

**Queensland Government
response to the
Road and Rail Freight
Infrastructure Pricing - Productivity
Commission Discussion Draft**

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QUEENSLAND GOVERNMENT PRODUCTIVITY COMMISSION SUBMISSION

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1.0 Executive summary

The Queensland Government is pleased to submit this response to the *Road and Rail Freight Infrastructure Pricing: Productivity Commission Discussion Draft*, September 2006 (the 'Discussion Draft').

Queensland raises several issues requiring resolution with the road funding models proposed by the Productivity Commission ('the Commission') to improve the efficiency and equity principles relating to road and rail freight infrastructure investment. In particular, Queensland questions the criticisms levelled at the current model of road investment (the departmental model). Those criticisms fail to take into account the distortions in investment caused by the failure of the Australian Government to return anything near the quantum of money collected from fuel excise back to the road network.

In its original submission in May 2006, the Queensland Government highlighted several issues that would need to be considered in any new proposed infrastructure pricing regime:

- a system wide approach to pricing and investment;
- appropriate pricing reforms both within and across modes; and
- support for regional and remote areas of Australia.

While the Queensland Government values the discussion draft's proposals as a potential way forward with road and rail freight pricing reform, the discussion draft does not appear to provide adequate focus on several key issues. The PC should focus on the benefits of taking a holistic, transport network view of freight, the need for the return of revenue collected on the network, and the need to adequately consider regional communities and provide a transport network for all users.

While highlighting these key issues and particular impacts on Queensland, this response will seek to provide the responses requested by the discussion draft, particularly to the three proposals for consideration – the national road fund, the road public utility model, and vertical reintegration of rail networks. Specific comment is also provided on the draft recommendations, while noting that we agree in principle with the draft's key findings.

The Queensland Government agrees that improving freight transport efficiency by improving the link between demand and cost is a critical objective, but it must be achieved in conjunction with other non-economic and non-freight community objectives. To apply pure economic criteria to the allocation of road investment could have serious detrimental effects on less densely populated and more remote parts of the jurisdiction.

The Queensland Government notes, as it did in the May 2006 submission (p.16), that the inquiry should not focus on the two modes of road and rail in isolation from each other. The discussion draft appears not to have considered the effectiveness and efficiency of the transport logistics chain as a whole.

If, as it has been argued, road and rail do not compete on price factors, then the Queensland Government suggests that the Commission take a whole of transport infrastructure network view that is less focussed on the individual modes (of road and rail) and more on transport outcomes when looking at improving freight efficiency.

Any move to mass-distance-location based charging for road would depend on the demonstration of cost effectiveness of implementation and amelioration of any regional and social impacts. This state has played a lead role in the development of technology such as the Intelligent Access Project (IAP) which enables safer, more productive heavy and other types of commercial vehicles, access to the road network while offering significantly better road transport compliance and asset protection. Like all other jurisdictions, the Queensland Government needs to maintain its ability to invest in transport infrastructure for reasons in addition to those based purely on economic efficiency.

Queensland supports a national approach to cost recovery charges. Cost recovery principles for the freight industry are vital to enabling ongoing investment and productivity improvements. However, the Australian government should not increase heavy vehicle charges without a commitment to return funding to the transport freight network. The failure by the Australian government to commit to re-investing increased fuel based charges into freight infrastructure under the Third Heavy Vehicle Determination proved to be a major obstacle to reform.

Almost two thirds of the total costs allocated to the heavy vehicle fleet are collected by the Commonwealth Government through a component of fuel excise. Unlike the Australian Government's treatment of fuel excise, Queensland spends much more on state-funded road works than it collects from motor vehicle registration revenue, as can be seen from table 1. This financial year will see \$846 million collected in registration, with Queensland's expenditure on state and local roads exceeding \$1.5 billion.

Table 1: Estimated Federal and State road charges and expenditure in Queensland 2006-07

	\$ collected in Queensland 2006/07	2006/07 Expenditure in Queensland on local and state-controlled roads	Expenditure as a proportion of collected revenue
Federal	Estimated \$2.93 billion (petrol and diesel excise)	Estimated \$560 million	19 per cent
State (Qld)	Estimated \$846 million (registration)	Estimated \$1.5 billion	177 per cent

This is in stark contrast to the New Zealand situation, where their national government recognises the need to return revenue collected from fuel excise and other transport sources to the transport system. In recent years, the New Zealand government has hypothecated 55 per cent of excise collected from petrol sales, and 100 per cent of excise from other fuel types, to fund transport operations. However, given the growing demands on their transport network, New Zealand has recently decided to dedicate the remaining 45 per cent from petrol excise to fund transport investment.

In fact, planned transport funding in New Zealand will exceed the combined revenues from *all* fuel excises, registration and other user charges by \$300 million over the next five years until 2010/11. The New Zealand package guarantees funding for five years of state highway construction and other land transport activity, including local road construction, public transport services and maintenance of the road network.¹

New Zealand Minister of Transport Annette King announced this funding commitment in May 2006, saying "the government was changing the funding arrangements to increase certainty, particularly around state highway projects". The Minister said this would assure New Zealanders that the government "regarded building a world-class transport network, which moves people and goods safely and efficiently, as a centrepiece of our drive to transform the New Zealand economy."

The Minister also said, "This is a significant departure from the past when funding was only guaranteed in one year blocks. Regions need to have confidence their issues are going to be addressed quickly. This major funding package shows that the government is determined to achieve this".

¹ <http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=25838>

Existing funding arrangements in Australia involving the three spheres of government are not delivering the level of road and rail investment desired by the community for the AusLink network. However, the only compelling reason to consider some new arrangement would be if it would deliver an increased level of road and rail investment without adverse effects. As highlighted in the Queensland Government's submission to the inquiry in May 2006, these key concerns will need to be addressed to ensure community acceptance of pricing and investment reform.

The third proposal for further investigation relating to the re-integration of vertically separated rail operations is not supported by Queensland at this time. The ongoing consolidation in the rail freight industry, in particular, makes it difficult to verify the merits of this proposal. As such, the issue of vertical separation is highly complex and has the potential to have far reaching impacts and serious consequences. Queensland proposes that this issue be set aside, and further investigated once the potential issues and impacts of the proposal have been clarified and resolved.

1.1 Key Messages

National Road Fund

Queensland notes that the proposal to evaluate the national economic costs and benefits of transport infrastructure investment through a national road fund has been previously considered and adopted in other countries with varying degrees of success in addressing non-economic outcomes. This model has also previously been considered in Australia, without successful resolution of several key issues such as how best to provide for non-economic outcomes of the transport network.

With the failure of the current arrangements to deliver the level of transport infrastructure when the community desires it, any proposals by the Productivity Commission will receive close attention by governments.

There is also a need to clarify the scope in applying a national road fund model. Would this model be limited to the AusLink network? Would this model apply to non freight users of the road network such as light vehicles, pedestrians and public utilities with infrastructure in the road reserve? How would this proposal be applied to non freight-dedicated roads where freight is only one of the many concurrent road users? Does the Commission envisage the funding of separate passenger and freight networks?

Further, there could be a need for economic distortions to meet the needs of rural and regional communities, such as the upgrade of roads to provide flood immunity to remote communities, to provide overtaking lanes that can double as emergency landing strips for the Royal Flying Doctor Service, or to ensure that local government authorities maintain their economic viability as well as their ability to respond to natural disaster situations.

Rural and Regional Impacts

Any change in how road and rail infrastructure is funded is likely to have impacts on rural and regional communities. Queensland would expect the commission to undertake an assessment of these impacts to ensure that they are not significantly adverse for regional and rural communities in this state.

There are considerable implementation issues that need to be accommodated in an eventual move to mass distance and location (MDL) based charging. Given Queensland's dispersed population, there is potential for considerable financial hardship to be inflicted upon rural and regional communities if a pricing regime is poorly implemented.

As a case in point, rural communities in south west Queensland receive a large proportion of their daily necessities via freight transported along the Cunningham Highway. Such rural highways have relatively high costs per heavy vehicle. Low densities of heavy vehicles utilising these regional roads result in each bearing a significantly higher cost than the per vehicle cost on high volume routes.

