Productivity Commission

Review of National Competition Policy Arrangements
Submission in response to the Productivity Commission's Issues Paper by
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1. TERMS OF REFERENCE

One of the tasks of the Productivity Commission in its review of National Competition Policy Arrangements is to assess the impact of competition reforms, and to examine opportunities for "*significant gains to the Australian economy from removing impediments to efficiency and enhancing competition*", ("Review of National Competition Policy Arrangements, Productivity Commission Issues Paper", Productivity Commission, April 2004 (**"Issues Paper"**) at p 1).

The Issues Paper states that there may also be *"...opportunities to extend road transport reform- for example, through modified charging regimes for road users to encourage more efficient road usage, funding alternatives for infrastructure investment and maintenance that could provide the community with better value for the funds expended, and promoting more effective competition between road and rail transport to facilitate a more efficient mix of transport services"* (Issues Paper, at p 10).

Pacific National's submission will address these critical issues from the point of view of one of Australia's largest private rail operators. In doing so, Pacific National acknowledges the release on 7 June 2004 of the Federal Government's AusLink White Paper. In the time available, Pacific National has been unable to absorb the proposed funding and policy arrangements detailed in the White Paper in a manner which would permit it to make detailed comments on those arrangements and the extent to which they affect the Productivity Commission's Inquiry. Accordingly, some of the comments made in this submission may cover some of the same ground or be addressed in the AusLink White Paper.

Pacific National welcomes the Federal Government's policy initiatives set out in the White Paper, including:

- its integrated, long-term approach to national transport planning, including its defined "National Network" of important road and rail infrastructure links and their intermodal connections and its single funding regime for the National Network, including the funding proposed for the rail industry reforms; and

- its recognition of the historical deficiency in the quality of rail infrastructure and its stated desire to progressively improve the capacity of rail operators to effectively compete on their merits for a greater share of the forecast growth in freight traffic.

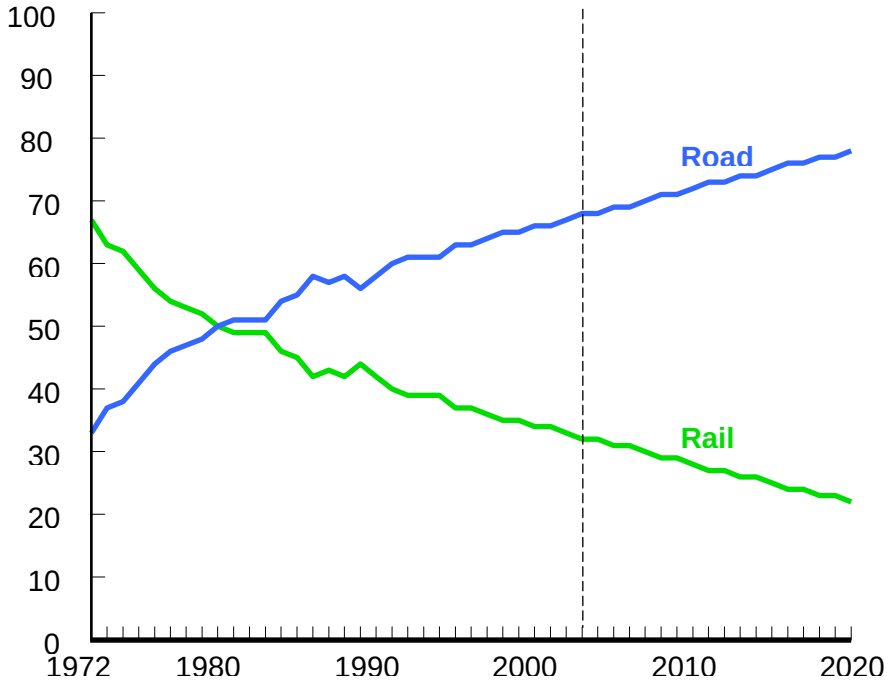
Pacific National believes that the AusLink funding and policy initiatives are a step in the right direction. However, the White Paper, of itself, does not remove the need for the Productivity Commission to examine the issues affecting the transport of freight in Australia that are set out in this paper.

2. OVERVIEW OF ISSUES IN THIS SUBMISSION

2.1 Competitive Neutrality Between Road and Rail

In terms of non-bulk freight transported overland, rail competes most closely with road. Over the past two decades, however, there has been a significant modal shift from rail to road which is predicted to increase over time.

