



GOVERNMENT OF WESTERN AUSTRALIA

**Submission to the**

**Productivity Commission  
Inquiry into  
Road and Rail  
Freight Infrastructure  
Pricing**

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**Minister for Planning and Infrastructure  
Western Australian Government**

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# PRODUCTIVITY COMMISSION INQUIRY INTO ROAD AND RAIL FREIGHT INFRASTRUCTURE PRICING

## WESTERN AUSTRALIA'S SUBMISSION

### EXECUTIVE SUMMARY

The Western Australian Government considers that there are two key issues that the Productivity Commission Inquiry must address:

- That any pricing regime must provide greater equity between road and rail pricing in areas where rail infrastructure is already in place or where it might become feasible to introduce it.
- That the pricing regime must take into account the situation of remote areas, ie. those dependent on the transport of their supplies over a supply line of a distance greater than 500 kilometres.

The Western Australian Government believes that the current system of recovering costs is deficient in two areas, which must be redressed in any new pricing regime. The current approach of a variable fuel and a fixed annual registration charges is deficient in terms of its cost allocation, as it effectively subsidises larger vehicle classes. There is some urgency to find a suitable solution to this problem. There is also a need for a broad based review of pricing across road and rail sectors, recognising that there is a profound difference between road and rail in charging principles and in the way prices are regulated.

It may be difficult to level the playing field given that road and rail operate in different regulatory, policy, ownership and operating environments. The current arrangements for managing the land freight transport system do not provide the best results because of the unequal investment and cost recovery regimes applicable to the two transport modes.

Remote communities in Western Australia do not have the capacity to pay for the required transport infrastructure due to the magnitude of the distances that are involved. Thus, cost recovery for remote communities in Western Australia needs to be different from cost recovery for other metropolitan or regional community locations. It is incumbent on Governments at all levels to contribute to this for the regional development of the Nation and to foster export earnings.

A new system can be phased in over an appropriate time frame. The important issue is that a new and better system is implemented in the future that allows real competition based on a more equitable treatment of the land transport modes, and that takes into account the situation of remote areas. This equitable treatment should be properly reflected in the pricing system and should exhibit greater clarity in investment decision making. A case-by-case approach to specific industry/project requirements for land transport infrastructure investment could well be taken and appropriate cost recovery strategies determined within a framework of general principles that are applied across all sectors of the economy.

There are three other issues that the Western Australian Government would like to draw the Commission's attention to:

- Government investment in rail infrastructure;
- Improved pricing is a necessary but not sufficient mechanism for efficient investment and use; and
- A business framework for Government action is proposed.

## 1. INTRODUCTORY REMARKS

The regulation of transport services in Western Australia dates back to the *State Transport Co-ordination Act 1933*. Through the 70's and 80's and into the 90's a program of deregulation of freight transport transpired and competition between the land transport modes was encouraged.

These included:

- 1970s *Major policy review recommended removal of regulations restricting competition between road and rail*
- 1980s *Deregulation of the transport of general freight, wool, public freezer/chiller road transport services and removed previous 9 tonne limit from most road haulage of many loads within the deregulated zones*
- 1990s *Deregulation of the transport of grain, fertiliser, minor bulks, bulk fuel, timber and major bulks*

Other reforms to improve the efficiency of land transport followed:

- 1992 *Agreement between WA and the Commonwealth for National Rail to operate on the Kalgoorlie to Kwinana line*
- 1996 *Nationally consistent road charging for heavy vehicles*
- 1996 *Amendment to the Government railways Act to enable Westrail to enter into access arrangements under Section 61 of the Act*
- 1998 *Interim rail access arrangement for interstate operators on the standard gauge railway line between Kalgoorlie and Kwinana*
- 1998 *Government Railways (Access) Act 1998*
- 2000 *Sale of the Westrail freight services to the Australian Railroad Group*

Clearly, the transport industry in Western Australia has changed rapidly over the past three decades and Western Australia has not been averse to making changes to improve its land transport systems.

This inquiry is timely as Western Australia is currently experiencing unprecedented economic growth, which is exerting tremendous pressures on the State's transport systems. While economic growth will provide benefits to the State and its citizens, the projected doubling of the State's freight tasks over the next 15 years will provide significant challenges to the Government and industry in facilitating an efficient, safe and competitive cost recovery system for freight infrastructure which takes into account Western Australia's unique circumstances.

