime. Similarly communities that may not have been targeted for a community service obligation may also receive one. Therefore this approach may cause a distortionary effect greater than what would otherwise occur.

Transparency in community service obligations is generally considered a desirable feature as it has less of a distortionary effect. Cross subsidies are not very transparent. Despite this, it could be argued that a cross subsidy will encourage the efficient delivery of a community service obligation. The argument is a direct subsidy may not be efficiently delivered as there is no incentive for the service provider (in this case, road managers) to do so. Conversely, if the provision of the community service obligation impacts on the financial viability or profitability of other services, there is an incentive to deliver the community service obligation for the least cost possible. However, this argument is less likely to be relevant in the road sector, which is not subject to full commercial incentives for efficient delivery of road services. Therefore the approach taken to community service obligations in the current regime could be considered sub-optimal.

2.2 The impact of a change in the price structure

Direct pricing is intended to ensure that operators pay for the service provided i.e. for the road that they operate on. In doing so, cross subsides are completely or largely removed as costs are recovered on the basis of individual use of the network as opposed to average usage. Whilst this is desirable and ensures that people receive correct price signals related to their individual usage, there may be adverse impacts in certain communities where the benefit of the service provision may extend beyond those who are required to pay for it. For example, direct pricing is likely to affect the agricultural sector. Whilst initially farmers may be required to pay higher transport costs[2], the expectation is this would be passed on to customers, including those in lower socio-economic groups. Government may wish to reduce or eliminate the impact of the higher transport cost.

There are three approaches which could be taken in the application of community service obligations and industry subsidies in a direct pricing environment —directly adjusting the cost base, adjusting prices of specific roads or providing rebates. Although all three have difficulties they are all generally preferable to the current approach primarily because they are more transparent and would be more targeted.

One of the greatest challenges in implementing direct subsidies, regardless of the specific approach, is determining the appropriate value of the subsidy. This is particularly an issue in the road sector because of the diversity in road type and use.

One of the issues associated with the valuation of community service obligations is the extent to which the service is a universal service obligation. A universal service obligation is a basic essential service which government is expected to deliver. It could be argued either that this should be paid for through general taxation and therefore users of that service should not incur a further charge or that a uniform charge should be applied. Access to a road network is generally accepted as being a universal service obligation. However, this does not mean the full cost of a road can be attributed to access and therefore paid for through general taxation. Arguably the access component of road provision is the cost of providing a basic road network at a relatively low design standard (sufficient only to meet the minimum level of service you would expect to provide to any community). Service provision over and above this basic standard may still be required to support a community but does not have the same universal benefit as general access. The standard of the road provided over and above the basic and economic levels is not necessarily expected to be provided at no cost, but at a reduced cost.

In the context of a rural or regional road, a very basic road could be argued as satisfying the general access requirement of a community service obligation. This is likely to be paid for by government. Further economic activity may justify a slightly greater design standard – this higher standard would be paid for by the users of the road. However because of the small community the road may service, and the distances involved, any economic activity may not justify a considerable improvement in the standard. Government may therefore decide to provide a higher standard still, to better facilitate the movement of say agricultural vehicles. The cost of this would be expected to be shared between those users of the network and government.

An additional issue to be considered when valuing a community service obligation is the price signal it will create. Traditionally community service obligations have been developed to ensure that government responsibility to provide basic public services continues in the face of privatisation. They are therefore generally targeted at vulnerable members of the community who are less likely to change their consumption as a response to the lower price (i.e. they will not adversely respond to a distorted price signal). For example, pensioners who receive a discount on their water bill are less likely to consume more water simply because it is cheaper. They are in effect, budget constrained.

[2] It is worth noting that the costs to farmers of operating their own vehicles may well decrease, as generally farmers operate very low annual distances, and often operate vehicle types (for example, rigid trucks) for which there is currently over recovery.

However, community service obligations are increasingly being used beyond their original mandate where instead of targeting vulnerable members of the community, they target vulnerable industries. This is particularly the case in the road sector where there is considerable diversity in the use of the network and the consequential impacts on communities of transport costs. However, as mentioned above, a community service obligation can often result in a distorted price signal – consumers who may not suffer a budget constraint may ultimately pay less than the actual cost of providing the service and therefore may be encouraged to use it more than is optimal or efficient. This will further increase the cost of providing the service through increasing the maintenance cost associated with the road.