The downward trend (both historic and predicted) in modal share between road and train by net tonne kilometres for inter-capital corridors is demonstrated graphically as follows:



Source: Bureau of Transport Economics Working Paper 40, "Competitive neutrality between road and rail" ("**BTE Working Paper**") at p 8.

The BTE Working Paper found, *"[W]ith no change in relative input costs, and in the absence of a solution to some of rail's logistic difficulties relative to road, the long-term decline in rail's share of the freight market is unlikely to change*."(BTE Working Paper, Abstract, p (ix)).

Rail's declining ability to compete with road for non-bulk freight haulage featured in the Productivity Commission's report, Progress in Rail Reform, 5 August 1999 (**"Rail Reform Report"**). In that report, the Productivity Commission found that the Government's policy framework and processes have tended to foster this disparity in modal share,

> "*Competitive neutrality issues arise regarding government policies applying to different modes where they favour one mode over others. In this broader sense, a lack of competitive neutrality need not necessarily stem solely from government ownership of transport enterprises, but rather the policy framework and processes*
>
> ...
>
> *Key government policies and arrangements which could affect competitive neutrality in the land transport market include investment, taxes and charges, as well as access regimes, safety regulation and operation procedures and standard*s.." (Rail Reform Report at p 232).

This reflects Pacific National's experience on the east coast corridors between Melbourne, Sydney and Brisbane. The quality and standard of the infrastructure on this corridor is generally poor. Coupled with the pricing distortions faced by rail the current scope for increasing rail freight volumes is severely limited. This is of particular concern because these locations have significant freight volumes for which rail is hampered in its ability to compete because of the quality of the infrastructure and the fact that heavy vehicle road use does not bear the costs properly attributable to its use of the road infrastructure.

On the east-west corridor, rail has a significant proportion (over 70%) of total freight moved. Whilst, to some extent, this is a function of the distances involved, it is also related to the quality of the infrastructure.

On the east coast corridor, poor quality infrastructure and inappropriate heavy vehicle road use charges mean that rail is not able to effectively compete on its merits for the substantial volumes of traffic on this corridor.

With the implementation of further reforms at an industry level and, most importantly, at the Governmental level, there are significant further potential gains in the efficiency of north-south inter-capital freight on the east coast corridor.

2.2 Efficiency gains

Progress has been made in improving the efficiency of rail operations in recent years. Productivity and service quality in above rail operations has been enhanced by the privatisation of National Rail and Freight Rail Corporation, while integrated privatisations in Victoria, Tasmania, South Australia and Western Australia have also improved rail efficiency.

There has also been encouraging progress towards a single approach to national accreditation and regulation, although further work is needed to eliminate some duplication and complexity.

However, Pacific National believes that greater efficiency gains can be achieved and that the Australian transportation landscape has yet to fully realise the benefits of an efficient transport system.

Pacific National supports national regulation for the rail industry and a level playing field for all transport modes. With appropriate reforms at the industry and governmental levels Pacific National considers that:

(a) larger efficiency gains can be achieved and rail freight can realise its potential as a considerably cheaper transport mode than road on all inter-capital corridors; and

(b) rail can considerably increase its share of the transport task.

2.3 Benefits to Consumers and to the Economy

There are substantial benefits to Governments, transport users and the economy from rail, a fundamentally lower-cost mode of transport, gaining a greater share of the transport task. They include:

(a) a more efficient transport system;

(b) price signals to consumers reflective of the true costs to consumers of using each mode of transport;

(c) cost savings to customers; and

(d) a reduction in the indirect costs of road use (e.g. pollution, congestion; incidence of accidents).

An efficient Australian transport system would result in significant cost savings for transport users, which will flow on to increases in real Gross Domestic Product. There would be corresponding increases in real consumption, which would be reflected in

increased community welfare or living standards. In addition, an efficient system would lead to generation of additional employment in the transport and related sectors.

2.4 Areas for Reform

In Pacific National's view, the major outstanding areas for reform are:

(a) **Infrastructure Charges** - The existing road user charging system which under recovers costs attributable to classes of vehicles which compete with rail (Rail Reform Report, at p 249). Road access pricing policy provides a significant subsidy for heavy vehicle owners, which not only inflates charges for passenger car owners, but also severely impacts on the competitive position of rail. Until reform in this area is achieved, the road access pricing mechanism will continue to confer a distinct competitive advantage on long distance road transport operators.

