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TRANSCRIPT
OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO ROAD AND RAIL FREIGHT INFRASTRUCTURE PRICING

MR G. BANKS, Chairman
PROF C. WALSH, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON MONDAY, 13 NOVEMBER 2006, AT 9.38 AM

Continued from 6/11/2006 in Canberra

MR BANKS: Welcome, everybody, to the final day of hearings for the Productivity Commission's inquiry into road and rail freight infrastructure pricing. My name is Gary Banks. I'm chairman of the Productivity Commission and presiding on the inquiry, and my colleague is Prof Cliff Walsh who is associate commissioner for the inquiry. The inquiry had its genesis in a February 2006 meeting of COAG with subsequent terms of reference being transmitted via the treasurer, requiring the commission to report back to COAG by the end of this year.

The task that we've been assigned has three main dimensions, which I'll just mention briefly. The first focuses on the competitive neutrality between road and rail. The second relates to the potential for new road pricing instruments to achieve more accurate cost reflective pricing and the efficiency gains that could derive from that, and the third focus is on non-price impediments to the efficiency of both road and rail.

We have put out a discussion draft which contains the commission's preliminary findings, and a range of questions for participants that would help us in progressing to the final stage of this inquiry. The discussion draft follows extensive meetings and discussions that we've had with a wide range of participants, including 70 or more submissions that were presented to us in the first round, and two roundtables that we had, one in regional Australia at Emerald in Queensland, and another involving a range of experts in this matter, including people from government agencies which we held in Canberra.

These public hearings, together with the further round of submissions that we're receiving, are an important part of the process of getting to our final report. They provide the opportunity for views to be put and discussed in a public arena. We conduct the hearings in a reasonably informal manner, but I need to remind participants that a transcript is being taken, and for this reason, comments from the floor can't be taken, but at the end of the day's proceedings, I'll provide the opportunity for anyone who wishes to do so to make a brief presentation. Participants are not required to take an oath, but are required under the Productivity Commission Act to be truthful in their remarks. Participants are welcome to comment on the issues raised in other submissions.

Transcripts will be made available to participants and will be available from the commission's web site with a short delay following the hearings. I believe a number of the submissions from the earlier hearings are already available. Copies can be purchased using an order form available from staff here today.

To comply with requirements of the Commonwealth occupational health and safety legislation, you're advised that in the unlikely event of an emergency requiring an evacuation of the building that the exits are located just outside this hearing room, and we have members of staff here who can assist in helping you if that were to become a problem.

With those preliminaries out of the way, we'd like to welcome Euan Morton who has been a late starter for these hearings. Welcome, Euan.

MR MORTON: Thank you very much for accommodating me.

MR BANKS: We've got Euan, for the benefit of the transcript, appearing via telephone conference from Brisbane. Is that correct?

MR MORTON: That's correct.

MR BANKS: Euan, I might just get you to perhaps indicate for the record the capacity in which you're presenting, and then hand over to you to make whatever remarks you like.

MR MORTON: Certainly. Thank you. My firm has assisted Queensland Rail in a number of submissions to the Productivity Commission and other bodies on road pricing and rail pricing related issues. However, on this occasion I'm appearing in a personal capacity, and I guess as an interested person who has I guess spent some degree of professional time on transport pricing issues. The key issues I wanted to mention were the issues surrounding PAYGO, and I, I guess, felt that the commission could have been more cautious about the efficacy of PAYGO as a means of costing and pricing roads. There are some comments made in appendix E about the elasticities and the fact that that is an area of considerable - that the elasticities where road and rail compete may in fact be - the cost of elasticities may be significant.

I wanted also to talk about some of the issues associated with pricing and how I think that the pricing should work in relation to road pricing for heavy vehicles, and finally to indicate some areas where further work may be appropriate for the commission's consideration.

MR BANKS: Good. Thank you, Euan. We'll let you proceed through that. That's quite a nice little agenda.

MR MORTON: I think if we start with PAYGO - the commission in its report was I guess - and I don't want to put words in anyone's mouth, but wasn't as critical as I believe it might have been about the PAYGO system. To me the PAYGO confuses the stop and a flow concept, and I've got no doubt that the commission would be aware of a number of these issues. I think that it is likely to understate materially the cost recovery from the stock of the asset of the road asset. What concerns me most about the PAYGO system is that it is very tempting to gloss over the cost relationships and the cost intricacies by simply adopting a highly average approach that the PAYGO system invites.

What we've seen in the pricing of other monopoly industries, some of which are very nearly as complex as roads when you consider the realities of our telecommunications and electricity networks, is that the full asset valuation, capital maintenance cost process does in fact reveal enormous information and very significant information about the nature of the costs of providing the network and how those costs change in relation to different users of the network. So my concern about the flow concept of PAYGO is that it encourages a cost averaging approach which may have been all that's been able to be done in the past, but to my mind it's very important that this report or the commission consider the long-term adverse consequences in terms of holding back pricing reform if we continue to rely on PAYGO.

MR BANKS: Okay. Thanks, Euan. I think the points you raised are ones that we obviously did consider in the discussion draft and we'll continue to consider. I think on the broader issue of PAYGO as an approach, if you didn't need to do it because you had technologies available to do other things - I mean, we're being quite critical of it being a very blunt charging mechanism, indeed, the way it's been implemented is effectively a taxing regime. So I think we're trying to argue pretty strongly in the discussion draft that over time you'd be wanting to move to something that was more attuned to forward-looking costs and prices that reflected those.

MR MORTON: Sure. Gary, perhaps I should have been - I guess in reading the report, you read it from a certain perspective. I acknowledge all of those things. I guess I was keen to emphasise the importance in my mind of swiftly moving away from the PAYGO, because it's become an excuse to sweep a lot of things under the carpet in terms of the complexities of the cost relationships, and that is my concern; that the road pricing agenda has really been bedevilled by ignorance, and the difficulties associated with developing and analysing the relevant data, and I think the more quickly we move to address some of those difficulties and deficiencies more quickly, we will be able to better signal both road and rail pricing impacts.

PROF WALSH: Euan, we're clearly hearing that message from lots of quarters, and I think we obviously agree entirely in principle. It's the question of how fast we can move in practice, but can I go to your stop versus flows story. Clearly at least since 92 when the heavy vehicle charging system was formally introduced, capital costs have been effectively paid for as they occur, roughly speaking. There may be some sort of overs and unders over time, but they have been. So your stock concept must really be applying to the capital before 92. Is that the story?

MR MORTON: I think there are two issues there, Cliff. A lot of the capital expenditure I believe that has occurred since 92 was in fact driven by the fact that the stock of roads that existed in 92 weren't well adapted for the nature of the vehicle task it was asked to carry. So much of the capex at least on the major arterial roads we've seen since 92 was in fact driven by the need to accommodate heavy vehicles and heavy vehicle roads. Given the averaging and the nature of the PAYGO system, it would not have or it's highly unlikely to have actually fully captured those costs or assign them in a forward-looking efficient way. So in the context of the attribution of those costs to the causes of those costs, I think it's unlikely that PAYGO would have accomplished that. So we've got an issue of cost attribution under PAYGO.

There is still the issue of the capital stock that existed in 92 for corridors and investments that were in place at that time. So the issue pre-92 is that even then, there's likely to have been a fairly substantial stock of assets that hasn't been consumed at all in the context of the subgrades, the easements and many of the bridges.

PROF WALSH: But you'd concede, would you, that the fact that since the 50s some time, there's been a diesel fuel excise, and at times that's been pretty high. In real terms that suggests that heavy vehicles were actually contributing to the capex pre-92. I think you're obviously making two points. One is about whether or not you actually capture and trucks pay for the capital expenditures, and the other is about whether those expenditures were efficient.

MR MORTON: Sure.

PROF WALSH: I think on the first one, what we suggested in the discussion draft was that when you look at it from the 1950s, it looks like you can say, broadly speaking, that heavy vehicles have paid for capital expenditures that are appropriately attributable to them.

MR MORTON: That's a difficult conclusion to make in the absence of knowing what is truly attributable to the heavy vehicles, isn't it?