This may well be the purpose of the community service obligation. However, the extent to which this distortion occurs must be considered in the development of the community service obligation approach. This outcome is more likely to occur in an environment where a subsidy is applied to a community that does not face a budget constraint in order to achieve an industry outcome. Therefore, if an industry is being targeted it may be more appropriate to offer a rebate rather than allow for a flat reduction in the price of the road in question. However, if the objective is to ensure the survival of a particular environment, the community will already be budget constrained (hence the requirement for a community service obligation). Therefore reducing the price of a road servicing that community is unlikely to lead to over use of the asset.

A further issue is who will set the community service obligation. Depending on the service provided, the community service obligation in most other sectors is generally set at either State or Federal level through the respective Treasury. However, the road sector is complicated due to the multi-jurisdictional nature of its provision and the impact that even local networks can have on the broader state or national economy. To that extent, the benefits of a community service obligation may not be derived by the jurisdiction responsible for providing a particular road. This raises the question of who should bare responsibility of paying for a community service obligation. A further issue is the extent to which local governments are in a financial or legal position to determine and pay for a community service obligation, despite the local governments arguably having the strongest policy objectives for doing so. Therefore a clear national policy on community service obligation provision will need to be established, as well as a state level policy, both of which may need to apply at local level. In doing so, it will be clearer who has responsibility for the cost of providing the community service obligation.

2.2.1 Treatment of subsidies through adjusting the cost base

This approach most closely resembles the subsidies provided through the current regime. It essentially involves the exclusion or only partial inclusion of costs associated with the community service obligation which is then reflected through prices. It can be adopted under either a PAYGO or whole of life cycle costing approach and in effect targets a community (rather than an industry) as all users of the road would benefit.

Under the PAYGO approach, the costs included in the revenue requirement are reduced by the amount the government wishes to subsidise. The difference between this approach and the current approach is that the under-recovery would not be made up with an over-recovery in other areas. That is, there is no cross subsidisation.

The extent to which this approach is successful depends on the linkage between the cost base and the price structure as well as the price structure itself. If costs are not appropriately allocated, it is possible that the intended recipients will not benefit from the community service obligation. This is likely to be the case anyway, as even if the costs are properly attributed, they will be attributed to a road category which is likely to be based on road characteristics. The approach would be considerably less targeted than alternative approaches and could very well result in a reduced cost for all roads within a certain classification rather than specific roads which are considered a community service obligation.

The extent to which this is a problem is dependent on the classification system which supports the price structure. With this approach, there would be no further adjustment of prices as this would lead to a double counting of the community service obligation.

This approach has the disadvantage of being non-discriminatory over different users of the community service obligation road – there is in effect a distortion in the price signals that reaches further than the social benefit. Whilst the transport of essential goods and services would benefit from the reduced road cost, other more discretionary road users would also benefit. For example, it might be decided that a particular road should be regarded as a community service obligation in order to support a specific industry located on that road. However, all other industries serviced by the road would also benefit, and may result in higher levels of use by trucks supporting these other industries than would be otherwise justified. As a result, the potential for an inefficient outcome is greater under this option. This could lead to greater maintenance and operating costs than would otherwise be the case. These additional costs would need to be incorporated into the community service obligation cost or else it would simply increase the price associated with the road and mitigate the community service obligation benefit. The concern is that the cost of any free riding behaviour may outweigh the cost of an alternative approach which seeks to minimise this behaviour.

This approach also makes the accounting of historical costs cumbersome if there is a movement in costing methodology to a whole of life cycle approach. A historical value of assets is required for a whole of life cycle approach to establish an opening regulatory asset base. The Regulatory Asset Base is the basis upon which returns on and of capital are applied. If a community service obligation is addressed through the cost base, then it would be reasonable to deduct partially or fully those community service obligation roads that are in the opening Regulatory Asset Base [3]. Historical expenditure on the community service obligation would need to be estimated and explicitly excluded from the cost base. Again, depending on the attribution and cost classifications, this may not fully be reflected in prices for the targeted recipients.

Under PAYGO the treatment of historical costs is not an issue as they are treated as already recovered.

A complication of adjusting the cost base is that any system of road freight infrastructure pricing will be a partial system, where only part of the use of the road, and consequently only part of the costs, is considered. If community service obligations are to be provided by adjusting the cost base, a distinction will need to be made between the heavy vehicle related share of costs and the total costs of providing and maintaining the road asset.

[3] The calculation of the Regulatory Asset Base is complicated because it can be argued that a large portion (if not all) of the network has already been paid for through past road charges. However, this paper assumes that there is an outstanding balance in the Regulatory Asset Base and that this would include capital expenditure undertaken to achieve social objectives. A more complete discussion of calculating the Regulatory Asset Base is contained within a separate NTC technical supplementary submission to the Productivity Commission Inquiry.