It is highly unlikely that one national prescriptive solution will suit Western Australia. Therefore, any changes to the national system of road and rail transport cost recovery must be flexible enough to suit the remote communities of our State to foster development of these communities and our export industries.

A competitive road and rail transport sector is essential to the efficient operation of an export-oriented state such as W.A. In many parts of the State, particularly in the north, there is often no alternative to road transport, and the impact of any proposed changes needs to be thoroughly analysed. Any adjustment to road infrastructure pricing, particularly where there is no rail alternative, has the potential to severely impact on the State's economy and in particular, its export industries.

Western Australia has a progressive regulatory regime in relation to road transport. The charges paid by heavy vehicles are cross-subsidised across the State, with major arterial roads carrying a lot of traffic compensating for the cost of more remote roads. Road and rail traffic generally compete only in relation to the carriage of grain and general freight within the State, as interstate freight is mostly carried by rail. The viability of hauling more grain or minerals such as iron ore by rail could only be improved through greater investment.

Maintaining international competitiveness requires continuous improvement in efficiency, safety and environmental sustainability. Addressing competitive neutrality between road and rail transport represents one of the most significant opportunities for future reform. It is vital that the State and Commonwealth Governments are able to ensure correct and efficient pricing policies of road and rail infrastructure through the implementation of consistent and competitively neutral pricing regimes.

The Commission will be aware that at the same time as regulation was being reduced, more flexibility was being given to road freight vehicles which were improving efficiencies through engines and trailers technology and other logistics arrangements.

The following comments have been provided against the Commission's Terms of Reference. The Western Australian Government would be prepared to send a representative to support this submission in person if required.

## 2 PRINCIPLES AND PRACTICAL OPTIONS FOR THE STRUCTURE OF THE DIFFERENT PRICING REGIMES

**The Western Australian Government believes that the current system of recovering costs is deficient in two areas, which must be redressed in any new pricing regime. The current approach of a variable fuel and a fixed annual registration charge is deficient in terms of its cost allocation as it effectively subsidises larger vehicle classes. There is some urgency to find a suitable solution to this problem. There is also a need for a broad based review of pricing across the road and rail sectors, recognising that there is a profound difference between road and rail in charging principles and in the way prices are regulated.**

The existing pricing regime has certain significant advantages, but it also has some weaknesses and disadvantages. Inefficient heavy vehicle road charging has not provided the right incentive to use the road network in an efficient manner. Distortions include a cross subsidy for heavy vehicles as a result of under-estimating the impact of heavy vehicles on road expenditure. Non-road damage externalities such as safety, enforcement, environmental degradation and congestion are not factored into the cost bases for road.

The charging methodology is also incapable of fairly attributing costs and prices to users, and delivering efficient investment in transport networks. There are increasing examples in Western Australia where inefficient heavy vehicle prices are having a profound impact on investment, and have led to the over use of freight haulage by road.

There are several major and minor weaknesses with the existing regime (although in themselves, these are not sufficient to be certain that a totally new regime is required). These include:

- Cross subsidies of various types;
- The PAYGO principle, which results in trucks being charged for the current costs of building and maintaining roads rather than the consumption of the road asset; and
- Uncertainties in the analysis due to assumptions and poor data (eg the proportion of truck use on local or unsealed roads).

A new pricing regime will have advantages and disadvantages, which must be clearly and completely described in order to decide whether to move to a new regime.

A purist economic pricing model could severely affect remote WA adversely, including the viability of nationally significant economic enterprises, particularly for exports. Most exporters are price takers on international commodity markets and have generally limited ability to pass on any increase in costs to their overseas markets. Consequently any cost increase has to be absorbed and in some cases could lead to job losses or reduced viability. Revenue and royalties earned by Western Australian exporters are vital for the health of Australia's economy, and because of the vast distances involved, remote communities do not have the capacity to pay the full cost of the transport infrastructure required to get their products to overseas markets.

Unbalanced mode competition is reflected by the continued growth of road transport and the commensurate reduction in rail mode share in the haulage of contestable freight in Western Australia, which is also of growing concern to the Government and local communities.

This trend occurs because the pricing of road transport services does not require the customer to provide for a return on the capital invested in the road network that is comparable to the return expected from rail or to cover the externalities generated. This anomaly creates an uneven playing field between the land transport modes that favours road transport over rail transport and leads to wasteful use of transport infrastructure.