PROF WALSH: Yes, and there might be some disputes about what's in and out and how precisely you attribute it, but at the moment I'm talking about the broad principle.

MR MORTON: Just in response to that, Cliff, what we've seen with each of the thee determinations is increasing charges being levied upon heavy vehicles or the heavy vehicle proportion of the fleet. That would suggest to me that they had a pretty low base in 92. I don't know the situation since the 50s, and to a large degree that does become an equity issue rather than an efficiency issue moving forward as to what is truly the incremental costs of these vehicles of the freight task on the road, and what is the sensible attribution of common costs according to Ramsey principles.

So in responding, given the levels of charges have increased materially since 92, much of the capex that has occurred in relation to the arterial roads that carry the heavy vehicles has been to actually substantially modify the road surface because they simply weren't built to accommodate the heavy vehicles. So we've had a complete capital overhaul, if you like, of the road stock carrying heavy vehicles where it has been changed. The axle load has been a key driver of that. I'd be quite cautious about making the observation that heavy vehicles have paid their way, although I'm very happy to concede that they've obviously paid something.

PROF WALSH: Doesn't your point about the need post-92 to increase capital expenditures to accommodate the nature of the vehicles that are on the road imply that pre-92, trucks were actually overpaying. They were paying for inefficient investment decisions and suffering either lack of access or additional damage as a result of poor quality roads. We basically should be discounting quite a lot of the pre-92 from any base that you might alternatively calculate an appropriate rate of return on.

MR MORTON: So you're saying that heavy vehicle users were overcharged in 92 because they had an asset. The asset that presented didn't accommodate effectively their needs?

PROF WALSH: I'm saying that pre-92 that would be one interpretation of what you're saying about the inadequacies of the road stock at 1992.

MR MORTON: That's quite possible. I mean, the history has been that the road users have actually pushed for heavier axle loads and that there has been an absence of a proper assessment of what roads can really carry, and that's really been a function of the road provision being part and parcel of a political rather than as a commercial process. So the politicians have come under pressure to allow vehicles onto the roads that they weren't designed for, and consequently we've needed to actually substantially upgrade roads to accommodate the vehicles.

So if you like, if you take the incremental pricing type approach, the vehicles were let onto roads that weren't built to accommodate them, and what we saw was the need to actually substantially invest to upgrade the roads to accommodate the vehicles that were already travelling on the roads. It's an open question, Cliff. I guess we're re-examining history to some extent.

PROF WALSH: Sure. Perhaps we should move on to the next part of your agenda.

MR MORTON: In terms of the mass-distance charging issue and location-specificness of it, I was very grateful to be involved in a meeting in Canberra on Friday where these issues were discussed, as you know, and the location-specificness is an issue that really came home to me as being something that is perhaps more important than I had previously recognised. One of the issues that I think we'll find as we move to mass-distance charging, be it location-specific or otherwise, is that we will actually start to capture a great deal of the data that has directly alluded us, and the value of that information will be very considerable in forming not only pricing issues, but wider policy issues.

I would also note that the price sensitivity of road users to the road charges is likely to be quite significant, and I say that in the context of the international experience being that road fleets change very quickly to exploit any opportunities or to respond to the pricing signals embedded in a tariff structure. I think that's quite important because the road fleet that is actually on the roads today has materially different suspensions, and one of the issues I think we need to consider in the context of road pricing is the fact that different users even with similar axle loads can impose different costs on the road system.

If we had the capacity to differentiate between users and their impacts on the roads, we'll be able to substantially reduce the road maintenance expenditures over time. So what I'm saying is that where this is homogenous in terms of the damage that it imparts on roads and some capacity to actually acknowledge that in the pricing mechanism is quite a desirable thing to do if we are to move to such a form of pricing or charging.

MR BANKS: We'll let you continue. I've just got one eye on the clock, Euan.

MR MORTON: Of course. I'm very grateful for you fitting me in at such short notice. When is your next speaker?

MR BANKS: Scheduled for 10 o'clock, but I think we have another 10 minutes.

MR MORTON: I'll be quick. There's not a great need to say a lot about the elasticities other than making really two quick observations. I suspect that we are likely to see where road and rail compete, greater elasticities or at least reasonably significant cost elasticities, and I think that that's reflected in the history of the east-west corridor over the last decade. I acknowledge that that's certainly a conclusion that the Productivity Commission left open in its draft discussion paper, but that is perhaps one area where further work could be undertaken on a corridor-specific basis.

So moving finally to the corporatisation issues, we've touched on this already. The history of road provision is very much like the history of other government utility provision price corporatisation, and corporatisation hasn't completely addressed the issue of political interference, it has actually substantially alleviated them, and I think that's an area in road reform where distancing that political involvement or at least reducing the intensity of political involvement in decision-making would be highly desirable. The corporatisation process is likely to much better align the incentives just from a maintenance and an efficiency perspective and a pricing perspective over time, and I recognise that that's an inter-governmental challenge of quite historically significant proportions, and in fact is perhaps even more complex than the GST process.

But the corporatisation reform of roads seems to me to be an entirely desirable action to take, and not inconsistent with some of the corporatisation reforms we're seeing in other sectors that present substantial provisions of public or where public goods are a substantial part of the output or where there's substantial social ramifications associated with the provision of the service.

Finally in terms of further work, it seems to me that understanding the cost relationships which ultimately is an engineering issue, but one that requires fairly significant - at least one of the highest priority agenda items, not only in terms of traffic by themselves, but the interactions between the traffics where the nature of one use actually has an interdependency between the cost impacts of another use. So there is at least some evidence to suggest that light vehicle passes become far more disadvantageous or have a higher impact on roads that are already affected by heavy vehicle passes than light vehicle passes in isolation for example; so understanding those cost relationships.

Finally developing efficient charging structures that I mentioned also reflect the varying degrees to which different road users actually affect the roads, and that provides us with a vehicle to incentivise more efficient vehicle fleet in terms of their interactions with the road over time, and finally to understand the elasticity issues where road-rail competition exists in particular which may inform Ramsey pricing allocations of common costs to varying user classes. Thank you very much for accommodating me at very short notice late in the inquiry.

MR BANKS: Euan, that's fine. In fact I wish we had a bit more time perhaps to explore some of those things, but both Cliff and I have a couple of questions. On the Ramsey pricing approach, in practical terms, how much scope do you think there is to employ Ramsey-type approaches?

MR MORTON: The reality is that nobody truly undertakes the Ramsey pricing approach because we're always tipping the scales for elasticities. My sense is however that understanding the elasticities can assist the judgment that must be made about the assignment of common costs. So whilst we live in a second-best world, understanding the elasticities will actually assist in forming the allocations of common costs. So whilst we may not be able to have the confidence of a precise number - and that's a comment the commission has made a number of times in relation to regulatory processes and regulatory issues which I very, very strongly endorse - it does help you move to a better world rather than a world that is unavoidably ignorant and a world that is I guess held back by the fact of simply ignorance in terms of what the elasticities actually are.

So in answering your question, whether we get a pure Ramsey-type pricing solution is highly unlikely, whether the knowledge of the elasticities and likely impacts can assist the cost allocation process I think is quite likely.

PROF WALSH: Can I follow up on a slightly different point. You're suggesting that the potential for corporatisation of roads is not significantly more difficult than some other areas. I'm wondering - - -

MR MORTON: Sorry, I said that it has actually been quite effective in other difficult environments.

PROF WALSH: And you were suggesting that those are environments where there's a relatively large sort of public goods element in there. Can you give us some for examples.

MR MORTON: Yes, certainly. The employment arrangement, the jobs network for example, the Commonwealth provision of those services which the Commonwealth provided in the early 90s has been substantially reformed. We're seeing corporatisation increasingly in the health services and the provision of health services, and public, private contracting arrangements in relation to the provision of health services. In education we're also seeing corporatisation reforms of TAFEs for example.

So we are seeing corporatisation reforms in also very challenging services areas, but understanding the separation of the purchaser and the provider I think brings some clarity to the service provision process, and certainly anything that we can do to distance the politics from the commercial decision-making is desirable, recognising that in fact it's information asymmetry that provides so much latitude for rent-seeking behaviour which is ultimately what drives political processes. It's the lack of information that in fact facilitates all resource allocation decisions through political processes.