Queensland would oppose any model of MDL charging that would result in significantly increased freight costs for rural and remote communities, as this could have a significant effect on the cost of living in these communities. Options for ameliorating the impacts of pricing reforms on rural and remote communities (thereby maximising the net benefits of such reforms, as indicated in the February 2006 COAG communiqué) should be developed in parallel with pricing reform proposals.

Vertical Reintegration of Rail Networks

Queensland does not support the proposal for wholesale reintegration of rail networks. Competition in above rail services (whether real or potential) has prevented monopolistic pricing practices since the introduction of vertical separation between track owners and rail service operators. In a number of instances, the existence of competition has driven down the price of commercial contracts for rail services, such as in the haulage of coal both here and in New South Wales.

Moreover, vertical separation is now enshrined in various competition regulation regimes which may or may not be possible to overturn without the Australian government repealing certain provisions of its Trade Practices legislation.

Given the complexity of this issue and the potential for wide ranging impacts and unintended consequences, Queensland proposes that this issue not be considered by COAG at this time and only be brought forward for First Ministers to discuss once the potential issues and impacts of the proposal have been clarified and resolved.

Inter-modal Integration

When considering the net effect of inefficiencies on the users of the transport system, the Commission should note the potential productivity gains of increased efficiency due to inter-modal integration along logistics chains. AusLink corridor strategies and investigation of the logistic chains of national importance are a useful first step, but strategies to improve freight efficiency need to include detailed long term planning from a transport network perspective, for all modes and all spheres of government.

Rail Infrastructure Investment

The Queensland Government is encouraged that the discussion draft highlights the importance of rail infrastructure investment in stimulating freight productivity. AusLink provided \$1.8 billion for rail from 2004-05 to 2008-09, but ignored Queensland in comparison. The only rail project to potentially benefit Queensland from allocated rail funds is a proportion of the AusLink funds allocated to upgrading communications links between Casino and Acacia Ridge on the standard gauge line. Funds for this initiative are allocated to New South Wales. Queensland's share, from the border to Acacia Ridge, of this rail funding is potentially around \$7 million or about 0.4 per cent of national rail funding over the five-year period. A further \$25 million has since been promised towards an overpass of Beaudesert Road which will improve safety and traffic flows and potentially increase efficiencies at the Acacia Ridge rail terminal, following further investment.

The key North Coast rail line from Brisbane to Cairns, which totals 1680km, has not been allocated AusLink funding to date. In this important corridor, rail accounts for approximately 57 per cent (3,179,100 tonnes) of the total freight flow pass while 2,407,300 tonnes of freight (43 per cent) moves along this corridor by road. Rail leads on long haul routes where uncomplicated point-to-point delivery is required, while road dominates over short-haul routes, where smaller cargoes are transported or which require delivery or pick-up to various localities.

Comparative Expenditure to Sources of Revenue

Despite increasing levels of Queensland Government funding for both road and rail infrastructure, there is a pressing need for all three spheres of government to secure additional funding for additional capacity, road maintenance and bridge strengthening and new strategic links for freight transport.

The discussion draft's examination of the current fiscal arrangements with regards to road pricing is also welcomed, as it highlights the need for transparency between charges collected from transport users and returned to the transport infrastructure network.

The need to address the imbalance between federal income streams and state expenditure responsibilities has become pressing. Queensland continues to face greater expenses without matched income streams. This is particularly evident in the transport arena. While Queensland has relatively costly responsibilities, and few sources of revenue, the converse is true for the Commonwealth. Although the current vertical fiscal imbalance is a much broader issue than transport, in order to continue to provide transport services and infrastructure that meet the needs of today and tomorrow, this imbalance needs to be addressed.

Queensland has a vast road network with almost 177,000 km of public roads including the largest state-controlled road network of all Australian states, extending for 34,000 km, representing 19 per cent of the total state network. Although state controlled roads represent a relatively small proportion

of the total road network, they carry almost 80 per cent of the traffic. All of Queensland's roads carry mixed traffic - both passenger and freight movements.

The national network comprises some 4,183 km of national highways, for which the Australian Government has full-funding responsibility. This includes a number of state controlled roads that now form part of the AusLink National Land Transport Network.

In particular Queensland is concerned that while transport services are used to raise revenue (for instance the fuel excise levied by the federal government) only a relatively small proportion of this revenue is allocated back into transport services and infrastructure. This anomaly needs to be addressed in order to provide a sustainable transport network in a climate of escalating costs and an ever harsher physical environment that contributes to increasing construction and maintenance costs.

Queensland notes that the Commonwealth Department of Finance and Administration and Transport and Regional Services stated that..." fuel excise is principally a revenue-raising tool". This point was reiterated in the 2001 Federal Fuel Tax Inquiry. Currently the Commonwealth determines funding levels based on the priority it allocates to each program. Effectively this has removed the link between the revenue generated by fuel excise and the amount the Commonwealth allocates to transport.

The House of Representatives Standing Committee on Communications, Transport and Micro-Economic Reform (the Committee) recommended the removal of provisions within the Australian Land Transport Development Act 1991 (Commonwealth) that suggested that excise revenue was hypothecated to expenditure, to end the notion that such a link existed. The Committee also identified that the impacts of uncertain Commonwealth road funding levels:

- impeded the attainable benefits of long term planning;
- inhibited the efficient operation of transport; and
- sustained higher construction costs.

It should be noted that hypothecation of revenues does not necessarily equate to hypothecation of expenditure to jurisdictions. The allocation of expenditure (under the proposed Road Fund model) could take place in accordance with some set of assessment and prioritisation tools. Queensland would not support such a model without suitable consideration for local and jurisdictional issues (such as decentralisation; community access; rural and remote needs and so on).

The Australian Government's 2006-07 budget papers demonstrate total estimated revenue from petrol and diesel excise as \$14.65 billion². This equates to petrol and diesel excise collections of approximately \$732 per capita, Australia wide. Queenslanders will contribute approximately \$2.93 billion to this Australian Government tax in 2006-07.

The total estimated expenditure by the Australian Government on roads in Australia is \$2.58 billion for 2006-07. This represents a return to the road network of only 17.6 per cent of the amount of fuel excise collected from road users.

The Australian Government's 2006-07 payments to Queensland for local and State-controlled roads are estimated to be \$560 million. This equates to approximately 21.7 per cent of total Commonwealth roads funding and 3.8 per cent of the total fuel excise collected.

This represents an approximate net overall deficit between excise revenue raised in Queensland and Australian Government roads grants distributed back to Queensland's State and local governments of \$532 per capita. None of the fuel excise is directly returned to where it was collected (hypothecated).

Almost two thirds of the total costs allocated to the heavy vehicle fleet are collected by the Commonwealth Government through a component of fuel excise. Currently, the Commonwealth collects approximately \$1.095 billion with the current charge of 20 cents/litre. Under the proposed

² 2006-07 Commonwealth Budget Paper No. 1

third Heavy Vehicle Determination, the fuel charge would have increased to 22.1 cents/litre. The Commonwealth has failed to commit to spend this extra revenue on key transport infrastructure.

It should be noted that Queensland, would the third Heavy Vehicle Determination have been adopted, indicated publicly it was prepared not only to commit (as always) that increased registration to road funds, but further to spend it directly on road that were a priority for B-double usage, given they would have shouldered the increased burden. This would have amounted to \$4.6 million a year for the first year and \$10.5 million for each year after. Pointedly, the Federal Government refused to make a similar commitment for their increased fuel excise received of \$115 million. It would have gone to consolidated revenue.

Unlike the Australian Government's treatment of fuel excise, Queensland returns 100 per cent of its registration fees directly to roads funding. In fact, Queensland spends much more on state-funded road works than it collects from motor vehicle registration revenue. This financial year will see \$846 million collected in registration, with expenditure exceeding \$1.5 billion. Any increase in heavy registration charges is returned proportionally to roads.

AusLink funding to Queensland represents about 22 per cent of Queensland's total road funding and far less than the \$6.6 billion the Queensland Government will spend on road construction, maintenance and support for local government infrastructure over the life of the Bilateral Infrastructure Funding Agreement (BIFA) from 2004-05 to 2008-09. In addition, Queensland will spend around \$2.95 billion on rail and public transport over the same period. That's a total of \$9.6 billion that the Queensland Government has committed to roads, rail and public transport infrastructure.