Privatisation of railway infrastructure has further exacerbated the inequality between the competing land transport modes both in terms of the returns expected from the infrastructure capital investment and the means by which this investment is recovered from users and the community. This has directly impacted on the price setting mechanism in the competitive markets. As a result, the long-term future for rail infrastructure appears to be at risk, unless measures are taken to redress the issue.

The evidence indicates little capacity for undertaking a quantum upgrading of the existing railway infrastructure or investment in new railway infrastructure. For rail, investors expect to achieve commercial rates of financial return on infrastructure investment whereas for road transport the expected economic return is the Government's social discount rate. These differences in assessment methodologies create an imbalance in favour of road use over rail use in the underlying cost structures that operate. In addition, if road does not cover its financial costs, there is a negative return, which is only acceptable if the social benefits of transport infrastructure are included in the Government's analysis. Analyses of new railway infrastructure by the private sector do not include these social benefits, thus road projects, which may be socially desirable but commercially unviable, proceed, while this is not the case with rail. Competitive neutrality would require that the assessment approach be equally applied across transport modes.



### 3 IMPACT OF CHARGING REGIME OPTIONS ON TRANSPORT OPERATORS AND USERS AND SPECIFIC LOCATIONS

**Remote communities in Western Australia do not have the capacity to pay for the required transport infrastructure due to the magnitude of the distances that are involved. Thus, cost recovery for remote communities in Western Australia needs to be different than cost recovery for other metropolitan or regional community locations. It is incumbent on Governments at all levels to contribute to this for the regional development of the Nation and to foster export earnings.**

The freight transport task in Western Australia is enormous with small population centres and long freight lines. Goods are transported across vast distances because of the size of the State, its isolation from other Australian States and Territories and the dispersed location of its agricultural, mining, production and population centres.

Not only is distance a factor that differentiates WA in the context of transport, other factors include a small population base, a large export economy, a large road infrastructure investment, dramatically increasing transport demands, very efficient road transport and a lack of rail as an alternative to road transport in remote areas. The State's small population base, along with the growth in transport demand over the next fifteen years, means that recommendations from the Inquiry need to take into account the limited capacity of Western Australia's remote communities to pay for, or readily adjust to, a cost-reflective pricing regime without adjustment support or funding from the Commonwealth.

The State's remote export industries mainly rely on road transport to;

- Deliver equipment and supplies for their operations;
- Deliver essential items such as food, fuel, business and household goods to maintain work sites and associated communities; and
- Transport the product off site for further processing or to port for shipping.

Any increase in freight charges will increase the cost of living in remote areas and will exacerbate the already high levels of regional labour and skills shortages as well as increase the rate of urban drift.

There needs to be consideration of the impact of charging regimes on road vehicle operators, and a cost-benefit analysis to determine who should effectively pay for the charge.

Road vehicle operators are directly impacted by the charges imposed to recover the costs of roads. In the past, the redistribution of charges from the passenger car and light commercial vehicles to the heavy haulage vehicles, based on more accurate measures of road consumption has been proposed as a solution to producing a level playing field between the land transport modes. In most cases such solutions propose a charge on the vehicle operator directly (and are not seen as a charge on the industry client).

The highly competitive nature of the trucking industry has already driven profit margins to low levels so that many owner/drivers would be put out of business from any increase in charges that they find difficult to pass on to their clients. For this reason, and given the owner-driver status of most of the road transport industry in Australia, it is politically difficult to implement such changes. A means of levying the charge on the industry client may prove to be a more viable alternative.

It is difficult to maximise rail freight share if the low charges applied by road transport operators result in rail transport being a "price taker" for marginally contestable freights. As the contestable proportion of the freight task moves further towards road transport, the viability of rail transport on certain routes deteriorates to such an extent that rail transport becomes unsustainable, rail lines are closed, and whole systems can become economically unviable.

The trend towards increased use of road freight has an adverse impact on the State, road networks and communities.

The community is impacted adversely through higher congestion and the compromising of safety under the current pricing regime. The cumulative effect of road transport choice over rail by transport customers has resulted in adverse impacts on the community. These are considered an unsustainable outcome for the Government and some intervention in this trend is needed to return to a balanced freight transport and handling system serving the State.

