

ARTC Submission

Heavy Vehicle Road Reform Consultation Paper

Proposed changes to the way heavy vehicle charges are set and invested

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ARTC



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1 ARTC Background

ARTC was created in 1998 through an Inter-Governmental Agreement (IGA) signed by the Commonwealth, Victoria, South Australia, NSW, Western Australia and Queensland and is a company under the Corporations Act, whose shares are held by the Commonwealth of Australia. The formation of ARTC was a key plank in the significant focus on rail freight productivity in the late 1990's which also included the creation of Australian Transport Commission targets and significant government investment to enhance the rail network's performance.

ARTC was established as a consolidated interstate rail track owner to create a single process for access. ARTC's charter is to:

- Provide seamless and efficient access to users of the interstate rail network.
- Pursue a growth strategy for interstate rail through improved efficiency and competitiveness.
- Improve interstate rail infrastructure through better asset management and coordination of capital investment.
- Encourage uniformity in access, technical, operating and safe working procedures.
- Operate the business on commercially sound principles.

ARTC currently has responsibility for the management of around 8,500 route kilometres of standard gauge track, in South Australia, Victoria, NSW and Western Australia which includes the interstate freight network in those states as well as the Hunter Valley Coal Network in NSW. In Queensland, ARTC leases the section from the Queensland Border to the Acacia Ridge Terminal. Over these corridors, ARTC is responsible for, inter alia, the operational management and infrastructure maintenance of the network.

Given the extensive degree of competition between road and rail for intermodal freight, ARTC has a significant interest in the development of an appropriate pricing mechanism which ensures heavy vehicles meet the full cost they impose on the economy. Only with heavy vehicle pricing reform can road compete with rail on a level footing and ensure the most efficient outcome for the Australian freight market and, therefore, economy as a whole.

2 Intermodal Freight Neutrality

ARTC supports the four elements outlined in the Consultation paper as a necessary, and long awaited, first step in driving Heavy Vehicle road reform. However, these reforms are insufficient to deliver policy neutrality between freight modes and address the market failure that pervades the Australian freight market due to overuse of roads. This market failure is evidenced by the significant externality costs on the Australian economy through worse safety outcomes, higher emissions and greater congestion.

As highlighted in the Productivity Commission's recently published Transport Review, there are significant regulatory variances that benefit road over rail. These advantages cannot be addressed through this process; however, the structural failures which drive excess consumption of road capacity by heavy vehicles can. The four key elements recommended in the paper are a necessary, but insufficient, step to eliminate the public good nature of roads and drive down the consequent externality costs imposed on the Australian public.

2.1 Road Market Failure

The market failure arises from the inability to commercially manage road access and the lack of network management principles, effectively making road capacity a public good resulting in substantial externalities based on the poor safety record of heavy vehicles compared to rail. Whilst the PAYGO system provides for some form of payment for the use of the road system through licensing and fuel excise, there is no practical method to control the use by trucks of road capacity at any time. That is, if an extra truck enters a highway, the consumption of capacity is uncontrolled and uncosted.

Whereas in rail, the consumption of network capacity is contracted and rigorously controlled; no such contract and no such control exists for heavy vehicles on roads.

2.2 Road as a public good

The tragedy of the commons is an expression that explains the market failure issue of public goods and has come to symbolize the degradation of the environment to be expected when many individuals use a scarce resource in common; where each user is motivated to increase their use of the resource without limit – in a world that is limited.