Future Pricing Reforms

The Queensland Government welcomes the proposal to move to mass-distance-location charging for roads, once the cost effectiveness of implementation can be demonstrated. The Government also reiterates the position stated in the submission to the inquiry in May 2006:

Gradual phase in of a new charging regime needs to be based on a clear long term objective allowing for community acceptance, adequate modelling and testing before wide spread application, and be consistent with international practice.

Queensland acknowledges that there is room for improvement in the decision-making process for road investment. Queensland Department of Main Roads is implementing a comprehensive asset management system to better guide infrastructure decision making. While the linkage between pricing and underlying costs could no doubt be improved, the gains from such an exercise are dwarfed by the potential for improved efficiencies to be gained by returning the charges and taxes on road users to the roads.

However, none of the suggested methods of more efficiently pricing roads such as location-based charging appear to offer significant comparative economic benefits and there is no guarantee that such savings will return to users or jurisdictions collecting it. The fuel excise is a highly effective means of collecting revenue and it offers significant efficiency gains provided users are able to see it returned to the roads that they use. Queensland would potentially receive an additional \$2.5 billion annually if all excise revenues were returned. In the Commission's own words (p. XLI):

Although there could still be benefits from location-based charges if revenues did not flow to the governments responsible for funding roads, it is doubtful that the potentially more substantial gains from improving the efficiency of decisions about the level and pattern of road spending would be realised. Given the implementation challenges and costs associated with introducing location-based charges, it would be desirable to ensure that the greatest possible benefits could be achieved by establishing a more direct link between road charges and road provision. Moreover, linking road revenues to spending would be likely to improve community acceptance of such a reform.

Moreover, it is likely to be the case that any of the pricing reform models considered by the Commission or participants will be subject to the same problems as the Departmental model: a massive imbalance between what road users pay in charges and fuel excise and what is ultimately returned to the roads. Without the reform of the vertical fiscal imbalance, the benefits of more precise models will be seriously undermined.

2.0 Comment on Discussion Draft recommendations

This section details the Queensland Government's responses to the Discussion Draft's eight recommendations.

2.1 *Strictly apply corporatisation model to government owned railways*

Draft Recommendation 11.1 - The corporatisation model should be more strictly applied to government-owned railways in order to improve industry performance. Particular priorities include greater clarity of objectives, improved transparency of the external governance role of ministers, and a general strengthening of accountability.

Greater transparency of funding of Community Service Obligations — including enunciation of objectives, and demonstration of how contributions will achieve stated objectives at least cost — should be introduced as soon as possible, among other things, to facilitate fully commercial provision of rail freight operations.

The Queensland Government supports this recommendation, noting that Queensland already substantially meets the proposed requirements, in that the corporatisation model is already strictly applied to Queensland Rail (QR).

QR is a multifaceted rail corporation which operates in a number of freight and passenger markets for the provision of the above rail services, and operates as a 'ring-fenced' track access provider with the acceptance of the Queensland Competition Authority.

There are four key principles of corporatisation under the *Government Owned Corporations Act 1993* (GOC) Act, which is currently under review:

1. *Clarity of objectives* - QR is required to have a statement of corporate intent which clearly outlines its objectives, financial and non-financial performance indicators and community service obligations.
2. *Management autonomy and authority* - QR has a Board of Directors which has the autonomy and authority to make commercial decisions. Shareholding Ministers have general reserve powers of notification and direction under the GOC Act and any notifications or directions given to Government Owned Corporations (GOCs) by shareholding Ministers are to be published in the gazette.
3. *Strict accountability for performance* - The statement of corporate intent forms the basis for accountability of QR to shareholding Ministers. QR is required to provide shareholding Ministers with quarterly reports on its operations and its subsidiaries. The QR Board is accountable not only to shareholding Ministers, but through shareholding Ministers to Parliament. QR's annual report, which is tabled in Parliament, forms the basis of that accountability.
4. *Competitive neutrality* - The competitive neutrality principle outlined in the GOC Act, is to ensure GOCs compete on equal terms with other entities carrying on business, and that any special advantages or disadvantages GOCs may have because of their public ownership are removed. For example, GOC borrowing rates through the Queensland Treasury Corporation are based on stand alone credit ratings of their businesses and do not take into account their ownership by government.

Community Service Obligations (CSOs) are non commercial activities which GOCs are directed to pursue by government. They were introduced to reinforce the government's approach to social policy - effective and fair delivery of services and programs according to the needs of the whole community.

CSOs are activities which would not be undertaken in a purely commercial environment. This CSO approach is more transparent than funding through cross subsidies or lowering the required rate of return for a GOC.

The Queensland Treasury Community Service Obligations Policy Framework (1999) articulates the objectives for the provision of these payments.³ Under this framework, QR has Transport Service Contracts (TSCs) with the government for the provision of outputs which include Citytrain, parts of Traveltrain, some freight services and network infrastructure. These are services undertaken by QR and delivered to the community on behalf of the Queensland Government for which QR receives funding from the Government.

The TSCs are transparent community service obligations which are referred to in both the Queensland Rail (QR) Annual Report and the Queensland Transport (QT) Annual Report. Details of TSCs are provided in the QR Statement of Corporate Intent, which is tabled in the Queensland Parliament each year.

Some features of the TSCs include:

- clearly stated objectives, terms and conditions detailed in the individual contracts;
- clearly outlined products and services which the government is purchasing on behalf of the community; and
- that they are calculated on an "efficient cost" basis.

Additionally, there is also a Shareholders' Agreement between Shareholding Ministers and QR which facilitates the non-commercial activities that QR undertakes in order to support Government outcomes and Government priorities as a GOC. The Shareholder's Agreement (SHA) includes the non-transport activities desired by the Queensland Government including employment and regional development outcomes. The SHA is complementary to the TSCs.

2.2 Expedite nationally consistent rail regulatory frameworks

Draft Recommendation 11.2 - National consistency and coordination in rail regulatory frameworks — including of safety, operational and technical standards — should be expedited.

Queensland supports the move to increased national consistency in rail regulation, and has taken a leading role over the last decade in working toward national consistency of rail regulation. The State also acknowledges and supports the National Transport Council (NTC) and the Council of Australian Governments (COAG) road and rail regulatory reform agenda, and has been working to implement these reforms since these were agreed to in February 2006.

In regard to regulatory oversight, the extension of the Australian Rail Track Corporation (ARTC) access model to other Queensland nationally significant rail corridors awaits the finalising of the Australian Competition and Consumer Commission (ACCC) approval of an approved Access Undertaking for the Hunter Valley coal network and a review of the appropriateness of this model to the Queensland situation. However the need for a nationally consistent access model is not an issue for Queensland, which already has a successful functioning access regime with regulatory oversight.

Notwithstanding this progress towards national regulatory consistency, Queensland, as well as other state and territory jurisdictions, does not support the introduction of a single national rail *safety regulator*.

³ <http://www.treasury.qld.gov.au/office/knowledge/docs/community-service/community-service.pdf>

National rail safety reform is occurring against a tight timeframe utilising both government and industry cooperation. Accordingly, it is premature to move towards a national rail safety regulator before allowing these reforms to be effectively implemented by all jurisdictions and industry.

At the October 2006 Australian Transport Council (ATC) meeting, Queensland supported a National Transport Commission proposal to review the effectiveness of these reforms and to report this to ATC to advise COAG in 2008. Queensland believes this review will provide initial evidence as to whether any enhancements to the current jurisdictional rail safety regulator structure should be considered.

Queensland is on track to implement new legislation, based on the model, by the COAG deadline of 1 July 2007.

2.3 Monitor and assess nationally consistent infrastructure regulation

Draft Recommendation 11.3 - Progress in implementing the February 2006 COAG agreement to adopt a nationally-consistent approach to regulation of all nationally significant infrastructure, should be monitored in relation to rail to determine whether there are likely to be additional benefits in moving to a single national regulatory regime and regulator.

The objects clause, declaration thresholds and pricing principles (which, among other things, allow for multi-part pricing and price discrimination when they aid efficiency) now embodied in Part IIIA of the Trade Practices Act should be incorporated in all rail access regimes.

Queensland fully supports and has made substantial progress towards implementing all of COAG's transport related regulatory reform agenda.