2.2.2 Treatment of subsidies through adjusting prices

An alternative is adjusting prices road operators are subject to. This approach is considerably more targeted than an adjustment to the cost base. As with an adjustment to the cost base, it best addresses community service obligations targeted at communities rather than industry.

The adjustment would be made by identifying those road services which are to be deemed community service obligations and applying a lower price to them – this could be done by applying a lower cost road classification to the community service obligation road or by discounting it by some other means. The cost base itself would include the full cost of service provision. The government supporting the community service obligation would then pay the relevant road agency the difference between cost and receipts for the provision of the community service obligation. This treatment is relatively simple and transparently allows for the passing on of the adjustment to end customers. It is therefore a relatively attractive approach to adopt.

The cost of the community service obligation can be relatively simply established by multiplying use of the road by the difference between the full cost price and the community service obligation price.

The further benefit of this approach is that historical community service obligations are more easily addressed. As discussed above, a historical cost base is required for a Regulatory Asset Base under a whole of life cycle costing approach. Where prices are adjusted, historical community service obligations need not be explicitly accounted for. Instead, they are taken into account with the adjustment of the price itself.

The key disadvantage of this approach is the free rider problem discussed above, which results from the non-excludable nature of the road network. However as discussed, vulnerable communities are less likely to respond to a distorted price signal because of their budget constraints. Therefore, this is likely to be a relatively minor issue if it is not used to provide industry subsidies.

2.2.3 Treatment of subsidies through rebates

In this approach, operators are charged the full cost of operating on roads. Targeted rebates are then offered to offset the impact of the charge. This approach is more attractive in the provision of industry subsidies rather than community service obligations.

The most simple method to administer the rebate would be to determine a set rebate rate (or discount amount) and apply the same amount to nominated industries operating in specific areas.

However, this approach may not adequately address government policy on specific industries. The difference in road prices may mean that a uniform discount would favour some areas over others and not provide an adequate subsidy in some areas to sustain the industry. If this is the case, a rebate option would become more of an administrative burden.

A rebate system is unlikely to be successful in targeting community service obligations. The individual nature of this approach would make it administratively cumbersome. Whilst it may be simple to think that general categories of users could be created to reduce this burden, it is important to remember that there are multiple policy objectives of road community service obligations and there are multiple categories in a direct pricing regime.

Furthermore, different people would consume transport at different rates. This creates a large combination of rebate options for a charging body to manage. Whilst a flat rebate may be offered to simplify matters as with a flat rebate for industry, this may not be equitable and may not achieve the policy objectives the community service obligation was intended to address.

Furthermore, the method by which the rebate is offered is important – especially if it is offered to members of the community. The experience of rebates in other sectors suggests that people will not necessarily claim a rebate even if they are entitled to them or would suffer considerably without them[4]. In utilities this issue is generally addressed through the rebate being automatically deducted from customers bills. However, this would be a difficult option in the road transport sector as end users may be removed from the transport component of the supply chain.

Offering the rebate to businesses or road operators may improve claim rates. However, it may not be transparent enough to ensure the flow through of that rebate through to end users – operators may try to benefit from the rebate. Therefore, the rebate may not fully achieve the policy objective intended.

Ultimately because of the complexity of this approach, its broad use (i.e. applying it to both community service obligations *and* industry subsidy) lends itself to the greater possibility of double dipping, where a community service obligation is effectively paid for more than once.

[4] This has been found to be the case because of the social stigma of receiving a benefit or the inconvenience associated with the claiming of a benefit.

3. INSTITUTIONAL ARRANGEMENTS TO SUPPORT SUBSIDIES

Section 2 described some of the difficulties associated with each approach to apply community service obligations and industry subsidies. However, as mentioned in the introduction to this paper, any approach will have difficulties due to the multi-jurisdictional nature of provision of the road network. This chapter seeks to discuss the policy framework and institutional implications of administrating direct subsidies for community service obligations and industry under a direct pricing regime. This section does not intend to comment on who should receive a subsidy, but on the framework which would enable community service obligation and subsidies to be applied regardless of the recipient.

3.1 Responsibility for setting community service obligations

The responsibility for setting community service obligations in most network industries has traditionally laid with the State Government. This is because most regulated industries are limited in their geography and therefore are clearly within state jurisdiction. However, the road sector has benefits beyond the local community it serves and a particular road may have a greater benefit beyond itself. Therefore, it may be appropriate to consider community service obligations from a local, state and national perspective to ensure that arrangements for vulnerable customers and communities are captured.