The under recovery from the users of the heavy haulage industry is also potentially large in Western Australia's remote communities due to the large distances involved. Roads in remote areas need to be able to cater for heavy haulage vehicles in the community's interest. At the same time the community will not be able to pay fully for these roads and does need to be subsidised. Thus, cost recovery for remote communities in Western Australia needs to be different than cost recovery for other metropolitan or regional community locations.

A concrete proposal with identified Commonwealth Government funding assistance programs will be necessary to ensure that any recommended road infrastructure pricing changes will not adversely affect the vital contribution made by Western Australia's remote areas to the State's, and Australia's economic performance.

## 4 OPTIONS FOR IMPLEMENTING ANY NEW PRICING REGIME

**It may be difficult to level the playing field given that road and rail operate in different regulatory, policy, ownership and operating environments.. The current arrangements for managing the land freight transport system do not provide the best results because of the unequal investment and cost recovery regimes applicable to the two transport modes.**

There are numerous options for implementing a pricing regime. The National Transport Commission (NTC) has undertaken initial investigations of options and preliminary assessment of effects for some alternatives.

There are also numerous policy options for overcoming the problem, however the most likely are discussed below.

### **Commodity regulation and access holidays**

Commodity regulation and access holidays (when no third party access is allowed) fundamentally contravene the philosophy of a free market economy and the principles of the *Trade Practices Act 1974* (if not the legislation). It is however relatively cheap for governments, although administrative and enforcement practices can be costly.

### **Subsidies**

Subsidies are potentially a significant ongoing cost for governments and are disliked by treasuries as they require governments to pick winners and play favourites amongst industries and operators. They are difficult to introduce effectively and to administer, and potentially expand over time. They are also difficult to terminate. Competitively allocated, publicly tendered and reported Community Service Obligations payments would be a preferable method of subsidy delivery, which may assist in implementing a fairer and more efficient land transport pricing regime while minimising subsidy costs.

### **Government investment**

Government investment can be expensive, and can be difficult to introduce, as it requires sound commercial knowledge within government. Its effectiveness is also dependent on the model for introduction. One advantage is that if governments own the rail infrastructure, then the asset value is retained by government. Investment can be arranged on a one off or fixed program basis.

There are many potential models for investment but the two most likely are grants or loans (with various repayment options). Grants are preferred to mitigate externality effects. Loans are preferred to overcome short term, single target or risk adverse decision-making.

Regardless of which option, all Government infrastructure investment requires sound processes to ensure probity. Investment in rail requires open commercial information from the rail industry and the freight customer to ensure that no market subsidy occurs. Robust information is required in any of the options considered to ensure that the benefits are soundly based.

## 5 OPTIONS FOR THE DESIGN OF AND TIMEFRAMES FOR IMPLEMENTING MASS DISTANCE LOCATION BASED CHARGING REGIMES

**A new system can be phased in over an appropriate time frame. The important issue is that a new and better system is implemented in the future that allows unfettered competition based on a more equitable treatment of the land transport modes, that takes into account the situation of remote areas. This equitable treatment should be properly reflected in the pricing system and should exhibit greater clarity in investment decision making. A case-by-case approach to specific industry/project requirements for land transport infrastructure investment could well be taken and appropriate cost recovery strategies determined within a framework of general principles that are consistently applied across all sectors of the economy.**

Use of mass-distance charging is becoming more and more widely accepted around the world and the case for its adoption in Australia is more compelling. The NTC oversaw the development of the 4<sup>th</sup> Heavy Vehicle Road Use Pricing Determination Scoping Study Options Report by KPMG. This paper sets out practical options for improving the heavy vehicle pricing arrangements ranging from improvements to the current arrangements to considerations involving changes to the methodology of calculating total revenue and attributing charges to users.

In principle, electronically based mass distance charging systems are an attractive option. However, much consideration needs to be given to moving to a new regime, unless it is clear that the advantages outweigh the disadvantages. We must also be certain that they can be effectively implemented, particularly based on the difficult experiences of overseas systems.

As there may be considerable cost and risk associated with an approach of full mass-distance charging, the Government would support a staged approach, which allows technology and systems that would be required for a more comprehensive pricing regime to be tested. Although there are advantages to a mass-distance charging regime, if it is based on very modern technology, it is likely to be costly, risky, hard to understand and may be unreliable.

It should be pointed out that an important requirement for a new road user-charging scheme to be successful is to gain full political and public support.