Rail access regulation for Queensland gauge track is undertaken by the Queensland Competition Authority. A rail access undertaking is currently in place until June 2009. The undertaking applies to the total QR network, however, the detailed pricing and capacity allocation process also applies to coal rail traffic.

In regard to a single national regulatory regime and regulator, the underlying Queensland legislation is being reviewed to align with the COAG principles. The Queensland model for rail access will then be reviewed when an ARTC access undertaking has been endorsed by the ACCC.

In regard to the objects clause, a review of the QCA Act is currently underway to align the matters to be considered by the Queensland Competition Authority (for example, those detailed at sections 49, 76 and 120 of the Queensland Competition Act) with the COAG agreed principles. (*Competition and Infrastructure Reform Agreement – February 2006*).

2.4 Review access regulation on vertically separated rail networks

Draft Recommendation 11.4 - There appears to be scope to moderate or even revoke access regulation where pricing by vertically separated below-rail operators is significantly constrained by competition from road and sea freight transport operators. Building on COAG's agreement to promote nationally consistent access regulation of major infrastructure, a process should be established for reviewing the need for access regulation of vertically separated rail networks.

Firstly, there is a need to define the terms "Moderate or even revoke access regulation". Rail access regulation for Queensland's narrow gauge track is undertaken by the Queensland Competition Authority and only coal is subject to below-rail price regulation. This approach is widely supported by freight transport users. Negotiated access does exist, for example, with Pacific National in Queensland on inter-modal traffic on the North Coast Line.

Examples exist elsewhere in Australia where the maintenance of rail vertical integration has resulted in a degradation of rail infrastructure resulting in poor outcomes for the community. There are also examples of vertically integrated rail operators granting access to third parties, but on terms which preclude financial and sustainable operations. Specifically, the privatisation of rail in New Zealand,

Tasmania, South Australia and Victoria created vertically integrated rail operations on parts of these networks that sought a commercial outcome. This resulted in an eventual deterioration in the standard of this rail infrastructure, with ownership eventually reverting to control by the respective governments (such as in Victoria, Tasmania, and New Zealand), and/or limited competition and the effective exclusion of other interested operators. In all cases, significant capital expenditure by these governments is now required to return the infrastructure to a satisfactory standard.

It is doubtful whether there is significant competition between below rail access providers and coastal shipping. Competition can exist between above line rail operators and shipping companies, but there is limited coastal shipping activity in Australia except in containerised freight carried by foreign shipping. This is due in no small part to the pricing practices of the overseas liner trade which treats all Australian ports as identical, regardless of sailing time. Given the origin of most commodities carried by rail (e.g. coal, iron ore and grain), there is no potential competition from shipping, and road competition is very limited and exists only where there is insufficient rail capacity.

2.5 Examine vertical reintegration of rail lines or networks

Draft Recommendation 11.5 - Given the mixed success of vertical separation in encouraging above-rail competition, whether allowing vertical reintegration of particular rail lines or networks would promote their commercial viability should be subject to detailed independent examination.

Whilst acknowledging that vertical separation and integration both have merit in particular circumstances, it must also be said that both have inherent complexities which go beyond rail-on-rail competition issues.

The Queensland Government suggests that the re-introduction of vertical integration for rail would only be considered on a case-by-case (line by line) basis, dependent on the nature of the freight task on each line and impacts on relevant communities. Moreover, Queensland notes that, while the issue of integration is worthy of exploration, the impact of Toll's undertaking to the ACCC regarding the sale of its 50% interest in Pacific National has not yet been determined. This issue would be better revisited by the Productivity Commission in two years time.

High capital expenditure requirements, low volumes, long lead times, low returns, limited destinations served by rail and seasonal traffics are more important than vertical separation/integration in establishing the modal split between road and rail. The outcomes expected from vertical separation (for example, rail on rail competition) have been constrained by a range of barriers to entry, and might not have had sufficient time to attract new entrants.

As the rail industry continues to undergo corporate consolidation, it would be risk laden to insist on vertical reintegration, as this may only serve to limit competition for these assets by potential bidders. The risks involved in below rail and above rail ownership and operations are quite different and these risks are now well understood by the market.

Furthermore, vertical separation is now the cornerstone of several access regimes operating throughout Australia and would be complex to unravel without significant legislative changes at both a state and federal level. These proposed reforms could also have flow on effects to other industries such as electricity and gas distribution, for example.

Without the competition among operators (actual or potential) that exists in road transport, vertical reintegration of particular rail lines could result in the monopoly operation of individual rail systems, not only in terms of pricing but also third party access.

An alternative solution to the allocation of train slots on multi use lines where demand exceeds supply at specific times of day would need to be developed for any integrated rail system (for example, suburban commuters and containerised or bulk freight may utilise the same track during the same time periods).

2.6 Meet timetable for performance based road freight standards

Draft Recommendation 11.6 - Prescriptive regulations that restrict particular types or configurations of heavy vehicles from using all or some roads, should be replaced, where possible, with performance-based regulations to promote flexibility, innovation and greater productivity in the road freight sector. The proposed package of Performance Based Standards to be agreed upon and implemented by all jurisdictions by end 2007 is a major step forward and it is important that the announced timetable is met.

The Queensland Government acknowledges that Performance Based Standards (PBS) represent a shift away from the traditional method of prescriptive standards for vehicle use on road corridors. The potential for PBS to operate as a stand alone framework, utilising existing compliance and conventional on-road enforcement, clearly provides an opportunity for all categories of heavy vehicle to operate under this system. However, it is recognised that further development of PBS is necessary, and that the current trials in some jurisdictions under Stage 1 of the NTC PBS project are designed to answer many questions prior to advancing to Stage 2.

Because Australian Design Rules (ADRs) are harmonised as much as possible to Economic Commission for Europe (ECE) standards, adoption rates of new technology can be cumbersome and potentially overly prescriptive for Australian conditions. Australia has a unique road transport environment that entails higher temperatures, larger combinations and longer distances. This suggests that the relationship between ADRs and PBS needs to be reviewed so that the two approaches are complementary. For example, ADRs are prescribed separately for prime movers and trailers- this can create instances of incompatibility, particularly where different ages of vehicle are combined. A comprehensive prescription of multiple mechanical components is required on both the vehicle and trailer to encourage stability control. Under a PBS approach, the vehicle combination as a whole is assessed on what its actual stability control is. This means the same outcome is reached with far less intrusion on innovative solutions.

ADRs are under the control of the Australian Government's Department of Transport and Regional Services (DOTARS) and any attempt to reform the regulatory environment of the States' jurisdictions should include complementary reviews in areas of the Australian Government's responsibility.

The Queensland Government has had a leading role in the development of PBS, continuing to support its application, and taking a proactive role in assisting industry to trial this initiative on selected routes throughout Queensland. The benefit of PBS in promoting industry innovation is well recognised and Queensland trials have demonstrated its potential to safely improve the productivity of the heavy vehicle fleet to help meet the fast growing freight task.

However, like other jurisdictions, Queensland remains committed, in the short to medium term, to maintaining its access powers, rather than ceding them to a national PBS body under any proposed governance arrangements. In this way the Queensland government remains accountable to the Queensland community in its support of PBS and that where necessary access approvals can be tailored to meet Queensland conditions. For example, it may be necessary for reasons of community amenity, safety or to avoid damage to fragile infrastructure to not approve access for certain PBS vehicles to routes such as the Brisbane urban corridor which are to be subject to heavy vehicle restrictions.

2.7 Review and assess appropriateness and cost effectiveness of regulations

Draft Recommendation 11.7 - Regulations applied to the road transport sector should be rigorously evaluated in accordance with regulatory impact criteria, to identify least-cost approaches and demonstrate net benefits. The appropriateness and cost-effectiveness of existing regulations in the sector also should be systematically reviewed, consistent with COAG's commitment that all governments undertake targeted annual public reviews of existing regulations.

The Queensland Government is fully committed to COAG's regulatory reform process, including regulatory gate keeping and assessment processes.

Irrespective of the transport mode, all regulations should be regularly reviewed to establish:

- if the objectives for establishing the regulations still remain;
- if the outcomes expected have been realised; and
- if a lower cost approach is available to achieve the same outcome.