(b) **Investment in Road and Rail Systems** - There has been significant disparity in investment funds allocated by the public sector between road and rail systems in recent decades. This lack of properly targeted investment in Australia's rail system, in particular the lack of investment in infrastructure facilities on the East Coast of Australia, continues to distort competitive dynamics, and confer an advantage on road freight operators.

(c) **Stamp Duty Reform** - The New South Wales Office of State Revenue is presently seeking to levy stamp duty on railway access agreements, on the basis that it is a lease of land, at the *ad valorem* rate of 0.35% of total access charges over the life of the access agreement. This represents a substantial impost. It is possible that other jurisdictions will follow suit. The opportunity to increase State revenue collections in New South Wales at the expense of railway operators, puts some operators at a competitive disadvantage compared with operators of other freight transport modes, in particular road. Such a tax could also affect rail on rail competition in some jurisdictions, as discussed below.

3. THE EXPERIENCE OF PACIFIC NATIONAL

Following agreement between the Commonwealth, New South Wales and Victorian governments, the sale of 100% of the shares held by those governments in National Rail Corporation ("**National Rail**") and the sale of Freight Rail Corporation's ("**FreightCorp**") assets proceeded in 2002. A joint venture of Toll Holdings and Patrick Corporation succeeded in the competitive tender process and formed what is now known as Pacific National.

Pacific National built on the efficiency gains already achieved by its public sector forerunners, National Rail and FreightCorp, to improve productivity and service quality. Costs have been reduced by 8.4%, while net tonne kilometres have increased by 6.7%. One third of the senior managers are new to the organisation, bringing a fresh approach that has broken down many of the old assumptions about efficiency limitations.

Most recently, Pacific National has secured a new Enterprise Agreement which will further drive efficiency improvements through a more flexible rostering and hours of work system and a more simplified job classification system.

Pacific National has driven innovation in rail to take share away from its closest modal competitor, road. Since privatisation, Pacific National's board has given approval to capital expenditure in the order of $300 million for investment in rollingstock and terminal infrastructure. For example, Pacific National has invested $12 million in new lower-set

wagons to accommodate specially designed "cartainers" for new passenger cars from Adelaide to Brisbane and Melbourne to Brisbane. More than 35,000 cars per year that would otherwise have been transported by road will now be going by rail.

Making substantial investments in above rail equipment and infrastructure such as locomotives and rolling stock, where that equipment and infrastructure itself has a long life, can be difficult when Pacific National is unable, as an access seeker, to obtain track access rights in excess of 5 or 10 years. This can operate as a disincentive to above rail infrastructure investment as discussed in section 5 below.

Pacific National is not the first rail venture for Toll Holdings and Patrick Corporation. Toll Rail was created in 1996 to provide a freight-forwarding rail alternative to the industry leader of the time, National Rail. It is generally recognised that Toll Rail's entry into the freight forwarding business and its competitiveness in the East-West corridor led to significant reductions in freight rates, and helped drive efficiencies across the industry.

Pacific National and its shareholders, therefore, are uniquely placed to discuss rail competition from two distinct experiences and perspectives – as a smaller, new entrant (Toll Rail), and as a major linehaul provider (Pacific National).

4. OBJECTIVES OF RAIL REFORM

As explained in the Productivity Commission's Rail Reform Report, the overall objective of rail reform is, *"an efficient transport system – this involves having the appropriate mix of transport modes which best meet Australia's freight and passenger transport needs"* (Rail Reform Report at p 290).

An efficient system is one in which:

(a) modes compete according to their respective strengths and weakness and one mode is not the subject of funding imbalances which distort competitive dynamics;

(b) investment in the infrastructure is efficient; and

(c) above and below rail perform efficiently.

An efficient Australian transport system would result in significant cost savings for transport users, which will flow on to increases in real Gross Domestic Product. There would be corresponding increases in real consumption, which would be reflected in increased community welfare or living standards. In addition, an efficient system would lead to generation of additional employment in the transport and related sectors.

5. REFORMS TO DATE

The Progress on Rail Reform Report made a number of recommendations for further reform. Some of the more significant are discussed below. A number of the Productivity Commission's recommendations have been implemented, although progress in some key areas has been slow.