MR BANKS: I was just going to ask, Euan, in relation to your comments about corporatisation, what are your views on the sort of road fund type approach that the commission has raised versus the more - - -

MR MORTON: I think it's more achievable in the short term, Gary.

MR BANKS: Beg your pardon?

MR MORTON: I think it's more achievable in the short to medium term.

PROF WALSH: It is a sort of corporatisation model, isn't it?

MR MORTON: I think that that's a move in the right direction. Given the horizon that the commission is asked to adopt in this process, I was keen to suggest that the road fund model that has been put is a desirable step and will start to improve the resource allocation outcomes. I think one of the desirable attributes of it is that, as I'm sure you're more aware than me, policy reform processors need to make a start, and that often the momentums from that start take you in directions that perhaps you weren't fully aware of, but in terms of public policy and economic reform, making a start, and an achievable start, is critical, and I'd see road fund in that context.

The corporatisation reforms that we've seen and all of the competition reforms we've seen had their origins in tariff reforms proposed by the AIC back in the 70s and before, and all I'm saying is that in the similar context, road fund as a start might assist in the move over time to a greater degree of commercial accountability and road provision, and that the natural outcome of that is likely to be perhaps - well, one outcome is quite possibly corporatised road providers.

MR BANKS: Euan, thank you very much for that, and also thank you for attending the roundtable on Friday.

MR MORTON: I was very pleased and grateful to be invited, and thank you again for fitting me in to a busy process at such late notice.

MR BANKS: Thank you. We'll just break for a minute now before our next participants, thanks.

MR BANKS: Our next participant this morning is Peter Brohier. Welcome to the hearings. Could I just ask you please, perhaps just for the record, to indicate the capacity in which you're here today?

MR BROHIER: I'm appearing, Mr Commissioner, in a private capacity, but I was chairman of the former committee known as the National Sea Highway Committee, and also the Committee for Bass Strait Transport Equality.

MR BANKS: Okay. Thank you very much. You provided multiple submissions to this inquiry as well as the one previously on Tasmanian Freight Equalisation. So I'll give you the opportunity to make the main points you want to make.

MR BROHIER: Thank you very much, Mr Commissioner. I think, Mr Commissioner, if you look outside these windows, you'll see a most magnificent city worth probably billions of dollars. This city in my view is entitled not only to one intercapital link to Sydney, one intercapital link to Adelaide, but also one intercapital link to the city of Hobart. I think those links should be provided under AusLink, the national transport system, and I'm comforted by this inquiry because it refers to road and rail, and I understand that "road" has been defined for many years as including vehicular ferries, and I would ask that this commission turn its mind to the importance of the major gap in the interstate linkages of this country, and provide all Australians with an equitable link between Melbourne and Hobart, using the ferries and the road system. So I see this issue as one that clearly falls within the ambit of this inquiry.

My papers have been directed to that area, but I would say this; that I think we lack that link not because of a lack of political will. I think John Howard as Prime Minister has done nearly everything possible that any Prime Minister could do to deliver that link. I think it's falling down in an area where it's perhaps at a lesser level than that, that this issue is not being delivered to the people of Australia and the people of Melbourne. I would ask that this issue be regarded as part of the COAG resolution for national significant infrastructure. Tasmania is part of this nation, so is Victoria. We're entitled to the same interstate links as every other state.

Every other state is getting intercapital linkages that offer fair and equitable travel. Some of the transport between Victoria and Tasmania is already getting that fairness through the Tasmanian Freight Equalisation Scheme, and to some minor degree through the Bass Strait Passenger Vehicle Equalisation Scheme, but those schemes aren't delivering comprehensive equalisation between these two states. But you'll find that most of the material crossing Bass Strait, including people and vehicles, are not getting equalisation, whereas the nation has enjoyed substantial equalisation over the years by the funding of these national highway roads principally who have been effectively fully funded by excise and by capital contributions.

But you will find that northbound exports from Tasmania travelling to Melbourne to go to international markets are excluded from the benefits of any highway principle or an equalisation principle. You will find that northbound exports from Tasmania are favoured by the Tasmanian Freight Equalisation Scheme, but southbound imports into Tasmania including consumables, building materials don't get any advantage whatsoever under any equalisation scheme. They are fully self-supported, and we look at $12 billion going into national highway networks across this country, and yet that gap still remains.

We don't see southbound exports covered by the equalisation scheme, and we see the Tasmanian Bass Strait Passenger Vehicle Equalisation Scheme, which was designed as Tasmania's sea highway and the Coalition acknowledged it as to be part of the national highway, is not delivering comprehensive national highway status and not bringing the volume of people through this city that this city deserves. It's not allowing the freedom of movement of people in this city and people across Australia to cross to Tasmania and back again as though it was on a national highway. So we see billions of dollars going into the national infrastructure, but when it comes to the national infrastructure connecting Australia's shortest intercapital route, we see nothing. We see only the existing schemes which don't comprehensively cover the field.

So if you're moving to pay as you go or you're moving in some way, what I'm asking is this; that the Tasmanian link - the link between Melbourne and northern Tasmania - be treated in exactly the same way as you may treat any other intercapital link. So if you're going to fund your highways fully, then you fund Bass Strait fully. You don't make Tasmanians or those crossing Bass Strait, including all Australians, pay a fuller cost or a greater cost than those who enjoy the privilege of the subsidy of the road system. That in essence is what I'm about. I believe that your findings should cover vehicular ferries, but I say this, only the vehicular ferries between Victoria and Tasmania on the intercapital link. I think that's the critical area.

It's a critical infrastructure omission in national infrastructure, and I think if you do that, you'll deliver to this nation what I think was intended by AusLink which was an integrated national network. Without that, it won't be national, and you won't be giving. You'll be advocating on an international basis the advantage of competition policy, but by providing freight in one direction with subsidies and freight not in the other, you'll be denying that. You'll be denying competition policy to people in Tasmania in relation to that. So the reality is this, that whatever principle you determine as appropriate for the interstate networks of road and rail, you should also apply to the intercapital, interstate ferry network on the nation's only intercapital route, and that involves ferries.

MR BANKS: Thank you for that. It's a strong position that you put through several submissions. You mentioned the AusLink approach justifying that, but isn't the AusLink approach also predicated on an assessment of costs and benefits in assessing where investment in the network goes?

MR BROHIER: I think that's a major component of it, but I would suggest that AusLink hasn't forgotten the intercapital connections; all intercapital connections are included by AusLink. I would submit that AusLink would be relevant to the width of the highway, but not the actual existence of a single lane. So what I'm suggesting is that the single lane highway concept be implemented between Victoria and Tasmania, and then let AusLink determine whether that ought to be a double lane; in other words, whether more resources out to go in. But at this stage you have significant goods that transit that route and people in vehicles that are not getting even a single lane concept between the two states.

Sydney is only entitled to, in my view, a link to Brisbane, a link to Melbourne and probably a link to Canberra out of the Melbourne link. Melbourne is geographically entitled to much more than that. Melbourne is entitled to the third link. So we call it AusLink 3, Hume to Hobart.

MR BANKS: Another way of getting parity would be to make all the other capitals' linkage only via sea and ban everybody from road.

MR BROHIER: I think, Mr Commissioner, that's what probably occurred before Federation. Those were the great sea lanes of the world. But when you took over the roads and the rail came in, effectively I think Tasmania dropped back and that link was forgotten. It's time this nation looked at that link. John Howard has not forgotten that link. John Howard has adequately funded the passenger part of it. He's offered, if we read Bob Cheek's book, a $50 fare crossing Bass Strait for passengers. It was rejected, but nevertheless John Howard was man enough to offer that. So I think we've seen a Prime Minister that's done that. It's now time for the bureaucracy and the various commissions that look at this to incorporate a fully national system, not just one that focuses on a land-based bitumen road.

We're really talking about interstate infrastructure here, either the Commonwealth has funded ferries in many ways, it's funded them either with a capital contribution or an ongoing equalisation contribution, depending on which flavour of government was in, but the reality is this is infrastructure equivalence, and it needs to be treated that way, and these reviews that are very significant reviews need to look at the transparency of community service obligations and things like that where substantial Commonwealth uncapped funding is going into Bass Strait, and it's important.