The recently released Legislative and Regulatory Reform Initiatives in the Queensland Government report (June 2006) is an example of Queensland's ongoing attempts to reduce unwarranted regulatory burdens on the community. Other examples include Queensland's Red Tape Reduction Taskforce which reviews regulatory impacts to streamline business operations in this state.

This review, undertaken by the Queensland Government's Service Delivery and Performance Commission, complements other work being undertaken in Queensland under the auspices of COAG's national reform agenda, to improve regulatory gate keeping roles and the regular reviewing process for legislative and related regulatory instruments.

However, it is important for the Commission to note that there is not necessarily a direct financial link between some regulation and net benefits. It may be the case that a restricted activity does not have a financial value, or has a value which is not easily established, for example, the requirement to fit noise barriers to some roads and railways.

2.8 Adopt consistent decision making processes for road projects

Draft Recommendation 11.8 - To improve existing investment decision-making frameworks, road infrastructure funding mechanisms should include a clear project selection process, stakeholder involvement and public transparency, including formal procedures for public consultation. These principles have been broadly adopted as part of the AusLink framework for investing in the national highway system and endorsed by COAG. They should be applied across all jurisdictions as soon as possible.

This recommendation relates to implementation of the National Transport System Management Guidelines ('the Guidelines') that have been endorsed by the ATC and COAG.

Queensland has already indicated that it will adopt the "National Guidelines for Transport System Management" for all infrastructure, which provide a sound basis for project selection, appraisal and stakeholder engagement. Queensland's Department of Main Roads (MR) and Queensland Transport (QT) have been active participants in developing the Guidelines and are satisfied with their content. As well as providing cost and benefit assessments, these guidelines provide for a holistic, whole of network approach, measuring impacts on key stakeholders, communities and regional and rural Australia. The proposed process demonstrates good governance, but there are costs involved in terms of time and money.

The transport system planning and project evaluation approach embodied in the Guidelines is consistent with the systems and processes being employed by MR. MR will progressively improve its processes consistent with the approach contained in the Guidelines.

The AusLink corridor studies will form a basis for making road investment decisions. The primary aim of the studies is to provide a basis for the Australian and Queensland governments to establish investment priorities for the current AusLink program and negotiations for AusLink 2. The studies are carried out consistent with the national guidelines for transport system management.

It is important that planning takes place early in the program development process. Accordingly, planning needed to be adequately funded. A good example of this is the \$220 million program for upgrading the Bruce Highway between Townsville and Cairns. The Australian Government has agreed

to allocate a significant amount of this program to project planning. Undertaking planning early in program development results in the selection of the right project, at the right cost. It also significantly reduces the time delay between planning and the start of construction. This approach is a step in the right direction toward better planning of work on the AusLink network.

In the case of rail in Queensland, there is an extensive South East Queensland Infrastructure Plan and Program (SEQIPP) project planning/prioritisation process, with the State Government as "owner" and buyer of rail services rightly determining the priority and where the money is spent. In the case of coal, we do have an extensive stakeholder consultation process (with the rail users) and Regulator (QCA) oversight of what gets built. Ports are slightly different, but major investment is primarily driven by commercial outcomes.

Issues about who should "own" the project, for example, Public Private Partnerships or direct government investment are really only of concern for very large, generally urban road projects which could be operated under some tolling arrangement.

3.0 Responses to requests for further information

This section details the Queensland Government's responses to the Commission's requests for further comments, input or evidence from participants on a range of matters.

3.1 Regulatory impediments to road freight efficiency

The Commission seeks further input from participants on other regulatory impediments to the efficient operation of the road freight transport sector (p.p. 10.9).

Inconsistent implementation of national reforms suggests a national regulatory framework is warranted. Critical to the successful implementation of these reforms is the need to get the balance right between productivity, safety, and environmental and infrastructure protection.

A recent analysis undertaken by the National Transport Commission (NTC) made it apparent that some jurisdictions have introduced unintended variations from certain national reforms in the local legislative instruments that implement those reforms. In order to achieve national uniformity, the Queensland Government has supported a proposal by the NTC to establish reporting mechanisms between jurisdictions and the NTC that outline the key aspects of each reform prior to local introduction.

The Queensland Government also recognises the need to balance uniformity with local conditions. National uniformity can result in 'one size fits all' policies that lack the flexibility to suit the unique characteristics of a state like Queensland.

Queensland's geography and settlement pattern (relatively small population and widely dispersed industry and communities) generates a higher-than-average demand for travel, with correspondingly higher costs. Providing infrastructure and services in regional and remote Queensland, where weather conditions, including drought, severe heat and flooding can be extreme is a challenge. Another challenge for Queensland is to balance investment in rural and regional Queensland with meeting the growth in South East Queensland and coastal areas.

Queensland's size also provides safety challenges for transport planners and providers, particularly in road safety. Queensland has a high proportion of its population outside its capital city, which contributes to people and goods moving longer distances. Both distance and narrow roads add to the safety risk.

It is for these reasons that, unlike other States, the Queensland Government has implemented the Fuel Subsidy Scheme. The Queensland Government has recognised its decentralised population makes it very susceptible to fuel price fluctuations, and accordingly subsidises fuel by 8.354 cents per litre to alleviate the impacts of high fuel prices. This is almost the entire Goods and Services Tax (GST) component collected by the Commonwealth Government and provided to States and Territories. In fact, when taking GST into account, the subsidy actually increases to 9.2 cents per litre (being the fuel subsidy of 8.354 cents per litre plus 10 per cent GST that the motorist would otherwise be paying).

Similarly, Queensland did not adopt the national "Three Strikes" policy for suspending the registration of heavy vehicles for repeated speeding offences. Queensland recognised the practical implications of the policy, and such avoided the inconsistency issues arising between those jurisdictions that did implement it. It is interesting to note that the NTC has since proposed to rescind the Three Strikes policy. Queensland will continue to work with the NTC on implementing a nationally consistent heavy vehicle speeding policy that is both practical and enforceable.

Rigidly pursuing uniformity has the potential to penalise parts of the community, particularly those in remote and rural areas. Secondly, unsatisfactory Commonwealth funding can also leave jurisdictions no choice but to digress from national uniformity. The expansion of higher mass limits in Queensland has been limited for this very reason.

The Queensland Government has called for the development of a national freight strategy. Such a strategy would be expected to provide overarching guidance for national reform, and create synergies between jurisdictions for the benefit of Australia as a whole.

Queensland leading Performance Based Standards (PBS)

Queensland has been the recognised leader of Australian jurisdictions on vehicle standards issues including computer modelling of vehicle dynamics, in-field testing of innovative vehicle combinations and has performed a pivotal role in the national development of this concept.

QT has pioneered and used the principles of the PBS approach to introduce a number of innovative heavy vehicle combinations that generally have improved dynamic performance characteristics over the conventional heavy vehicle combinations. This may also stimulate the development of technology to overcome negative impacts on communities, such as noise and other environmental factors.

Queensland is leading the nation in the trialling of performance based vehicle designs which incorporate the latest satellite tracking technology, as outlined below. Innovative vehicle design offers significant productivity gain in the haulage of commodities to service rural and remote communities.

The Intelligent Access Program (IAP) for road freight vehicles

The IAP enables safer, more productive heavy and other types of commercial vehicles, access to the road network while offering significantly better road transport compliance and asset protection, and provides a framework to assist jurisdictions establish collaborative partnerships across jurisdictions and industry that foster cooperation and compliance.

It will enable the advances being undertaken in the PBS, expansion of the higher mass limits network and the Compliance and Enforcement areas to be monitored through the use of technology.

It provides government and industry with a mechanism for dealing with increased freight task demand and provides for better management of the road asset, safety, and environmental issues and community expectations.

It is disappointing to note that the progress of IAP is being seriously hampered by lack of funding from the Commonwealth Government. It is clear that the Commonwealth is not meeting its funding obligations as a signatory to the Transport Certification Australia (TCA) Memorandum of Understanding. Without this funding, the timely delivery of TCA's business objectives will likely be compromised, which in turn will likely compromise the robustness of the IAP.

Queensland leading Quad-axles

The NTC is seeking endorsement from Ministers for the development of a national policy regime for quad-axles in semi-trailers and B-doubles. An ATC vote on a final policy will take place in December 2006. This initiative has been given impetus from the February 2006 COAG Directive which detailed the need for more general access for quad-axle groups in semi-trailers and B-doubles to assist with managing the growing national freight task.