5.1 Further Private Sector involvement

The privatisation of the merged National Rail and FreightCorp was completed in 2002, adding to other rail privatisations in Victoria, Western Australia and Tasmania. Interstate track infrastructure and the New South Wales network, however, remain in public sector hands through the Commonwealth-owned Australian Rail Track Corporation ("**ARTC**").

In Queensland, the Government-owned Queensland Rail runs a vertically integrated rail business.

5.2 A single approach to accreditation and regulation

The States and the Commonwealth have attempted to address the lack of consistency in this area over the last two years.

In some areas, a more consistent national approach is being taken. These areas include:

(a) Accreditation fee calculation.

(b) Material change application guidelines.

(c) Development of the Regulators Panel.

However, there is still excessive duplication and confusion, in particular when individual States pursue their own initiatives at the expense of a national approach. One example of this is the recent confusion over health assessment standards.

The Victorian Department of Infrastructure ("**DOI**") first began developing health assessment standards for the rail industry two years ago. A reference group was formed, and Pacific National's Executive Manager Safety, David Edwards, was part of that group. Pacific National made the point early in the process that while Pacific National supported the DOI initiative, it made more sense for the issue to be dealt with nationally. In this context, Pacific National proposed that the National Transport Commission ("**NTC**"), previously the National Road Transport Commission ("**NRTC**") consider the development of a national health assessment standard in its strategic planning process. The NTC accepted this proposal and began working on a national standard, with input from the States.

Despite the NTC initiative and the subsequent secondment of the DOI Project Manager to the NTC group, the Victorian DOI continued development of its own State based standard. The NTC standard was more than half complete when the Victorian standard was gazetted on December 21, 2003. Then the Waterfall Inquiry introduced another complication in this process. Picking up on one of the Inquiry recommendations, New South Wales adopted the Victorian standard and gazetted their own on June 1, 2004. This was despite the fact the NTC had passed the national standard in late May.

The end result is that we have three health assessment standards in Australia. They are all based upon the same underlying premises. However, the actions of Victoria and New South Wales have created unnecessary confusion and duplication. Pacific National's submissions to Victoria and New South Wales, that the ensuing confusion and duplication could be avoided if the two State standards were repealed and the NTC's standard was adopted nationally, have been rejected.

5.3 Inquiry into provision, funding and pricing of roads

The NTC has been responsible for tackling the issue of road access pricing. Unfortunately, it has done little to reduce the effective cross-subsidisation of heavy vehicles by cars and other lighter vehicles. This will be covered in more detail in the Issues Remaining section of this submission.

5.4 Establishment and operation of ARTC

The ARTC was created in 1997 to provide a single point of access for operators seeking access to the interstate rail network.

ARTC currently has responsibility for the management of 4430 route kilometres of standard gauge interstate track, mainly in South Australia, Victoria and Western Australia. It has recently concluded an agreement to take over the Hunter Valley track and interstate track in New South Wales.

While there have been some improvements to track management under the ARTC, one criticism of the new structure is the lack of a formal approach which would provide operators with certainty on either long-term access pricing or infrastructure investment. Whilst access providers have differing approaches, in Pacific National's experience it has been difficult to secure an access agreement for access rights for a term in excess of 5 to 10 years. When considering that the effective useful life of rolling stock is over 20 years and that the investment required to upgrade, repair and replace rolling stock and locomotive fleet is substantial, the current system is sub-optimal.

5.5 Access Regimes

The adoption of the policy in the 1990s to mandate access to railway infrastructure in Australia has led to the development of access regimes in all Australian mainland States and for the interstate network. There is great inconsistency in the application of these regimes.

The mandated access development has led to considerable difficulty for access seekers operating across State boundaries. Even with the ARTC/RIC lease agreement, there will still be six organisations controlling interstate track and associated facilities (sidings and loops) on the interstate network – Queensland Rail, NSW RailCorp, VicTrack, ARTC, Australian Southern Railroad, and Westrail. Each has a different set of terms and conditions and pricing structure.

It is worth pointing out that, as a result of the new rail agreement between the Commonwealth and New South Wales for the lease of the New South Wales interstate track and the Hunter Valley freight corridors to ARTC, Pacific National has three access providers in New South Wales alone - ARTC, the residual Rail Infrastructure Corporation entity and RailCorp.