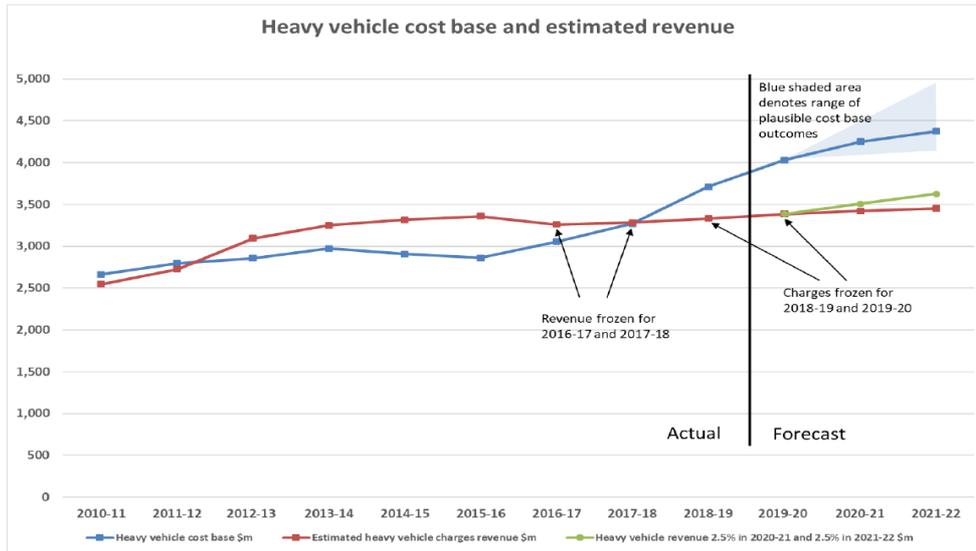
That is, the tragedy arises when each individual is able to treat access as unlimited, when in fact it is constrained. This is precisely the problem with roads; where the capacity is unmanaged and uncontrolled, so heavy vehicles can increase their marginal consumption of road capacity without limit – but that capacity is limited, resulting in increased congestion for other users, increased accidents and increased emissions.

Therefore, the continued treatment of access to road capacity as a public good, with neither commercial access nor network management principles, leads to excess consumption of the capacity; incurring substantial costs on the Australian economy. This therefore highlights the pervasive market failure that exists in the integrated freight market due to the failure to manage access of road networks by heavy vehicles.

2.3 Historic under recovery of costs

These costs are exacerbated when the failure of heavy vehicles to fully pay for their costs on the road network (let alone the externalities incurred through inefficient and excess consumption) is taken into account. ARTC believes that the allocation formula within the PAYGO model leads to an under recovery of the true cost impact of heavy vehicles on roads as it treats them as the incremental user leading to a cross subsidization of heavy vehicles. However, even if this calculation is accurate, recent decisions on charging levels have resulted in the under recovery of those incremental costs (as highlighted in Figure 5 of the NTC December 2019 Heavy Vehicle Charges Consultation report reproduced below):

Figure 5. Comparison of heavy vehicle cost base and estimated revenue



3 Four Elements of Heavy Vehicle Road Reform

The 4 elements defined in the consultation paper deliver critical first steps in developing the required commercial access framework based on fully costed access charges that is necessary to deliver modal neutrality and eliminate the market failure that exists in the Australian freight market. More steps, however, are required to ensure the requisite neutrality is delivered.

3.1 **Service Level Standards**

By defining appropriate service level standards, this addresses the standard of the service delivered by road managers and provides a firm basis for setting the basis for maintenance and capital expenditures on the road network. These standards will frame the efficient level of expenditures required to operate the network and are a critical aspect of establishing a commercial access framework by defining the service to be supplied.

However, this is not sufficient to address the market failures, as it does not manage the use of the network. That is, no controls exist to manage use of road capacity by heavy vehicles and define their usage commitments to road managers.

ARTC notes the HVRR seeks insight into the defining of these standards, including the willingness to pay. These are critical commercial decisions, the value of which are ultimately defined by the financial commitments parties are prepared to make. Given the service standards are the firm commitments of road managers to their users, a corresponding commitment must be made by users to the road managers to ensure that the process is effective. The negotiations which underpin these commitments will ensure that the service level standards are set at the required level by customers, based on efficient risk transfer, and hence will deliver a more efficient outcome for the economy.

This commitment should take the form of capacity requirements; which will ensure that the road manager has certainty of capacity utilization and requirements against which they can plan the need

for maintenance and expansion. Assuming the capacity is accurately priced, this will remove the ability for trucks to excessively consume road capacity and will result in less congestion.

Defining service level standards are therefore a necessary first step in eliminating freight market failure; but this must be met by corresponding capacity commitments by heavy vehicle users to provide an effective commercial access framework.