It is proposed that the national policy be based on the Quad-axle Semi-Trailer Policy developed by QT and MR. Queensland's Policy only covers quad-axles on semi-trailers, at present, of which there are 74 currently operating in Queensland.

A number of quad-axle semi-trailers are currently operating in the Brisbane and Rockhampton areas carting heavy inter-modal containers. QT and MR are currently developing maps of approved routes for these vehicles that will be available on the QT and MR web sites shortly. These routes will have been carefully assessed for suitability of quad-axles, and have been approved by each of the asset owners (including local governments). This is to ensure that minimal impact is made on residential amenity. The vehicles themselves are subject to a range of criteria, including complying with the 16 safety related PBS measures, participating within IAP when it becomes available, have a functioning

on-board mass measurement system, and must be fitted with a "lift-able" front axle and a steerable rear axle or another approved system for the effective reduction of horizontal tyre forces.

Other items for consideration:

- the potential uncertainty of revenue flows over the life of the asset;
- urban amenity, public perception and political influence; the urban freight transport task is often hampered by restrictions on the night time movement of freight; issues relating to noise and lighting mean that freight often needs to move in the already congested peak periods;
- the presumed adverse impact on rail contestability; and
- inefficiencies due to the differences in regulatory load limits between jurisdictions.

3.2 Impacts of vertical separation on interstate rail and regional coal lines

The Commission seeks further evidence from participants regarding the impacts of vertical separation or integration on the interstate track and on major regional coal lines (pp 10.13).

As stated earlier, this issue is highly complex and the proposal has the potential for negative impacts and serious consequences on communities across Australia. Queensland recommends that this issue not be considered by COAG at this time, but further investigated to determine and resolve the potential issues and impacts of the proposal.

3.3 Desirability of a single national rail regulator or regulatory regime

The Commission seeks comments from participants on the desirability of moving to a single national regulator or regulatory regime for rail infrastructure (p.p. 10.22)

Benefits are more likely to be captured by a national rail regulatory *regime* rather than a single national regulator.

Arguably, the undertaking of the regulatory role is enhanced by:

- local knowledge of the operations;
- local knowledge of the dynamics and interrelationships between links in the transport chain (for example, rail and port in the case of Queensland Coal); and
- local access to the regulator by the stakeholders.

This suggests it would be preferable to maintain the existing structure in Queensland where access to below line rail infrastructure is regulated by a Queensland competition regulator within a harmonious national regime. It is noted that in Queensland, only one coal terminal, the Dalrymple Bay Coal Terminal located at the Port of Hay Point, is subject to regulation. Queensland ports function well without regulatory access regimes, because customers have not sought to have access regulated.

Regarding rail safety regulation (as noted in the response to draft recommendation 11.2, in section 2.2, (p.p. 7-8) of this document) Queensland, as well as other state and territory jurisdictions, does not support the introduction of a single national rail *safety regulator*, given that national rail safety reforms are occurring against a tight timeframe utilising both government and industry cooperation. A move towards a national rail safety regulator before allowing these reforms to be effectively implemented by all jurisdictions and industry would be premature.

At the October 2006 Australian Transport Council (ATC) meeting, Queensland supported a National Transport Commission proposal to review the effectiveness of these reforms and to report this to ATC to advise COAG in 2008. Queensland believes this review will provide initial evidence as to whether any enhancements to the current jurisdictional rail safety regulator structure should be considered.

3.4 Appropriateness of current rail access regimes

The Commission seeks comments from participants regarding the appropriateness of the current coverage of access regimes for rail infrastructure. What might be the effects of removing access regulation on the vertically separated elements of the interstate track? (p.p.10.23)

Refer to the response to recommendation 11.5 on reintegration of rail networks (section 2.5 of this document) for further comment on vertical integration.

3.5 Performance of government owned rail providers

The Commission seeks participant's views on the performance of government owned rail providers (p.p. 10.28)

Queensland Rail (QR) is the only remaining government owned railway which provides a full scope of rail services, including freight services, passenger services, and infrastructure construction and management, including access to rail infrastructure which is declared under *Queensland Competition Authority Act 1997*.

Queensland Rail's financial performance is supported by the clear separation of its commercial objectives as a Government Owned Corporation (as defined by the *Government Owned Corporations Act 1993*), and other relevant legislation, and the requirements of its owners (the Government) which relate to the Government's social, state development, transport, industrial and other policies.

In regard to the Queensland Government's policy requirements, there have been established a set of transparent Transport Service Contracts (TSCs) (between QT and QR) which allow Government to purchase transport services from QR (and other transport service providers) on a commercial basis. Currently the services purchased from QR under TSC arrangements are regional rail (freight) services (at a cost of approximately \$20m annually), long distance rail passenger services (at a cost of approximately \$120m annually), rail infrastructure (at a cost of approximately \$270m annually), and urban rail services (at a cost of approximately \$300m annually). The services purchased under these contracts are on the basis of best practice costs.

Additionally, there is also established a Shareholders' Agreement between Shareholding Ministers and QR which facilitates the non-commercial activities that QR undertakes in order to support Government outcomes and Government priorities as a Government Owned Corporation.

The returns to QR from its provision the services provided by its infrastructure to third party rail operators is governed by an Access Undertaking as agreed between QR and the Queensland Competition Authority.

The Queensland Government is well aware of market developments in regard to freight in Australia, and has allowed and supported QR (from a policy perspective) in its efforts to establish itself as a profitable national general freight and bulk freight rail operator. This approach will limit the risk of hegemony of a single national operator and will facilitate the delivery of service and community outcomes available from a competitive above-line rail freight industry.

In that context QR has established Melbourne to Brisbane line haul services, operates coal services in the Hunter Valley of NSW, acquired CRT (a niche freight forwarding company headquartered in Victoria), and acquired the above rail assets of Australian Railroad Group (ARG) headquartered in Western Australia. These activities and acquisitions are expected to provide QR with a sound base for future profitable and sustainable freight operations. QR is also in the process of reviewing the efficiencies of its Queensland freight operations. These initiatives clearly demonstrate the ability of a Queensland Government Owned Corporation to respond to market developments in a timely and effective manner.

3.6 Remaining regulatory restrictions on freight movements

The Commission seeks information from participants identifying any remaining regulatory restrictions on freight movement. In particular are there any remaining regulations that effectively restrict particular commodities to rail or road? (p.p.10.31)

There are no regulations that restrict particular commodities to rail or road; however, Queensland does retain the right to charge additional amounts for the haulage of bulk minerals on the road network. This is only to cover the cost of increased maintenance, bring forward capital works, and so on. (Part 7A of the Mineral Resources Act 1989 restricts the carriage of minerals on road.) This is not used as a means for encouraging modal shift as it has proven ineffective in this regard.

There may well be a public good (social and environmental) to be achieved by encouraging more bulk commodities to be moved by rail, to ensure the best community outcome. With the projected increase in the freight task over the next 20 years, there is a need to minimise impacts on community safety and amenity such as through increasing the viability of long haul rail freight. Remaining restrictions on road freight are primarily infrastructure related, for example, HML, B-double routes. Examples are detailed in section 3.7 below.

3.7 Inter-modal issues

The Commission seeks further input from participants on inter-modal issues affecting the efficient transport of freight and appropriate strategies. (p.p.10.34)

Key inter-modal considerations include:

- Encouraging the use of the appropriate mode and vehicle for each freight task is critical in maximising the capacity of both road and rail and encouraging rail for long haul freight tasks and also assists with the looming crisis in labour shortages in long haul trucking. It would allow each transport mode to operate where it has a competitive advantage. The benefit of encouraging some road freight to rail would have a range of economic, community and environmental benefits, utilising a relatively underutilised rail track resource while reducing road congestion and providing an overall total cost reduction to the provision of freight movements. It would also improve labour efficiency enabling the line haul movement of substantial volumes to freight to be moved by rail, with trucks making the local deliveries.
- Terminal access can be central to access the rail network and undertake efficient operations.
- Considerations primarily related to infrastructure provision include:
 - Road train and B-triple access to ports (given relatively high importance in the AusLink Mt Isa - Townsville Corridor Strategy). Large multi-combination vehicles are used extensively on both the Flinders and Barkly Highways, but road trains are not permitted through Townsville City to the Port of Townsville. Combinations are broken down to the west of Townsville and taken to the port either sequentially (three return trips with separate trailers) or by additional prime movers engaged specifically for the task. This creates inefficiencies and is a cost penalty to road users accessing the Port of Townsville.
 - A majority of single track operations with short rail loops result in limitations in train sizes.
 - Delays are also caused where rail intersects with residential streets resulting in rail speed restrictions in some regional cities. Examples of this can be seen at level crossings in Rockhampton and Bundaberg.
- Port industrial conditions may restrict 24 hour operations.