5.6 Vertical Separation

With the exception of the New South Wales Intrastate system and the interstate network operated by ARTC, vertical separation has not been achieved in the Australian rail system. Vertical integration is the norm, as seen in the intrastate systems in Victoria, Tasmania, Queensland, South Australia and Western Australia. The experience internationally is the same.

Experiments with separation have been attempted in relatively few overseas countries, where again vertical integration is largely the norm.

The Bureau of Transport and Regional Economics Report 107, "Rail Infrastructure Pricing: Principles and Practice Report" released in 2003 makes some interesting observations:

- on the effects of vertical separation on infrastructure management and train control:

"*Vertical separation of infrastructure management and train control also adversely affects incentives for maintaining and optimising track and rolling stock and for controlling the impact of rolling stock on infrastructure. Finally, the shift from entirely integrated operations increases the resource costs required to maintain safety standards"* (at p (xiii)).

- on circumstances where vertical integration is preferred over vertical separation:

  "...if the likely on-track competition will be modest (due to small freight movements), the relatively low resulting benefits may not warrant the costs of vertical separation. For this reason, the Productivity Commission has concluded that where competition is not possible (for instance, because of low traffic density) then vertical integration is preferred over separation. (See, for instance, Owen, p. 19; Productivity Commission 2000, pp. 295–96.)" (at p 9).

6. ISSUES REMAINING

Rail is more efficient, has lower associated costs and is characterised by lower externalities than road. However rail pricing is unable to reflect these advantages over road because of current distortions (discussed below).

Despite this innate cost advantage, rail is holding the following shares of the freight market on the East Coast:

(a) Melbourne to Sydney (13%).

(b) Sydney to Brisbane (20%).

(c) Melbourne to Brisbane (27%).

The reasons for this lack of competitiveness include:

(a) The continuation of the current cross- subsidy for heavy vehicles through the road access pricing mechanism.

(b) The lack of investment in rail infrastructure on the East Coast contrasted by the current long-term investment forecasts and planning on road.

(c) In addition, the New South Wales Duties Office's treatment of rail access agreements as dutiable instruments and the possibility that other jurisdictions might follow suit puts many rail operators at a competitive disadvantage compared with operators of other freight transport modes, in particular road. It could also affect rail on rail competition in some jurisdictions.

6.1 Heavy Vehicle Pricing

Issues in Heavy Vehicle Pricing

The BTE Working Paper found that, "*The main reforms needed to achieve [a] competitively neutral scenario are to impose charges on heavy vehicles that more fully reflect the cost of heavy vehicle road use, and ensuring that both road and rail operators face the full costs of all externalities*" (at p 30). Pacific National agrees with this finding.

Despite the high level of competition, below rail access prices are based on "natural monopoly" principles, including as in input to access pricing, a return on sunk costs. Below

road access pricing is not based on the recovery of costs associated with natural monopoly infrastructure.

The BTE Working Paper found at (p 22):

> *"Full cost recovery may be desired to cover the costs of road provision. For example, where institutional constraints require full cost recovery in any one mode, say rail, then efficient pricing and investment may imply full cost recovery in all competing modes, such as road, to ensure efficient allocation of resources among the modes".*

In calculating its competitively neutral scenario, BTE found that to fully recover current network expenditure in road, a 6 axle articulated vehicle travelling interstate 189,000 km per year would pay $36,700 per year in infrastructure use charges, representing an increase of 67 per cent over charges current at that time (BTE Working Paper at p 23).

It is widely accepted that the heaviest trucks do not pay their appropriate share within the current pricing principles. The Commonwealth Government in its 2002 Transport Green Paper stated that … "*While charges for heavy vehicles are calculated by the National Road Transport commission (NRTC) to recoup the costs of road wear … those trucks that carry greater than average loads and travel greater than average distances bear less than the costs allocated to them by the NRTC*" (Department of Transport and Regional Services, AusLink Green Paper, 2002 (at p 36).

Australia, like many other countries, uses what may be described as an "equity" allocation approach, as it seeks to allocate all costs between users in an "agreed" fashion based on prescribed principles that, among other things, emphasise simplicity, efficiency and equity. More recent work suggests that this approach is inferior to both "engineering" and "econometric" methodologies. These have a common link in that they seek to base charges on the actual marginal costs of road usage, including both direct marginal costs and what are termed 'damage externalities' which are the costs to other vehicles imposed by road damage and which can be significant. The "engineering" approach seeks to use pavement management systems that determine when various maintenance tasks are necessary. The "econometric" approach uses historical data to estimate the actual impact of traffic on costs. It is empirical, not theoretical.