There is already funding there. It can be enhanced or it can be dropped off. You may decide to drop it all off, and if you want a full cost recovery on all your highways, then you won't have to fund Bass Strait or the Commonwealth won't need to fund Bass Strait. They can just say that it's equal because I'm sure sea transport will be much cheaper than going by land any rate. You could either go one way or the other, but the reality is don't keep the nation in such a way where the inequity of this issue continues for years and years until that's determined.

MR BANKS: Is your case partly predicated on the view that there is not cost recovery of roads?

MR BROHIER: I don't really know whether there's full cost recovery of roads, but you of course get diesel excise et cetera that goes into the cost recovery of roads. But perhaps there's capital contributions and things like that that have meant that roads are subsidised or get capital grants in some way from general revenue. If that's the case, then all I'm really saying is that the ferry system should be part of that general pool to deliver the same outcome as equalisation is delivered going down a comprehensive national land-based highway.

MR BANKS: I guess we've had participants in this inquiry, including the AAA as well as the ATA who were arguing that through various forms of taxation of road users that the taxes coming in far exceed the expenditure on the road - - -

MR BROHIER: If that's the case, that's fine. But what I'm really saying is the access to Victoria and Tasmania needs to be based upon the same sort of principle and form part of the common pool. There's no reason why we should go to water just because there's Bass Strait water there. The intercapital link should be treated in the same way. So if you were going to create a pool using excise, then create the pool using excise, but deliver the outcome, deliver the equalisation outcome. I think only a few months ago John Howard reinforced the equalisation principle very clearly to the nation in a media release. So that's the basis of the Tasmanian Freight Equalisation Scheme.

I see no reason why the definition of a road under the Australian Land Transport Development Act - or I think there's probably something in AusLink to that effect - shouldn't be applied by this commission or the principle enunciated by the coalition of bringing Bass Strait as part of a national highway. I don't see any reason why it shouldn't form part of one common pool where these matters are determined. But not at the expense of not having one equitable surface link between the states of Victoria and Tasmania. You need at least one. You can expand it into a four-lane highway by having more ferries or whatever you might need, but the people of Australia have still got Tasmania on their flag. Victoria is a fundamental state of this nation. It needs that link.

PROF WALSH: The concept that underlying AusLink is a notion of fairness is one that I really hadn't thought of before, and it's not entirely clear to me that it's so. The decisions about where to invest in the road system are being calculated, aren't they, on essentially the benefits that are going to be generated to those who want to use them, and then we're kind of recovering those costs through various means of taxation. It seems to me that the same principle on the face of it should apply to getting from Melbourne or Sydney to Hobart.

MR BROHIER: Yes. We want it through Melbourne. We don't want direct from Sydney, but we want it through Melbourne to Hobart, because you've got an idea of interconnecting capital cities, and Melbourne is closest to Hobart, so it's important. But AusLink doesn't touch sea. This is the issue. AusLink needs to incorporate this route, and it hasn't. The Victorian government has put a submission to the Tasmanian Freight Productivity Commission inquiry suggesting that the AusLink link incorporate the Victorian/Tasmanian sector. VECCI is already out as suggesting that to Peter Batchelor to take that to Canberra.

There are national resolutions dealing with the Liberal Party and the National Party asking for this link. There's uncapped federal funding going into the Bass Strait Equalisation Scheme and to the Tasmanian Freight Equalisation Scheme. The Tasmanian Freight Equalisation Scheme in my view can't remain an effective scheme or an equalisation scheme unless it covers northbound and southbound freight, because that would seem to be somewhat contrary to competition policies, and it can't exclude northbound exports.

In my view if you can establish a factory in Albury and you can send the goods down the Hume corridor, why shouldn't you be able to establish a factory in northern Tasmania and send it across the Bass Strait corridor in the same way? We're talking about bitumen equivalents, and AusLink is about fairness, but fairness has always meant that intercapital links have been connected. You see that right across this nation, but there's a big glaring gap in the fairness of AusLink. It can't be national unless it connects Hobart to Melbourne comprehensively, not just in part.

This is an issue that goes to the equity issue of transport equality, but it's an issue that goes to sound financial sense. If we don't have people flowing through this city going in three directions, why shouldn't we? We should have it. We're entitled to it. Every Victorian is entitled to access to Tasmania at highway costs. Why shouldn't they? If you're entitled to go down the Hume Highway - we wouldn't suggest on the Hume Highway for example that you can take goods in one direction and get a subsidy or use the Hume Highway, but if you wanted to take goods in the other, you have to get off the Hume Highway. Effectively this is sort of the principle that seems to be applied.

MR BANKS: Another principle is once you start giving subsidies, there's no end to it.

MR BROHIER: I don't believe in subsidies, because in my view you make it part of one common pool. Either you talk about transport for this nation or you don't, and if you're going to talk about transport for the whole nation, you've got to include the equalisation schemes or if you don't, then remove them completely, take away the equalisation schemes, take away every form of subsidy, and let them stand on their own. I'm not absolutely advocating a firm position in relation to what you should do in relation to this, but I just want the same principle applied to Bass Strait as you find for the rest of the nation. But effectively, you can remove your whole transport grid and just let everyone pay for their own transport.

If that had occurred to Tasmania, I suppose Tasmania would have grown and the rest of this nation would have probably suffered because we'd all probably need a four-wheel drive or some form of all-terrain vehicle to get from Melbourne to Sydney if there were no highways. So if you had to pay the full costs or there was no common transport pool, Tasmania would probably have boomed and the rest of the nation would be crawling over the Great Dividing Range using all-terrain vehicles; a terrible situation. I'm not advocating it.

MR BANKS: Good. We appreciate you attending the hearings, and the submissions that you've provided, as I said, to both the hearings. I think you've got a passionate view and you've expressed it and we've heard it.

MR BROHIER: I might say, Mr Commissioner, although I do have a passionate view, there's a history of support for this passionate view including a national mandate for the national highway connection to Tasmania, and I would hope that in your next report to government that you would include the people of Victoria and Tasmania in this vital infrastructure link, consistent with trade.

MR BANKS: Thank you very much. We'll break now for a moment before our next participants. Thank you.

MR BANKS: Our next participant this morning is the Great Southern Railway. Welcome to the hearings. Could I ask you to give your name, please, and your position.

MR BRAXTON-SMITH: Thank you very much. It's Tony Braxton-Smith, and I'm the chief executive officer.

MR BANKS: Thank you very much for attending the hearings today. Also thank you for the submission that you provided during the proceedings before we produced our draft report, which was very helpful. You've provided some further comments on the discussion draft, but they come in reasonably late and I'll give you the opportunity now to go through those.

MR BRAXTON-SMITH: Thank you very much for the opportunity to make a presentation. It's right we did make an initial submission which presented out particular views of freight infrastructure pricing as it applies to track access for our industry sector. I guess we're a little bit special because we are in industry a sector of effectively one long-distance passenger rail operators in the commercial sector with a result of the privatisation of Australian National's Commonwealth-owned passenger rail services. I wouldn't expect that you'd be getting any other submissions from this sector because we're basically it.

We made an original submission which responded effectively to the brief that the commission put out. We've since had the opportunity - and I promise you I didn't put all those colourful tabs against your report this morning. We have had the opportunity to go through the discussion draft in some detail, and we've given some consideration to the potential implications of what's in this document as it applies to this business and as it applies to our sector. So it's in that context that we'd now like to make a further submission.

I've actually started off by posing the question why consider track access for long-distance passenger rail at all within this, and really if you'll excuse me from reading from this, but really the background and the terms of reference that you've got state that:

> The purpose is to assist COAG to implement efficient pricing of road and rail infrastructure.

So naturally that's a road and rail freight infrastructure, and naturally therefore the focus of your work is going to be primarily on freight movement. But the terms of reference aren't actually restricting you to considering pricing or other uses, and whereas use of the road infrastructure for other purposes is I think a well-settled matter, particularly in long-distance passenger rail, although it's a minor use, it's an important use, and one that could be quite dramatically impacted by the outcomes of the work that you're doing.