3.8 Reintegration of rail networks

The Commission seeks the views of participants on the potential costs and benefits of reintegration on specific rail networks (p.p. 11.5)

As outlined earlier, in response to draft recommendation 11.5, this issue is highly complex, with the potential for unforeseeable impacts. In light of current reforms and changes in the rail market (including Pacific National ownership), Queensland proposes that this issue be further developed and revisited once the potential issues and impacts of the proposal have been clarified and resolved.

Vertical separation facilitates transparency of decision making for rail operating in different markets on the same infrastructure. For example, in Queensland, local and long distance passenger services and bulk and containerised freight services are provided on the same track, potentially by different operators. Vertical separation also provides a potentially competitive above line rail operating environment. A move to vertical integration could result in a monopoly rail operation. The outcomes expected from vertical separation (that is, rail on rail competition) have been constrained by significant barriers to entry for rail operators (for example, high capital expenditure costs). The market, therefore, might not have had sufficient time to attract new entrants and it would be premature to intervene until this proposal has been more robustly developed.

Under any re-integration proposal, there would be a need to develop an alternative solution to the allocation of train slots on multi use lines where demand exceeds supply at specific times of day. Vertical separation provides transparency for the allocation of track capacity between different rail traffics because a third party allocates access to the track to enable it to be used, and any operator can bid for that use. It is noted that QR is closer to the proposed model, as far as it is understood, than any other operation in Australia.

3.9 Impediments to operator payments for road upgrades

The Commission seeks the views of participants as to whether there are impediments to arrangements between heavy vehicle operators and road providers, which would allow heavy vehicle operators to pay directly for particular road upgrades (p.p. 11.7-8)

A major impediment to this occurring is likely to be the heavy vehicle operators' reluctance to pay, due to the large costs that could be borne by a single road operator. Because road investment is 'lumpy' with large economies of scale, costs will most likely need to be carried by a number of operators to prevent free-riding and to equalise costs to benefits.

Road upgrades can incur significant costs in both infrastructure assessment and construction costs. An operator who is willing to incur these large costs is expected to generate benefits large enough to cover the costs. The benefits will also need to be large enough to negate other operators taking advantage of the upgraded route who did not contribute any funding towards the costs (the free-rider problem).

Because of these issues, the costs may have to be shared amongst a consortium of operators. Alternatively, the costs may need to be covered by the first party benefiting from road freight efficiency, for example, the owner of a major freight generator.

Another major issue will be road asset managers agreeing on a common contribution calculation methodology. A 'contribution calculation' methodology that is transparent and consistent is necessary to prevent inflation of costs by individual road asset owners. In addition, upgrades will most likely (a) provide benefits to other road users and (b) extend the life of the asset. These additional benefits need to be included in determining the contribution cost as to not unfairly overcharge the operator.

Queensland's current Higher Mass Limits framework allows for operators to negotiate with road asset owners to upgrade a route in return for a range of benefits. Operators are likely to promote benefits such as local economic growth, job creation and reduced truck movements. However the current framework allows for asset owners to request a contribution to fund an upgrade. Although this is

arrangement has been in place since late 2002, there has been no suggestion of operators directly contributing towards upgrades ((presumably due to the above problems).

As mentioned above, government can charge for road improvements necessary for the safe transport of bulk minerals, but that is a charge imposed on the owner of the commodity, not on the transport operator.

3.10 National Road Fund

The Commission seeks participants' views about the feasibility of establishing a national road fund; particularly how inter-jurisdictional issues might be resolved. (p.p. 11.13)

This section examines the economic and institutional issues related to closer linking of revenue and investment within the transport portfolio.

It is clear that a better relationship between prices and usage and provision of the network could allow for improvements in efficiency, and potentially a better road network. Success hinges on strong decision making by both users and suppliers of the transport network. Better decision making requires better market signalling.

It is reasonable to hypothesise that a National Road Fund, as proposed in the Discussion Draft, could be one method of linking investment and user pricing. Jurisdictions and communities are unlikely to agree to such a proposal, without a clear demonstration of the increased efficiency and equity of such a model and the ability to meet wider community expectations and freight efficiency.

Queensland could only consider a road fund model if the Commonwealth agrees to return all funds collected from transport users for re-investment in the national transport network. As previously argued under AusLink, Queensland is not getting sufficient federal funding for either rail or federal highways, nor is it receiving sufficient funds for maintenance, and as a consequence, an increased return from fuel excise would be fully justified.

As highlighted previously in this submission and illustrated in Table 2, almost two thirds of the total costs allocated to the heavy vehicle fleet are collected by the Commonwealth Government through a component of fuel excise. Conversely, Queensland spends much more on state-funded road works than it collects from motor vehicle registration revenue. This financial year will see \$846 million collected in registration in Queensland, with expenditure exceeding \$1.5 billion.

Table 2: Estimated Federal and State road charges and expenditure in Queensland 2006-07

	\$ collected in Queensland 2006/07	2006/07 Expenditure in Queensland on local and state-controlled roads	Expenditure as a proportion of collected revenue
Federal	Estimated \$2.93 billion (petrol and diesel excise)	Estimated \$560 million	19 per cent
State (Qld)	Estimated \$846 million (registration)	Estimated \$1.5 billion	177 per cent

This is in stark contrast to the New Zealand situation, where their national government recognises the need to return revenue collected from fuel excise and other transport sources to the transport system. In recent years, the New Zealand government has hypothecated 55 per cent of excise collected from petrol sales, and 100 per cent of excise from other fuel types, to fund transport operations. However, given the growing demands on their transport network, New Zealand has recently decided to dedicate the remaining 45 per cent from petrol excise to fund transport investment.

In fact, planned transport funding in New Zealand will exceed the combined revenues from all fuel excises, registration and other user charges by \$300 million over the next five years until 2010/11. The New Zealand package guarantees funding for five years of state highway construction and other land transport activity, including local road construction, public transport services and maintenance of the road network.

New Zealand Minister of Transport Annette King announced this funding commitment in May 2006, saying "the government was changing the funding arrangements to increase certainty, particularly around state highway projects". The Minister said this would assure New Zealanders that the government "regarded building a world-class transport network, which moves people and goods safely and efficiently, as a centrepiece of our drive to transform the New Zealand economy."

The minister also said, "This is a significant departure from the past when funding was only guaranteed in one year blocks. Regions need to have confidence their issues are going to be addressed quickly. This major funding package shows that the government is determined to achieve this".

As highlighted in the Queensland Government's original submission in May 2006, it is necessary to recognise that Australia's rail infrastructure providers and state road agencies are in the business of providing transport infrastructure to meet the freight and passenger transport needs of the community. Queensland recognises that governments have complex objectives and will always need to provide infrastructure to meet both the social and economic needs of their respective communities.

It is possible that a National Road Fund of this type, with suitable governance arrangements, *could* result in improved economic efficiency across Australia, assuming that it is capable of objectively managing this complex task of competing priorities. The specific implications for individual jurisdictions and their communities are less clear. Also, the ability of such a framework to meet broader community expectations such as access to the diverse needs of regional and remote communities across Australia is doubtful.

One of the key tasks for transport agencies and governments is to connect regional and remote communities to essential services to support economic development and social cohesion. This proposed Road Fund would need to support a mix of social, economic and road safety outcomes to achieve an equitable result for both urban and regional Australia.