## 6 OTHER COMPETITION, REGULATORY AND ACCESS CONSTRAINTS

There are three other issues that the Western Australian Government would like to draw the Commission's attention to:

### **Government investment in rail infrastructure**

Government's decision to invest in roads is mainly driven by social and community factors, but private rail infrastructure owners' decision to invest in rail is driven on the basis that a commercial return can be attained. The different approaches to investment decisions does not help to maximise where possible, rail freight share for the benefit of the community and the environment.

Under current arrangements the decisions on rail investment are primarily driven by commercial decisions within both the rail industry and its customers. Such decisions have short-term horizons, require large returns on investment, accept low levels of risk or price risk very highly, and do not take account of externalities, long-term plans or synergies. The railway infrastructure owner currently pays for the risk for building railways. Railways are funded at commercial interest rates (two to three times the social discount rate) and a financial return is usually expected within ten to fifteen years. In a competitive environment, artificially low road user charges constrain the rail user charge levels, making rail track maintenance and investment unattractive. In turn, this leads to poor track quality and insufficient track investment.

On the other hand, the decisions on road investment are primarily driven by social/community decisions by three levels of Government. Such decisions have longer-term horizons, require only a social return on investment, have risk accepted by Governments, and are conducted within a National and State planning framework.

Clearly, the current approach to asset investment decision making is not conducive to the rail freight transport system, where assets have long economic lives, high acquisition costs and, in the case of below rail infrastructure, are not easily re-deployable.

There are at least three circumstances where investment in rail infrastructure is sub-optimal and there may be a case for Government to assist in order to balance the commercial risk and to pay for externalities, outside commercial responsibility:

- Where business does not have the capacity to invest (eg. start up companies with low cash flow or asset base);
- Where business does not (or cannot) take account of long term potential (eg. the first of several mines to commence operation, when more than one mine is required to provide a commercial return);
- Where business does not take account of externality effects (eg. pollution, road damage if the freight was carried on road).

### **Improved pricing is a necessary but not sufficient mechanism**

While improved cost recovery pricing will improve the potential for rail to win a larger share of contestable freight there are other factors that have the same or greater impact on the transport mode choice decision. An example from our MidWest illustrates:

Recently, a start up iron ore company investigated transport of approximately 2 million tonnes of product per annum from a distance of 300 kilometre to the port for export. The cost of rail freight was approximately 2 cents per tonne kilometre cheaper than road transport. However road freight was chosen because:

- The rail infrastructure company would not accept the infrastructure investment risk for the rail transport and demanded a bank guarantee for the additional infrastructure.
- The iron ore company didn't have sufficient financial backing to invest in a rail spur and rolling stock.
- It would take approximately 9 to 12 months to source rolling stock and build a rail spur while a trucking company could start in about 6 months.
- The iron ore company was not required to factor in the environmental and social costs or benefits of trucks travelling through towns or other environmentally sensitive areas.

### **A business framework for Government action**

Industry feedback indicates that there needs to be a firm set of rules by which the industry can assess and evaluate specific investment proposals. Their interaction with Government should be based on sound principles firmly rooted in good business practice with robust application over the term of Government.

To assist the private sector to make profitable and beneficial decisions with respect to investments in transport infrastructure, Governments should consider adopting the following business principles:

- Ownership and Funding of transport infrastructure can be separated;
- Those who fund transport infrastructure that is strategic to the State (Government or private) are entitled to a commercial return on investment of at least the social discount rate. The ability to earn higher returns is subject to commercial risk;
- Users of the infrastructure be required to pay for its use in proportion to the rate of consumption and cost recovery pricing should reflect this;
- Where a transport infrastructure asset is strategic to the interests of the State, Government may consider retaining ownership;
- Where commercial use of transport infrastructure results in costs imposed on the community then Government will seek to recover these costs through appropriate pricing mechanisms;

- The pricing mechanism will be used to ensure competitive equity between all transport modes and need to be sophisticated enough to take account of the position of remote areas;
- State strategic transport infrastructure assets will be accessible to all users provided there is no net cost impost by a new user over existing users. Cost recovery prices will be recomputed each time a new user is admitted with a decrease in the impost to earlier users; and
- Where transport infrastructure users are unable to meet the full cost of their use which is in the community interest then Government may decide to subsidize its use either through capital funding or capital recovery mechanisms or the purchase of services to a quantum and service level deemed appropriate for the community being served.