The Current Approach

The current approach results in low allocations to interstate road freight for a number of reasons. The first relates to the application of the "equity" approach.

The NRTC divides all road expenditure into "allocated" and "non allocated" categories. The latter includes expenditure on vehicle registration and heavy vehicle registration costs. It is unclear why this approximately 14% of expenditure is excluded for purposes of calculating road user charges.

Most important, the NRTC then divides the allocated costs into separable and non-separable costs. The latter represents 70% of allocated costs. This expenditure is supposed to correspond to the cost of building a minimum standard road, as well as some minor operational expenditure such as mowing roadside verges.

The NRTC allocates 100% of these non-separable costs by vehicle kilometres, and so treats a car and large trucks such as a B-double in the same way. At a minimum this expenditure should instead be allocated using Passenger Car Units (PCUs), which is a capacity measure of the space taken up by a vehicle on the road. Using PCUs, a B-double, for example, is equal to four cars, and this is more closely representative of the impact of different vehicle

types on the need to incur non-separable costs. This change alone would significantly re-weight road user charges in a more equitable fashion.

The second reason for a low allocation to heavy vehicles flows from the findings of the "engineering" or "econometric" approaches. On the one hand, using this research would likely see non-separable expenditure at less than 70% of allocated costs. That is, more expenditure would be driven by vehicle axle weight on the road than is currently assumed. More work is needed to determine the appropriate extent of non-separable expenditure.

On the other hand, separable expenditure could more reasonably be allocated by the weight over the axle, not by the gross vehicle mass. This is best seen by looking at the emerging evidence from the econometric and engineering models, which demonstrate that GVM allocation of separable costs results in underestimation of heavy vehicle cost allocations

The effect of these assumptions is that the NRTC's application of the equity approach results in lower allocations of costs to heavy vehicles than is other countries which use a comparable technique (e.g. the UK) and approaches (i.e. engineering and econometric approaches).

The 3rd Heavy Vehicle Road Pricing Determination and the Government's recent fuel excise announcement

In its February 2004 Fact Sheet, entitled "Road Pricing", the NTC states that Australia is examining the role of the following factors in setting heavy vehicle pricing:

- managing demand for road use and costs of road wear and tear;
- managing environmental impacts of heavy vehicles;
- road and rail neutrality; and
- inter-governmental and institutional implications of improving heavy vehicle pricing systems.

The role that these factors will play in heavy vehicle pricing will not be known until after the third determination is finalised, which is expected in 2006. Pacific National welcomes, in particular, an increased role for road and rail neutrality and consideration of environmental impacts of heavy vehicles in heavy vehicle pricing as discussed below.

On 15 June 2004, in Prime Minister John Howard's address to the National Press Club on "Securing Australia's Energy Future", he announced that the excise paid on fuels used in heavy vehicles will be converted to a road user charge from 1 July 2006. This excise relief will apply to all fuels and is expected to benefit as many as 54,000 heavy vehicles. To qualify to this excise relief, Prime Minister John Howard stated that the heavy vehicle operators will have to meet one of five tests to demonstrate that they are not a high polluters before they gain access to excise relief.

These 5 tests were not articulated in the address to the National Press Club and in the time available Pacific National has not had the opportunity to fully comprehend the full impact this excise relief will have on road rail neutrality. Suffice to say that the excise rebate will affect road/rail neutrality.

Moving to mass distance charging

There are further problems with the current charging methodology for heavy vehicles.

The BTRE has recently described these problems clearly, *"Specifically, the current fuel-based heavy vehicle charges increase linearly with distance but at a declining rate with respect to vehicle load … for more heavily laden vehicles the costs of road wear per net tonne-kilometre increases with mass whereas the fuel-based charge per net tonne-kilometre decreases with mass*" (Bureau of Transport and Regional Economics, Working Paper 57, Land Transport Infrastructure Pricing, 2003).

A related issue, according to the BTRE, is that *"registration charges are set based on fleet average utilisation. The effect is that vehicles that carry less mass or travel below average distances pay a higher per unit road use charge than vehicles carrying more mass or travelling above average distances"*.