It is assumed that the allocation of road expenditure would take place in accordance with some set of assessment and prioritisation tools, most likely Cost Benefit Analysis (CBA). In the absence of suitable consideration for local and specific jurisdictional issues (such as decentralisation, community access amongst other issues) this type of methodology is likely to favour regions of Australia that stand to achieve the greatest economic stimulus from the expenditure. This is more than likely to be the high population and production centres, most of which are not found in Queensland as the most decentralised economy in Australia.

Additionally, without appropriate assessment criteria relating to whole of network (inter-modal) impacts, it is likely that such a model would not adequately realise the significant economic multiplier effects from inter-modal facility investments.

Consistent with COAG's decision on the National Transport System Management Guidelines, any assessment and selection of projects to be financed from the proposed fund should be based on the methodology contained in the Guidelines. The Guidelines make it clear that project selection and prioritisation should not be solely based on CBA analysis but should also include a strategic merit test. The strategic merit test takes into account factors not covered by CBA.

This raises the broader question of the scope of this proposed National Road Fund – importantly, will it apply to all roads and all vehicles, or only to significant freight routes and the charges collected from freight vehicles?

Queensland requests greater clarification of the scope of the proposed National Road Fund. We are concerned that in its current form all road funds will be centrally pooled and controlled, which could potentially reduce the amount currently returned to the state.

These matters highlight that one of the key issues for freight infrastructure pricing is how closely transport user charges and infrastructure spending should be linked?

The advantages of a clear and ongoing link between the charging and investment expenditure include:

- creating a pricing signal that might increase efficient use of infrastructure, while allowing the protection of vulnerable assets and ensuring the costs of using infrastructure are recovered;
- there is clear impetus for infrastructure investment to match future user demand;
- they may allow taxes to be imposed on socially undesirable activities and directed to programs that offset the costs of such activities;
- they may improve the certainty of funding for an expenditure program; and
- they may improve the public acceptability of charges by making clear to the consumers and users the purpose for which they are being levied, and the benefits that flow from the application of the funds raised from those charges.

The disadvantages of dedicating revenue to specific investment purposes include:

- it reduces discretionary control over expenditure and taxation policies, constraining government's ability to manage fiscal policy; and
- it may not be consistent with ensuring that taxation measures impose the least cost on the economy, or that expenditure measures realise the greatest gain across a range of economic and non economic dimensions.

Although "user pays" principles have been applied to other utilities, until recently, roads and rail have not been classified as such utilities in which to apply the user pays principle. Except for toll roads, there is no direct purchaser-provider relationship between road agencies and the users of the network. Most charges are hidden within mechanisms such as fuel excise, which restrict the achievement of some of these objectives.

It appears that for the National Road Fund model to be widely accepted, a variety of key issues would need to be addressed:

- taking a holistic, whole of the transport network approach that appropriately values inter-modal facilities and encourages the appropriate mode for each freight task, and avoids entrenching modal choice;
- ensuring that both attributable and common costs are factored into the funding model, particularly maintenance costs, but including social costs;
- ensuring whole of community expectations relating to access, safety, amenity and the environment are included;
- ensuring regional and other areas with lower population densities are not disadvantaged;
- that the scope of the proposal is clearly indicated;
- that broader community and government criteria (as well as economic efficiency) are incorporated into the road fund assessment model;
- that governance arrangements which are fair, objective and agreed by all parties, are able to be established and maintained; and
- including a clear mechanism (and timeframe) for review and potential reversal of this model.

3.11 Public Utility Model for roads

The Commission seeks participants' views about the feasibility of introducing more commercially oriented management for the major freight routes, the potential benefits and costs, and how pricing, network 'boundary' and other implementation issues could be resolved (11.15.)

The PC Discussion Draft (p. 9.29) states that:

The essence of the public utility approach to road governance is the establishment of a road company (or companies) tasked with total responsibility for funding and funding the road network like a business.

The company would be owned by Government, but would have a commercial structure. It would own and manage the road assets it provides to users, and would seek to generate adequate returns on its investment in these assets through so-called "commercial pricing" of road use.

The Public Utility Model has the potential to deliver more efficient outcomes in a pure economic sense, but an implication of the proposed model is that only commercially viable elements of the network lend themselves to this particular approach. Elements of the network that are provided or maintained to achieve non economic outcomes (such as community access) would not be suitable for this approach. In these cases significant, albeit transparent, subsidisation arrangements would be necessary.

For example, Queensland has a vast road network with almost 177,000 km of public roads including the largest state-controlled road network of all Australian states, extending for 34,000 km, representing 19 per cent of the total state network. Although state controlled roads represent a relatively small proportion of the total road network, they carry almost 80 percent of the traffic, and all of Queensland's roads carry mixed traffic - both passenger and freight movements.

The Public Utility Model would be aiming to achieve a commercial return for road provision, in a road network where passenger use is the dominant use type. This raises some questions, including:

- How, and how much, would non freight road users (that is, private car users) be required to pay for their use?
- Would currently non-registered road users (for example, pedestrians and cyclists) be required to pay for their access to the road system?
- How would other public utilities such as water, electricity and telecommunications be required to pay for use of the road corridor?

Models similar to the public utility model have been rejected in the past as they have failed to adequately address the non-economic issues associated with rural/regional communities and social policy objectives.

To implement such a model would require detailed investigation, especially regarding potential negative impacts on rural areas. Such a model has the potential to improve economic efficiency; however, broad social policy objectives and technical issues relating to implementation must be fully investigated before proceeding with such an option.

3.12 The Departmental Model—Queensland's Preferred Road Investment Model

The discussion draft asserts that the current "departmental model" has shortcomings, including poor accountability to road users, the absence of pricing that is responsive to costs and demand and the lack of a systematic link between road revenues and efficient future expenditure. The discussion paper asserts with little evidence that, without repair of the 'structural' shortcomings, the potential benefits of the hypothecation of road revenue for investment on the nation's road are unlikely to be realised. (9.19-9.20)

Queensland acknowledges that there is room for improvement in the decision-making process for road investment. Queensland Department of Main Roads is implementing a comprehensive asset management system to better guide infrastructure decision making. While the linkage between pricing and underlying costs could no doubt be improved, the gains from such an exercise are dwarfed by the potential for improved efficiencies to be gained by returning the charges and taxes on road users to the roads.

Nationally, only 17.6 per cent of the fuel excise dollars collected by the Commonwealth will be returned in the form of investment in roads in 2006-07. Unless the disparity between what is charged by the Commonwealth and what is spent is rectified, efforts to better link charges and expenditure through other mechanisms—such as a road fund or a public utility model or by the adoption of more precise charging schemes such as distance based charging or location based charging—will be largely ineffective.

Moreover, without the necessary investment of most or all of the excise funds, there is no basis for asserting that the departmental model is not able to deliver an efficient and effective road system. Nor could the benefits of improved pricing signals to road users be realised without making available the charges for investment.

What is apparent is that there is a current massive shortfall in investment in road spending nationally. While beyond the Commission's scope, the discussion draft itself acknowledges the widespread concern about the under-funding of the nation's roads, referring to numerous studies that demonstrate systemic under funding. These observations are borne out by the Queensland experience. Despite a massive increase in the State's investment in roads, roads like the Bruce Highway and Ipswich Motorway (which are the Australian Government's responsibility) fail to provide even an adequate level of service to the motorists and freight vehicles that need to use them.

This shortfall in spending needs to be understood in the context of the magnitude of the revenue paid by road users through the fuel excise. Road users paid fuel excise of \$13.83 billion in 2005-06, while the Australian Government spent only \$2.5 billion (or 16 per cent of the revenue) on roads in that year. Road users pay for a high standard of infrastructure but the failure to use the money paid into fuel excise to fund improvements means that they get an insufficient level of infrastructure despite efforts by states like Queensland to fund large increases in road infrastructure.

Queensland returns 100 per cent of its registration fees directly to road funding. In fact, Queensland spends much more on state-funded road works than it collects from motor vehicle registration revenue. This financial year will see \$846 million collected in registration, with expenditure exceeding \$1.5 billion. Any increase in heavy registration charges is returned proportionally to roads

Queensland proposes that the Commission reconsider the potential benefits of making the revenue raised by road users through payment of fuel excise available for investment in those roads. In particular, Queensland proposes that the Commission reconsider the viability of the departmental model in the context of a commitment by the Commonwealth to reinvesting some or all of the fuel excise revenue coupled with improvements in infrastructure investment decision making.