3.2 *Expenditure planning and what costs are recoverable from heavy vehicle users*

ARTC supports the use of service level standards for the development of an expenditure planning approach as the basis of defining the costs recoverable from heavy vehicles; especially where underpinned by a commercial framework based on volume commitments by heavy vehicles. This framework should reflect the fixed recovery of costs regardless of volume, up to the level of volume committed to by heavy vehicles. Volumes above this level, would be in excess of that defining the service standards and would contribute to congestion effects on other users (given the road services have been planned on a particular level), which impact should be recovered via a congestion impact (or overrun) charge on the additional volumes. This ensures that planned expenditures are consistent with service standards, and volume risks are allocated to the appropriate party.

This link between planning and volume commitments is critical as the understanding of future usage will be most accurate when it is driven by financial commitments rather than a forecast. Reliance on forecasts can drive capital inefficiencies; especially when made by independent bodies with no financial exposure to the accuracy of those forecasts. However, where forecasts are underpinned by commercial commitments, the resulting expenditures are efficient to meet required demand. The performance of energy network investment when determined by an independent regulator as compared to that when determined by commercial commitment clearly demonstrates the efficiency of commercial commitments in determining required expenditures.

This process defines the level of cost. The portion recoverable from heavy vehicle users is then the next, and crucial, step to ensure no customer segment is cross subsidizing another. Given the relative size of trucks to domestic cars, their greater impact on all aspects of road expenditure must be accounted for to ensure their impact on those costs are accurately determined. Importantly, this would also address the inherent cross subsidy which exists in the PAYGO method between lighter inner-city trucks and vans and intercapital heavy vehicles. In turn, this impacts on the efficiency of the overall freight supply chain given the reliance of other freight transport modes (eg rail) on the cost of urban road transport. This is especially so where those trucks use toll roads as they end up double paying for the toll road as well as subsidizing other roads via their registration and excise level. ARTC firmly believes that this is best achieved by the independent pricing regulator who can assess the cost allocation principles to ensure they follow causation and any cross subsidies are eliminated.

Again, the presence of a commercial access framework will ensure that this assessment is undertaken based on core commitments and deliver the most accurate outcome.

Heavy vehicle usage creates significant externalities to the Australian economy. They are the least safe method of transporting intermodal freight, they currently have the highest emission intensity

and their excessive use of road capacity incurs congestion costs on other road users. The non recovery of these costs is a factor in excessive use of roads by heavy vehicles. In a system where charges reflect cost causation, it is critical to ensure all costs are covered. Therefore, these externality costs should be part of the independent cost assessment.

The Transport sector is the second largest source of greenhouse gas emissions in the economy. The ability to price these emissions would be a significant step in encouraging technological and modal shift ensuring the transition to less emissive forms of transport. ARTC notes these are not part of this consultation; however, it strongly recommends they form part of the next phase of reforms to ensure that the full costs of heavy vehicles are recovered.

3.2.1 Independent Determination

As highlighted above, where the NTC as an independent body has had its pricing recommendations overruled by government; the independence of the calculation is not a sufficient condition to deliver an efficient outcome. The decisions of the independent body must be binding, and unable to be overridden for political or other reasons. To ensure fairness, the approval process must involve stakeholder consultation and a clear process with defined timelines for publishing draft decisions, appropriate stakeholder consultation on those decisions and reasoning for final decisions. Given the linkage between costs, revenue and prices, there should be a single process to address all issues to minimize the regulatory burden of submissions on all stakeholders.

To ensure consistency, this must be a national body. Rail access regulation is a mix of federal and states and this is a significant constraint on the efficiency of rail.

A single, independent, national body should therefore be responsible for:

- assessing the efficiency of proposed expenditure plans based on commercial commitments;
- the appropriate allocation of forward and historic costs to heavy vehicles;
- determination and allocation of externality costs; and
- approving the pricing framework to apply; independent of political influence

3.3 Independent Setting of heavy vehicle charges

As above, ARTC strongly supports the use of a single, independent and national body to transparently define the binding heavy vehicle charges to apply; free from political influence.

ARTC supports the use of the standard regulatory building block model in this process. The stability of prices that arise from this process ensures that competitive outcomes are impacted by excessive price movements in one direction or another and ensure the intermodal freight market will operate at its most efficient level.