The communique also asks the commission to develop proposals for pricing regimes in a manner that maximise net benefits to the community, in particular rural, regional and remote Australia, and the communique further states that you will be including an analysis of how particular communities might be impacted by the work that you're doing, and in fact you've noted yourself that you were asked to assess potential impacts of pricing reform options on rural and remote communities.

So throughout my further submission, I'm talking about long-distance passenger rail, but I'll just abbreviate that to LDPR if I may. So the key points that I want to kind of link what I've got to say with the framework within which you are working are these. It's true the principal use of the national rail infrastructure network is for carriage of freight, but it is also used for LDPR. Reforms in the track access pricing regime will have clear implications for all uses, not just freight, particularly in our case as freight pricing is at the present time just applied to LDPR.

So whatever happens to freight pricing, unless something is said, will happen to long distance passenger rail. LDPR only accounts for a small portion of the total usage of the rail freight network, but we'd humbly submit that it does nevertheless make an important contribution to rural, regional and remote communities. Broadly the benefits are both economic - we make an economic contribution from the tourism usage, but there is also a broader social impact, because we do provide transport, and particularly transport to those sectors of the community who have limited means or have special needs or restricted options for use of public transport. So there is a broader community impact of our services.

The future pricing regime that applies to passenger is going to therefore have some impact on rural, regional and remote communities that we serve and we work with. It could either sustain LDPR or it could bring about its early demise, and that would have some material consequence for some of the remote communities with which we work. So we understand the key focus of the commission's work, but we'd respectfully submit that you take into consideration the implications of your findings and your recommendations on rail infrastructure, and to consider how particular communities may be impacted by the consequences for LDPR of the work that you're doing. The rest of my submission I'd like to just offer some observations, analysis, recommendations on your draft report aimed at maximising the net benefit for rural, regional and remote Australia from LDPR usage of the rail infrastructure.

If I could turn first to price discrimination. In the draft report you've noted that vertical separation and access regulation might constrain the scope for efficient price discrimination across users and impede efficient investment. It also goes on to say efficient price discrimination by below-rail operators should not be discouraged. Effectively the body of the report, we accept the findings and we support the views that you're articulating. However again we'd ask for the potential impact on long distance passenger rail to be recognised and for the recommendations to provide for further consideration the consequences for LDPR as and when government takes action on the Productivity Commission's findings.

On price discrimination, draft recommendation 11.3 - and if I could just - I'm sure you're aware of it, but in part you're stating that:

> The objects clause, declarations threshold and pricing principles (which among other things allow for multi-part pricing and price discrimination where they aid efficiency) now embodied in the Trade Practices Act should be incorporated into all rail access regimes.

In relation to that recommendation, we'd offer you the following observations. We're operating in multiple jurisdictions and dealing with several track access providers. They have varying systems within which they work and to which they refer when we talk to them about track access pricing. A uniform regime will be of benefit through the reduction of red tape, and the simplification of business processes just by virtue of the consistency it will provide. So we support the finding of a uniform regime across Australia.

MR BANKS: The flip side of that is you're currently experiencing some difficulties with multiple regimes.

MR BRAXTON-SMITH: We have experienced some difficulties, and I'll actually get to those in a moment but, yes, effectively we have multiple track access pricing regimes. If you take the Indian Pacific, we deal with three access providers, and four pricing systems within the three. If we take the case of the Ghan it's simpler. There's two, but the pricing approach and the organisations you deal with, they each come at it from a different angle. I'll get to it in just a moment.

The second point in relation to price discrimination. Effectively when we put our original submission up, we were arguing for price discrimination for LDPR on the grounds that LDPR imposes a lower unit cost on the infrastructure owner. It has a different end market capacity to pay, and simply to facilitate its long-term economic sustainability. So again we support the principle that's being articulated of price discrimination. The thing we would say is that access providers to date have dismissed all approaches from GSR to consider a pricing regime that recognises the specific circumstances of LDPR. They have simply used their market power to maintain premium rates, in the case of ARTC particularly, and to extract substantial price increases in the case of APT, the access provider from Tarcoola to Darwin.

The regulatory regimes that have been in place, particularly in the latter case, were of little practical use in negotiating because of the way they set floor and ceiling pricing systems.

The final point here is the draft report notes elsewhere that - and I use your own words:

> Rail track operators may have scope to discriminate more finely between types of freight than can road infrastructure providers.

That's in Efficient Pricing of Road and Rail at page 8.11. Clearly it's within the capacity of infrastructure providers to establish a separate category of pricing for LDPR. They can do it. They simply choose to rely on their bargaining position, the fact that we're not very big, and the scope that's allowed to them by the regulatory regime to continue an imposition of a rate regime without any adequate justification we would say. So on the basis of that, we'd respectfully submit to the Productivity Commission that it needs to include within the recommendations that you've made at draft recommendation 11.3 that there's some specific consideration given to providing protection for and/or special consideration of the particular circumstances of LDPR and its use of the rail infrastructure, simply to ensure its economic sustainability, and I'll further address that point in this submission.

We also note in this section in the draft report that the commission acknowledges that there's some evidence that pricing discrimination already exists in rail - and again I'm using your words here. In Road Infrastructure Costs, page 4.24, you say:

> Some evidence that price discrimination already exists in rail, with commercial track operators allocating the largest share of common costs to particular types of freight such as coal.

Price discrimination does effectively exist already. They distinguish intermodal from bulk, coal, and charge coal a higher rate. I guess we support the finding. That's self-evident, but we'd suggest that the price discrimination for bulk freight such as coal is based not so much on the principle of efficiency, but rather on the capacity to pay in combination with a high costs of switching to alternative modes. Once an organisation makes an investment in coal transport infrastructure, they are caught, and effectively although they are a large customer, the dynamic is such that market power is concentrated in the hands of the rail infrastructure owner, giving them a very strong bargaining position. So again we'd suggest that oversight is required, not just for the little guys like us, but even when dealing with larger customers.

Finally in relation to price discrimination, the commission already recommends for price discrimination at 11.3. We'd simply ask you to consider recommending further that there be explicit price discrimination for LDPR that considers, amongst other things, its capacity to pay, the costs it imposes on the infrastructure, and its economic sustainability, as well as ensuring there's effective oversight to guard against potential misuse of market power.

PROF WALSH: Would it be all right if I ask a question at that point.

MR BRAXTON-SMITH: Please.

PROF WALSH: It's not entirely obvious to me, if the financial viability and sustainability of your business is at stake here, why the rail infrastructure providers would have an incentive to set a price that might make your business less marginal than it otherwise might be. If there was a chance that you were going to drop out, they lose something, don't they?

MR BRAXTON-SMITH: In the extreme, some revenue is better than no revenue is what we would say, yes. The sequence of events for our business as I understand it - and I've come to the business two and a half years ago from outside of the industry, so I've had to do a lot of study to understand our circumstances, but as I understand it, the Commonwealth government in 97 decided to sell the assets of Australian National Rail, and to discontinue its involvement in operations except for provision of rail infrastructure. So it undertook the sale process and it set up ARTC, and ARTC subsequently introduced its pricing regime, and the government intended to maintain some interest in track access pricing to ensure the sustainability and the competitiveness of the particular mode of transport.

Access providers strictly commercially, if they were operating at or very near to capacity, might not have the incentive. They might simply choose to price us out of the market. I would suggest that given that the Commonwealth government sold the business to our organisation with the intent of providing a viable future competitive environment for that industry, that there's some greater obligation there than merely leaving us to the whim of market forces. I guess that's more a policy thing. If the access provider were operating somewhere below capacity, then there is an argument there to suggest that at least incremental costs or anything above incremental costs represents some real return to them as opposed to having that capacity simply not utilised.

PROF WALSH: We've commented in the report on the, in a sense, underpricing of much rail infrastructure, at least relative to the regulated ceiling prices that apply. How do the prices you pay relate to the allowable ceilings specified by the regulators?