The simplest way to achieve this is to have a clear national social policy as to the social objectives of the road network. The policy would identify what is considered a vulnerable group that would be considered for a community service obligation. Further it would identify the jurisdiction which is responsible for identifying and paying the community service obligation. The social policy is likely to need to extend beyond heavy vehicle movement and also consider passenger vehicles. It will be important to identify to what extent a community service obligation is attributed between the two groups for cost allocation purposes – although the amount of the subsidy will remain, the cost will need to be deducted from either heavy vehicle charges or light vehicle charges. Failure to appropriately allocate may mean that one group receives the benefit over others (keeping in mind that direct charges only apply to heavy vehicles – light vehicle costs are met through separate taxation mechanisms).

The development of such a policy would need to involve all levels of government, including local government.

3.2 Institutional frameworks

The ideal and clearest institutional arrangement for the payment of community service obligations would be for those responsible for a specific subsidy to meet the costs. However, this is complicated due to several of factors – namely fiscal and legal constraints particularly at local government level.

The current vertical fiscal balance between the three levels of government in relation to the receipt of heavy vehicle revenues is not relevant for the purpose of funding community service obligations. This is because community service obligations should not be funded through heavy vehicle charges revenue but through general taxation. To do otherwise would effectively mean that cross subsidies are occurring.

What is relevant is the relative wealth of various jurisdictions and their ability to fund community service obligation. Local governments in particular are finance constrained with sources of general taxation revenue being limited to council rates. Those local governments more inclined to declare a community service obligation are likely to be those with large geographical areas and limited financial resources.

Local government are also currently recipients of grant revenue through state and commonwealth grants commissions. In relation to road revenues, local government receives grants from the Federal government through Auslink (for roads of strategic importance) and Roads To Recovery. It may therefore be necessary for the grants system to expand beyond reallocation of heavy vehicle funding to include community service obligation payments. The arrangements potentially becomes easier if heavy vehicle price reform leads to institutional reform that links heavy vehicle revenues to expenditure. In this case grants would need only to consist of community service obligation payments and the potential for cross subsidisation (the use of heavy vehicle revenues to pay for subsidies) is minimised.

Even if funding arrangements are resolved, there may be further legislative constraints which make the application of community service obligations difficult. This may again arise because of the constraint placed on local government to implement charges. Although legal advice obtained by the NTC would suggest that local government is able to implement a direct price, the price must be clearly based on cost. This may not be considered the case if the price is discounted to allow for a community service obligation. Further legal advice would need to be sought to clarify the position of local government.

4. CONCLUDING REMARKS

Addressing adverse impacts on rural and regional communities is difficult. The mechanism by which they are addressed is a community service obligation. A community service obligation is intended to address market failures and ensure that basic levels of services are provided to the whole community. In effect, a community service obligation is provided when the market cannot fulfil a government objective. Similarly Government may believe it prudent to support vulnerable industries through the provision of subsidies.

Currently both community service obligation and industry subsidies are provided through cross subsidies inherent in the averaging process supporting the heavy vehicles pricing regime. In effect this means that some users pay more than the cost they incur on the network whilst others pay less. However, the process of averaging is expected to be significantly reduced with a movement to direct pricing (averaging is unlikely to be removed completely) will leave some users of the road network facing considerably higher road prices.

Therefore community service obligations must be addressed in another way. This paper has identified the three main approaches to community service obligations which could be applied. The features of each approach are summarised in table 1.

Table 1. Different approaches to applying community service obligations

Approach	Features
Adjusting the cost base	• Similar to the approach taken now • Blunt approach • Treatment of historical costs under a WOLC approach complex • Although transparent in identifying exact community service obligations costs, achievement of policy objective highly dependent on cost classification categories and structure of charges.
Adjusting prices on Community service obligation roads	• Relatively simple • community service obligation is explicit • Better when targeting vulnerable communities • Others may benefit other than the intended recipients
Offering a rebate	• Better when targeting industry • End customer may not receive the full benefit if it is offered to other parties • Could be administratively complex

The complexity of the road sector makes the application of community service obligations more difficult than in other sectors. The approach adopted will need to be further considered in light of policy decisions on the costing methodology, road classifications and price structure and institutional implications. However, it is likely that an adjustment to prices will be the simplest approach and best achieve the required objective.

Ultimately it is not necessary to adopt only one approach. It may be possible to apply a combination of rebates and price reductions in order to achieve the specific objectives of the community service obligations with the least distortion. It is less desirable to combine either of these two approaches with a reduction in the cost base as this would very likely lead to a double counting of the cost of the community service obligation – beneficiaries could benefit twice.

Regardless of the approach taken, a number of other issues will need to be addressed. These include identifying who will be responsible for declaring and paying for community service obligations and the institutional frameworks which will support it.