However, it is crucial that past investment be reflected in this process; especially given it is clearly demonstrated that heavy vehicles have not historically met their full costs incurred on the system. Not to take this approach would effectively sink historical investment by Australian taxpayers and, further, would expose the underfunded roads to a cost recovery mechanism that highly funded

roads are not. This would be reflected in the Opening RAB, as identified in Figure 5 of the Consultation Paper. Failure to define the Opening RAB would therefore:

- Sink historic taxpayer investment in heavily funded roads to the benefit of heavy vehicles; and
- Drive inefficient investment outcomes by increasing the cost of underfunded roads compared to well-funded roads.

Defining this opening RAB must be the critical initial step of the independent regulator

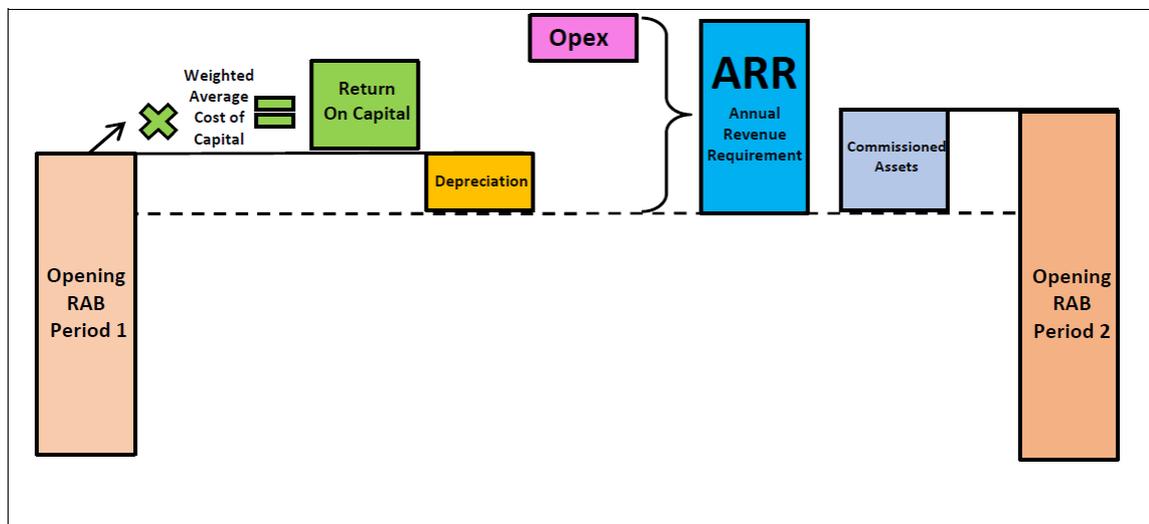


Figure 5: Visual representation of the building blocks of a FLCB

3.4 Dedicated road funding – hypothecation

The link between costs and revenue in driving an efficient system are critical. Cross subsidies can exist not only between classes of users, but also between jurisdictions and roads. If charges are based on cost causation, then it is essential those costs are recovered; which only occurs through hypothecation. This process should, however be part of the transparent independent assessment discussed above

4 Conclusion

ARTC supports the four elements proposed by HVRR and believes these represent much needed progress in a process which has been beset by inertia.

However, these are only necessary conditions to address the pervasive market failure which exists in the intermodal freight market driven by the inability to price and control road capacity utilization by heavy vehicles; they are not, however, sufficient. Therefore, without quickly building on these reforms and ensuring the introduction of a commercial access framework to deliver balanced commitments between road users and owners, the market failure and consequent externality costs on the Australian economy will persist.

Therefore, ARTC recommends that the HVRR focus its efforts on ensuring the:

- development of a commercial access framework for heavy vehicles to the road network that aligns charges to volume commitments and appropriately charges for excess usage;
- removal of cross subsidies received by heavy vehicles from other road users and Australian taxpayers;
- prior investment by Australian taxpayers is not sunk resulting in distortions to efficient road investment by increasing the relative costs of underfunded roads; and
- inclusion of externality costs in assessing the charges to ensure the full costs of road usage to the Australian economy (and taxpayers) are recovered and an incentive to transition to less emissive forms of transport is created