MR BRAXTON-SMITH: The allowable ceilings that are specified by the regulators are so high as to bear no real practical benchmark for us. ARTC has an access undertaking, and the prices are set. We don't know where that sits in relation to floor and ceiling. It's simply an undertaking. In the case of APT, which is the other major portion of track we use, when we took a look at it, the ceiling price was something like - don't quote me on the exact number, but around 30 times the floor, and we were substantially above the floor, we would say.

So the frustrating thing about that particular negotiation is we couldn't actually get any reference to freight rates because the access regime didn't require any disclosure of benchmark freight rates. So we actually don't know - we suspect that we're paying more than freight because it can be extracted from us. Certainly on the APT line, we are paying the highest unit rate on the whole network.

PROF WALSH: I'd taken it from your submission that there was sort of uniformity and lack of differentiation, but you seem to be implying that in some respects, it's differentiated in a way that disadvantages you.

MR BRAXTON-SMITH: Yes. That's precisely it.

PROF WALSH: That presumably is a commercial judgment that gets back to things like perceived capacity to pay and what effect it will have.

MR BRAXTON-SMITH: Yes. The perceived capacity to pay is a big thing. When the Ghan went through to Darwin, there was a lot of positive press, a lot of hype. It was characterised as a great success. People actually took a mental shortcut and said, "That means they're making a lot of money." The fact is that we're in no better position now than we were several years ago before the Ghan went through to Darwin.

PROF WALSH: In terms of overall profitability.

MR BRAXTON-SMITH: In terms of overall profitability or return on investment. But there was a perception created that, "You guys are carrying a lot of people. You must be making a lot of money." It's a high-cost industry and high fixed-cost industry, and those fixed costs are year round and the demand is seasonal. In fact I often joke with my management team that if we could just stop the year in October and have a decimal year, we'd be heaps better off in terms of profitability.

PROF WALSH: Is that right.

MR BRAXTON-SMITH: Yes, because the demand falls away for travel to the

Top End during the end of the year, but we still carry all the costs.

PROF WALSH: I'm still a little bit puzzled - I know you've got more you want to say, but on the track you're using, you're operating below capacity. So there is no incentive for the access provider to put you in a position where you might fall over, and you're saying, "This is pretty marginal."

MR BRAXTON-SMITH: Possibly I address that more in two or three sections over, when effectively you've made some observations - in fact it's in the very next section.

PROF WALSH: Okay.

MR BRAXTON-SMITH: If I could just go to this, it might answer your question.

PROF WALSH: Sure.

MR BRAXTON-SMITH: The next part of my further submission goes to government policy settings for LDPR. The draft report asserts the following. It says:

> For vertical separation to increase above-rail competition, there needs to be the prospect of profitable entry into above-rail markets. However, most rail networks typically face strong intermodal competition and struggle for commercial sustainability, particularly where there are low volumes of freight.

That's in Addressing Non-Price Impediments, page 10.13. The same analysis holds true for LDPR, ie LDPR faces strong competition from private vehicles, buses and air transport modes resulting in low passenger volumes and a struggle for commercial sustainability. The unintended consequence of vertical separation in 1997 and the track access pricing regime that was subsequently established has been to compromise LDPR's long run commercial sustainability. We've detailed that further in the submission, section 2.6, our original submission, but effectively what the numbers are showing is that in the short run, it's a viable business, but in the long run, it's not commercially sustainable.

In the draft report, Rail Infrastructure Costs, page 5.9, what you're saying is if infrastructure providers are not covering their full economic costs, even though they may be profitable based on the book value of their assets, they may not be viable in the long run. In other words, infrastructure would not be able to be replaced at the end of its useful life if the decision were based purely on commercial considerations. That's an observation you make about infrastructure. This is precisely the situation that GSR is in. As I said before, we are the only privately-owned commercially-run LDPR operator in Australia, and we respectfully request that the commission modify or comment on draft finding 5.1 which follows that analysis.

Just to indicate that this could also apply for certain rail infrastructure users, that same observation, and particularly our case; ie we struggle for commercial sustainability and may not be viable in the long run within certain policy settings on track access pricing. There is no doubt. We've had an engineering assessment done of our rolling stock. Our rolling stock from an engineering life point of view still has 10, 15 years. In terms of its interior presentation, it's a little tired and needs refurbishment.

In certain cases, we could probably make a business case for some interior refit and change the bedspreads, pillows, different wall linings, but we are going to be faced eventually with the need to replace rolling stock with new, and under the present pricing regime, there is absolutely no prospect. What would happen is the asset will be run down over time, and then you would withdraw from the market at a time when you could no longer bear - you could no longer make the economics work. So it's short-term viable, but long term not commercially sustainable.

The cost of replacement of a carriage, we've had some indicative costings from engineering firms, the sorts of carriage that we operate, the rolling stock, is somewhere around $3 million per carriage. That would make the replacement value of our fleet somewhere around $300 million. The numbers are disclosed in the report and in fact available through ASIC, because we put in company returns. We are a magnitude away from being able to contemplate that, and because we have capacity constraints on how many tickets we can sell, how many people we can fit on the train, even if we were to run at full capacity all year round, we still wouldn't make the business case for any replacement of rolling stock.

MR BANKS: So when you say even if you're at full capacity all year round, implying also frequency of service, is there scope to have more frequent service?

MR BRAXTON-SMITH: Our rolling stock is pretty much fully utilised at the moment. We have to take rolling stock out of traffic for maintenance. We have an average in-traffic use of about 90 per cent, and that's very close to its theoretical maximum when you take into account maintenance requirements, and we have an average year-round capacity utilisation above 80 per cent or seat factor above 80 per cent. If you look at an airline like Qantas, Qantas averages 75 per cent year round, and most airlines would say when you're getting up to 80 per cent, effectively you're full. Effectively you're never going to sell that extra set of seats you've got.

We certainly have some opportunities on capacity in some sectors at some times of the year - like I said, the November, December effect - but from March through to November, we are pretty much operating in the 90s - 90 per cent plus - of available berths being sold, and that's in our premium end which is our main revenue-generating end. In terms of the seating area, we are operating somewhere in the 60s or 70s. So there are some additional seats to be sold, but the revenue potential there is another 10 per cent growth. It's not going to take us to a level we need to be.

I make the observation and I make the point here, and I use the phrase quite carefully, I would suggest it's an unintended consequence of the process of privatisation and establishment of the track access pricing regime. Infrastructure owners clearly have their own charter to get an economic return on their assets. A system has been established, and we are caught with unintended consequences of that system. So if I could just return to this outcome, I would suggest it's contrary to the Australian government's intent in privatising passenger rail operations because their intent was to ensure its ongoing commercial viability. Consequently we say that further consideration of the policy settings for LDPR track access is warranted. It's the only area of our business that has not been subject to open market contestability, and the only area where we haven't been able to achieve any cost reduction.

GSR suggests the commission recommend that consideration of specific government policy for LDPR to promote its commercial viability should be subject to detailed independent examination. In considering this proposition in the context of the commission's work brief, the commission may find it useful to refer back to our original submission which illustrated the benefits of LDPR to rural, regional or remote communities or alternatively the commission also might like to consider the dis-benefit to such communities in the event that changes to the pricing regime that arise out of the recommendations that you make have, as a consequence, the discontinuance of the services we operate. We feel a real risk.

Additionally in support of this point, we observe in your draft recommendation 11.5, there's a recommendation that:

> Whether allowing vertical reintegration of particular rail lines or networks would promote their commercial viability should be the subject of detailed independent examination.

It's in the same vein of that recommendation. We understand the scope of your work. We're not trying to divert you wholly from it to focus on what is after all a small use of the network, but we submit that it warrants a recommendation for consideration of specific government policy for LDPR to promote its commercial viability, and that should be the subject of detailed independent examination. Those were my comments on government policy settings. I do have some observations now on vertical separation, unless you wanted to - - -

MR BANKS: Okay.

PROF WALSH: Sorry, can I just come back a step there. It sounds like the access providers are either acting in a very sort of short run revenue collecting manner because they know and accept that in 10 to 15 years when the rolling stock needs to be replaced, that you're going to go out of business at the current charges.