The solution to these problems is to use mass distance charges instead of either fuel-based or registration charges. This would further rebalance the bias against rail as the latter competes against the heaviest trucks travelling the longest distances. Currently, a number of European counties are in the process of introducing mass distance charging. Switzerland introduced a mass distance charge in 2001, and Germany and the UK are both planning truck-km charges that will take account of vehicle environmental and road damage characteristics.

Factoring in externalities

The final measure required to rebalance road and rail access charges is to factor in the non-road damage externalities. These include allowing for the larger safety, environmental, and congestion problems associated with road transport compared to rail.

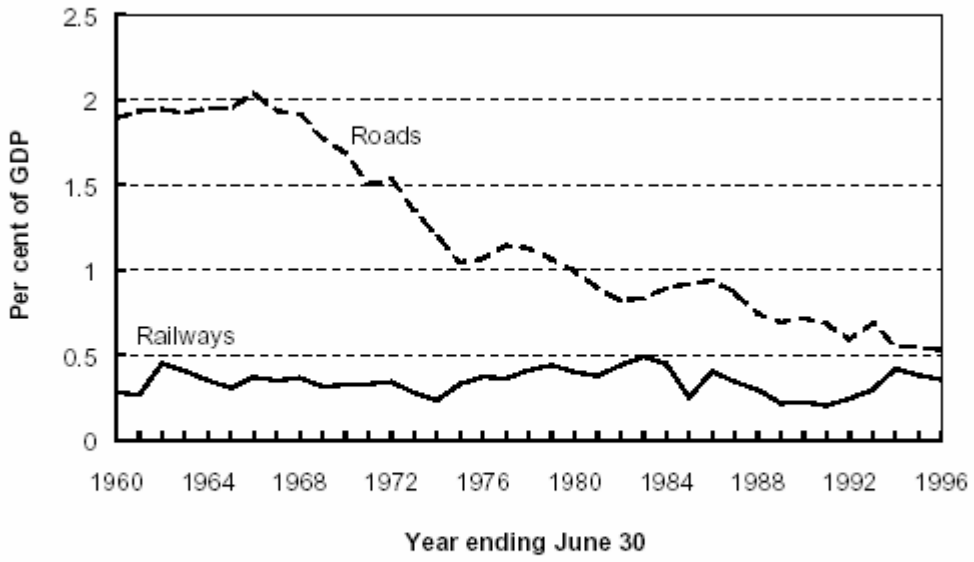
While the theoretical case is strong, in practice, of course, externalities are often not factored into public policy. This is usually due to complexity, and to political difficulties.

There is, however, an important issue. People wishing to move goods on inter-capital corridors are making constant choices between road and rail. Price is an important consideration, and the externalities associated with transport by road are much larger than they are for rail. Ignoring these externalities leads to poor pricing from a public policy perspective, and so poor decision making.

6.2 Lack of Infrastructure Investment

The Rail Reform Report (at p 234) found that there has been a significant disparity in investment funds allocated by the public sector to rail and road systems in recent decades, depicted in the following figure:

Figure 10.1 **Public sector investment in land transport infrastructure, Australia, per cent of GDP [a,b,c], 1959-60 to 1995-96**



[a] Gross fixed capital expenditure as defined by the ABS. [b] The public sector comprises the general government sector and the public trading enterprise sector including government-owned railways. [c] The data include Commonwealth and State/local sector investment.

Data source: ABS (unpublished constant price estimates; *National Income, Expenditure and Product*, Cat. no. 5206.0).

The Report noted that the disparity in road and rail investment coincided with road transport capturing an increased share of the domestic freight and passenger markets (Rail Reform Report at p 235).

Many participants to the Rail Reform Inquiry commented upon the poor condition of existing rail infrastructure, as well as the route congestion in the Sydney metropolitan area, as deficiencies in the rail infrastructure in Australia.

National Rail was one such participant. In its submission to the Productivity Commission's Inquiry into Progress of Rail Reform, National Rail identified a number of issues with the track, including:

(a) Obsolete alignments which restrict speed and therefore transit time (a critical factor in intermodal competition), and increase fuel consumption and track access charges (which are generally based on a mass-distance formula).