MR BRAXTON-SMITH: Or alternatively there would be a market failure that potentially the government might feel obliged to step in and provide some assistance. I think that's also very much in their thinking when I've had the discussions with access providers. Basically they've pointed to their charter and they've kind of said - and I'll quote from one who says:

> Their corporation is answerable to its board of directors. The public interest issue that you raise would perhaps be better addressed by the appropriate government bodies -

and effectively they point us back towards government bodies and say, "We hear you've got an issue, but tell someone who cares," but talk to other parties.

We have made approaches, particularly to ARTC. We've made submissions to their board of directors on a general basis, along the lines of the submission we made here, and we've made specific representations to them about a particular service, The Overland, which at one point was looking to be in difficulty. The Overland does receive government funding, effectively a CSO, from the state governments of South Australia and Victoria. Both governments wanted to effectively quit that, and both governments would have been able to quit that had there been a different view of access pricing taken.

We made a submission to ARTC. They heard our submission. I think they expressed some sympathy for our position, but basically said they couldn't move. That effectively had us turn to the governments and say, "The choice is yours. The service can't be operated on a commercial basis. Are you willing to provide some support or shall we turn it off?" We put together a business plan with the governments which demonstrated what we thought we could do, and they provided us with funding, but effectively what's happening is the Victorian government and the South Australian government are giving us money which is returned to ARTC.

It's the only service which actually does get government funding. The others stand on their own two feet, and I would hazard a guess that the access providers are saying at a certain point of time we will turn elsewhere.

MR BANKS: They might have empirically some valid basis for a presumption of that kind if you look at what's happened generally in the industry.

MR BRAXTON-SMITH: Yes.

MR BANKS: In the meantime it doesn't make your life any easier.

MR BRAXTON-SMITH: It does make it very difficult because what it effectively says is that you run it down until it's going to run into the wall, and then you turn to government for support.

MR BANKS: In a crisis situation.

MR BRAXTON-SMITH: Yes.

MR BANKS: Is there no issue here in relation to the opportunity cost of you being on the network in terms of freight that could otherwise be on the network?

MR BRAXTON-SMITH: That is something that has been presented back to us, and it does depend on the time slots. Certainly in the case of The Overland, we used to occupy slots that were seen by the freight sector as very desirable, night-time slots heading out of Melbourne westbound. When we reorganised the timetable, we actually gave up those slots and took daytime slots which was convenient for us, because our market research said that our guests prefer to travel during the day. Those slots were certainly available. We had to do a bit of working around the existing operators, but not a lot, and we surrendered slots that I think have a lot greater commercial value, but there is - again it was part of our submission, but no recognition of that particular issue.

PROF WALSH: And you didn't get a discounted price for giving up valuable slots and taking - - -

MR BRAXTON-SMITH: Slots that are in higher demand? No!. I think possibly part of that for ARTC is they say a slot is a slot is a slot for a freight operator, but I think at the present time, we have occupied capacity that might not necessarily be otherwise utilised. That's our perspective. Obviously we don't have perfect knowledge of ARTC's program.

MR BANKS: Okay. Good. We'll let you go ahead.

MR BRAXTON-SMITH: Vertical separation, again it goes to the same point. The observation in the report Addressing Non-Price Impediments, page 10.13, the same point about:

> For vertical separation to increase above-rail competition, there needs to be the prospect of profitable entry into above-rail markets. However, most rail network operators typically face strong intermodal competition and struggle for commercial sustainability, particularly where there are low volumes of freight.

In the same section you go on to say:

> Vertical separation is likely to compromise the commercial sustainability of these networks.

There's some suggestion that vertical consideration should be a case-by-case consideration. Whilst we don't object in principle to vertical reintegration or the concept of reintegration, we do hold some grave concerns for the future viability of LDPR in such circumstances without adequate checks and balances. We do foresee a risk that a vertically integrated track owner may subsequently implement some cost allocation or pricing practices that discourage access by third parties, and inhibit the use by LDPR, whether that's intentionally or otherwise. I'm not suggesting that they will necessarily deliberately do it, but the unintended consequence again might be that it results in some disadvantage to LDPR.

Again we respectfully submit that recommendations for consideration of vertical integration incorporate some explicit recommendation for robust oversight mechanisms, but guard against the misuse of market power and/or discriminatory pricing practices that result in the exclusion of LDPR, whether that's intentional or not.

MR BANKS: I guess what you're saying is the vertically integrated situation, the incentives change for the below-rail operator relative to now where they might not have such strategic - might there be strategic reasons why they would favour - - -

MR BRAXTON-SMITH: I think in any business, if you were vertically integrated - in other words, own the infrastructure, own the operating equipment - there is always areas of cost allocation where there is some ability to - well, there are different views about how you might allocate costs. If I were a vertically integrated operator owning a track network, then in principle I would want to interpret my cost allocation principles to allocate costs to the below-rail component wherever possible and then establish the highest possible transfer price to my above-rail component.

That would effectively mean that I would charge what I think my end market freight customer can bear. They'd get the best they could commercially, but internally, I would then be taking my "profit" on my below-rail. The effect of that would be to shut out competition. The effect of that would also be to price the track access component as high as possible. Again it would discourage third party access. Obviously there are limits to that, but an integrated operator could have some incentive to work at the limit.

PROF WALSH: Typically there are requirements, aren't there, for ring fencing. I mean, as much separation as you can kind of get, at least in an accounting sense, and you think those are not particularly robust.

MR BRAXTON-SMITH: You would need to be careful, and that's effectively the point I think I'm making. You would need to make specific provisions there, and I don't know how you do it frankly. It's beyond my capability in terms of - beyond my competence to make some considered or detailed assessment of how you might put those safeguards in. I guess what I'm saying is you'd need some pretty robust safeguards there.

MR BANKS: I suppose what you're saying in a way, too, it just heightens the relevance and importance of the access regime regulation as well, which you could argue has more merit or rationale in a situation of vertical integration perhaps than separation.

MR BRAXTON-SMITH: Yes. Certainly if it was vertically integrated, then you would want a tighter regime. I haven't seen a lot of it, but as I understand it, in the United States for instance, the vertical integration is the common model, but there's cooperation between access providers because they have complementary networks. So to get freight on rail from point A to point B, they need to get across three. Number 1 doesn't get business unless he cooperates with number 2 and number 3. I'd suggest that the circumstances are different in Australia because of the ownership of the infrastructure in general. You couldn't assume that that would necessarily be that model applying in Australia.

MR BANKS: Okay. Thank you.

MR BRAXTON-SMITH: In fact that leads neatly on to the next area of comment for me; the effect of removing regulatory controls. The commission was seeking some comment from participants on the potential effects of removing access regulation. In considering this issue, the commission notes from comments from ARTC and the ACCC, quoting section Addressing Non-Price Impediments, page 10.23, the commission says:

> Concerns about market power and the ability of access seekers to obtain competitive prices seems misplaced.

Again I have probably already said it, but let me repeat it in writing. This is not GSR's experience. To the contrary, ARTC has consistently dismissed all attempts by GSR to negotiate, rejecting written submissions out of hand, and verbally indicating that really charges should be substantially increased. They've gone on to say they're nice guys and they won't do it, with a smile, but that's the verbal feedback and the context that we get. So we see that the effect of removing regulatory control is likely to lead to the imposition of increased charges, and that in turn could make commercially operated LDPR completely unviable. Again we respectfully submit that recommendations include explicit recommendations for robust oversight mechanisms that prevent the misuse of market power.

MR BANKS: Are you thinking about any particular provider here or is this a general proposition?

MR BRAXTON-SMITH: ARTC is the one that leaps immediately to mind, but I think there's potential there for each of the key providers, and for us there are three; WestNet, ARTC and APT.

I'd like to, if I can, comment on - I guess there's kind of a theme been emerging so far, but I'd just like to turn to something slightly different, which is treatment of common costs and pricing methodologies. In the draft report, there's some discussion of Ramsey pricing. It's in Efficient Pricing of Road and Rail, page 8.11, and the conclusion that it reaches is that whilst it's at best likely to be applied in a rough and ready manner, even this is likely to be superior to other allocation methods.