(b) Obsolete signalling and communications equipment on much of the network, which slows average speeds and reduces capacity on some parts of the network. For example, despite decades of promises to correct the problem, the manual, archaic staff system is still used to provide signalling from Casino to Greenbank.

(c) Short crossing loops, which limit the train length and are a major factor in operating costs.

(d) Inadequate height clearances, which prevent double stacking of containers and limit use of larger containers in east coast corridors linking Adelaide, Melbourne, Sydney and Brisbane where trucking competition is greatest.

These submissions led the Productivity Commission to make the following finding:

> *"There has been inadequate investment in some parts of the rail network. The resulting problems for the rail industry are particularly acute in the Sydney area"* (at p 239).

Despite this finding, the problems identified by National Rail in its 1998 submission to the Productivity Commission detailed in (a) to (d) persist. For example, there is still a myriad of severe speed restrictions within the New South Wales network, under which trains are required to slow to speeds of 10 kmh, holding back transit times and greatly impacting on the efficiency of rail operations.

While these issues continue with rail infrastructure, road operators have been benefiting from generous Government funding of the national highway system. This investment has been a catalyst for major productivity improvements among road operators, because it has permitted such competitive improvements as increases in vehicle mass and dimension limits.

The AusLink announcement of $1 billion in new rail funding (incidentally dwarfed by the $12 billion boost for national road highways) will go some way to addressing some of the rail infrastructure issues.

As set out in the introductory section to this submission, in the time available, Pacific National has been unable to absorb the proposed funding and policy arrangements detailed in the White Paper in a manner which would permit it to make detailed comments on those arrangements. However, it appears to Pacific National that there are no formal processes under AusLink, at this stage, to ensure that these investments are the most appropriate to encourage complementary above rail investments in locomotives, wagons and terminals. Pacific National reserves the ability to make further submissions on the AusLink funding proposals, at appropriate times, during the course of the Productivity Commission's inquiry.

6.3 State Taxes

The New South Wales Office of State Revenue is presently seeking to levy stamp duty on railway access agreements (as a lease of land) at 0.35% of the total access charges over the life of the access agreement. This is a substantial impost.

This approach has resulted in inconsistent treatment of railway operators as opposed to operators of other transport modes.

A truck operator does not pay an access charge which is based on its "use" of the road network. Although truck operators may pay to use toll roads, such tolls are not liable to taxation at the State level. Although there may be GST levied on those toll charges, this can usually be recovered through the input tax credit system.

Unfortunately for railway operators within the New South Wales jurisdiction, there is now an additional 0.35% duty on their access to railway infrastructure. As a matter of policy, this duty is calculated on a GST inclusive basis. This not only means two levels of taxation but also an effective tax on a tax, as stamp duty is payable on access charges increased by 10% GST. Unlike GST, stamp duty is at all times a cost of the rail operator, which can either be passed directly on to its customers or absorbed as part of the operating costs of the business. Either way, it puts a rail freight operator at a competitive disadvantage compared to a truck operator.

At this stage, Pacific National is not aware of the policies in this regard in other jurisdictions. In addition, if other vertically integrated jurisdictions, for example

Queensland, were to adopt a similar policy to the New South Wales duties Office, such a tax could affect rail on rail competition. It would put rail freight operators like Pacific National at a competitive disadvantage to its vertically integrated freight competitors like Queensland Rail which would not be liable to pay the State tax because they own the infrastructure, access to which is the object of the tax.

Pacific National considers that reforms in this area are required now before policies such as that adopted by the New South Wales Duties office disadvantage freight operators and affect rail on rail competition.

7. RECOMMENDATIONS

Road currently enjoys subsidisation benefits which make it a more attractive mode of transport than is reflected by the underlying economics.

The competitive distortions between modes should be addressed by road usage charges for freight operators being moved to align with the costs (including relevant externalities) of providing services to those road operators.

Increased investment by the Government in rail infrastructure and policy which creates proper incentives for efficient investment and disincentives to gold plating is required before road and rail can compete according to the intrinsic strengths and weaknesses of those modes.

We propose that the Productivity Commission makes the following recommendations to improve the competitiveness and flexibility of the Australian land transport sector:

(a) The overhaul of heavy vehicle access pricing to create a true alignment between road operator charges and costs (including relevant externalities).

(b) A more equitable and consistent land transport capital funding approach under AusLink.

(c) Reforms which would prevent State taxes from affecting rail on road and rail on rail competition.