Again we suggest noting in this section that the consequences of allocating more common costs to LDPR and escalating access fees further will put pressure on a sector that's already struggling for commercial sustainability. In fact, we would suggest that the commission identify some potential measures to mitigate the risk of failure of commercially operated LDPR for consideration by government policy-makers. Again it's for consideration of the government policy-makers. It may or may not be within the scope of your work, but it occurs to us that one such measure would be to establish a discriminatory pricing regime for LDPR that provides for a certain percentage of capacity, and it would only need to be a small percentage of total available capacity, like 5 per cent, to be made available to LDPR and at strictly its incremental cost.

Should arrangements then as a consequence of that be needed to enable infrastructure owners to continue to recover common costs, however they allocate them, that could theoretically be facilitated by CSO payments. I'm just identifying one method, and I guess the key thing to highlight is our use of the network is fairly small.

How did I come to this proposition and how would I suggest considering this proposition, again I'd just point to other parts of the draft report. Draft finding 8.8 which says:

> Prices charged to users of freight transport network services should at least cover the directly attributable or incremental costs of providing the services they consume.

That's in Efficient Pricing of Road and Rail, 8.19. We do not quibble with having to cover the incremental costs of our use of the network, and we think if we were just covering those incremental costs, then you would find that LDPR at least in theory should be commercially viable. A couple of other points in support of perhaps putting forward that as one possible method for the policy-maker's consideration, you do say elsewhere that:

> CSO payments made to publicly owned operators could be passed on to private above-rail operators through lower access fees or where private providers own below-rail infrastructure by covering commercial access fees.

I think it's within the framework of the way that you're seeing the issues for rail access. In fact you've also noted in Efficient Pricing of Road and Rail on page 8.18, you say that:

> Strictly speaking, a government subsidy to meet the common or fixed costs of providing infrastructure need not result in inefficient outcomes provided the investment is efficient and that subsidy doesn't distort choices between modes.

We're not looking for any relief on track access to go out and make a grab for market share. We're looking at a long-term way to deal with the commercial sustainability of this particular activity. So that sort of approach, the discriminatory pricing regime for LDPR that provides for a certain proportion of available capacity, example 5 per cent, to be made available to LDPR at strictly its incremental cost, it's consistent in general with the framework that's being put forward in the draft report.

PROF WALSH: Perhaps just as a general observation, that quote about, "Strictly speaking, a government subsidy need not result in inefficient outcomes," I think we do sort of go on and say we think there are very good reasons for wanting not to have government subsidies in there for full cost recovery for incentive reasons.

MR BRAXTON-SMITH: Absolutely. I understand the point entirely. Government subsidies are never desirable, but in terms of the particular circumstances of LDPR, if there are no other avenues with which to accommodate it, then - I guess there's two legs to what I'm saying. Number 1, if you said to access providers, "You've got to provide 5 per cent of your available capacity to LDPR and price it only at incremental cost," that's leg number 1. 5 per cent of capacity, in most cases they're not at capacity. At incremental cost is - whereas from their point not commercially desirable, it's not costing them anything, but if in the long run that were undesirable, then supporting the CSO payments as the second leg, I guess whilst preferably you wouldn't have government subsidies within the framework of what's being said, it's not out of the question.

Some comments about price sensitivity if I may, and I found this particular area quite interesting or particularly interesting. In analysing - just to introduce it. In analysing the common costs, in the draft report it suggests that - and again I'll quote the words:

> Given that freight's usage of rail is widely viewed as more price sensitive than passenger use, it might be expected that infrastructure operators would allocate common costs more heavily to passenger trains.

The draft also notes something from DOTARS suggesting that:

> Both passenger and freight demand is inelastic with respect to price albeit with less demand; somewhat less price sensitive.

I'm not certain, but these two points might seem to be a little contradictory. At the end of the day, we would submit - and I'll take you through a case study in a moment - that passenger pricing is sensitive or passenger is price sensitive. But first a general comment. We would say that any assertion on the subject of price sensitivity by a government-owned enterprise, and particularly one that's vertically integrated, has to be treated with caution. If any government-owned enterprise argues that passenger is not price sensitive, please treat it with caution. Why? Because in the public sector, if there's an increase in cost allocation to long distance passenger rail for track access, then there are really three options; increase the ticket prices, reduce the service costs by reducing the service availability or turn to the government for more CSO funding.

The first two are always going to be politically unpalatable, increasing ticket prices or cutting services, and government will tend to almost invariably simply increase the CSO payment. So the argument about lack of price sensitivity - I mean, there's a distorting factor there in the public sector. That's a general comment. In particular we've got some evidence for you, and perhaps if you've got with you the very last page, you will see there's a recent change in our pricing practices that demonstrates price sensitivity. So let me just give you the context of this, and then there's a chart. I'm not quite sure if you've got it on the last page, but allow me - - -

PROF WALSH: Yes, got that.

MR BRAXTON-SMITH: The context of this is when we commenced the new service to Darwin - the Ghan always used to run to Alice Springs, terminate in Alice Springs, and across the network in Australia for pensioners, concession travellers, there is a system in place where we receive partial funding for any concession we give to a concession cardholder. There's a great history to that, but effectively there was never any contemplation of how it would be funded. But we assumed that it would be funded, and therefore when we opened the service to Darwin, we simply applied the same concession discounts to our ticket prices for Alice Springs-Darwin as on the rest of the network.

So in 2004 and 2005, that meant that a pensioner who travelled Adelaide to Darwin got a discount on the entire travel, including Alice Springs to Darwin, of between 32 per cent and 55 per cent to the normal adult price. We were engaged in protracted discussions with both the Commonwealth and the Northern Territory government then about who should be funding the concessions because there's a mix of funding across other parts of Australia. Not surprisingly, the Territory pointed to the Commonwealth and the Commonwealth pointed to the Territory, and ultimately neither was willing to provide the funding. So from 1 January this year, we changed our pricing for concessions for travel north of Alice Springs.

So now for travel north of Alice Springs, as a pensioner, present your pension concession card, we'll still give you a 20 per cent discount. We receive no funding, but we still offer a discount to pensioners. What's been the result of that - that's really what table 1 is about. What it shows is the change in concession fare passenger numbers and the average spending, comparing January-October this year to the two prior years. Effectively what's happened is, following the price reset, we get an average of 23 per cent more spend per concession person travelling. However, volume falls by 33.6 per cent. We've got 33.6 per cent less concession travel north of Alice Springs because the prices have gone up, and total revenue is down 18 per cent. Compared to Adelaide-Alice Springs where there's been no change in pricing, there's been no change in volume and no change in yield or no material change. It's a very clear impact.

So from where we sit, that demonstrates that for LDPR, at least in the end market, it's price sensitive and it exhibits price elasticity. That's the end market of the passenger that travels. If we then take the intermediate market which is ourselves on a strictly commercial basis, there's little ability to absorb increases in track access prices. In the absence of any external distorting factor, ie CSOs, there's likely to be either reduction or cessation in services, or if we put the prices up more, we'll get more of that reaction across the whole of our passenger types. So we would submit that in any scenario of increased prices, there's likely to be a reduction or a cessation of services, and therefore a reduction in the level of consumption of available capacity. So for both intermediate and end markets, there's price sensitivity.

On the basis of that, we ask yourselves to reconsider the analysis that suggests that passengers are not price sensitive. It is price sensitive, and the demand is elastic.

PROF WALSH: This is a segment of the market perhaps where you might expect there to be somewhat more elasticity than elsewhere, but even so, you're saying, what, a 30 per cent increase in prices brought about an 18 per cent decrease in - - -

MR BRAXTON-SMITH: Total revenue.

PROF WALSH: Sorry, passenger numbers have come down by - yes.

MR BRAXTON-SMITH: An average increase of 25 per cent in price yield per ticket has brought about a 33 per cent decline in volume and an 18 per cent decline in revenue. We've also market-researched - I don't want to be shy about this - travel on our trains, even at full adult fare, is at a premium price if you travel in gold, the tourist accommodation. If you travel in red, then it's very economically priced. It needs to be because you're most likely a person of limited means. In fact, as discount airlines have increased their offer - Jetstar and Virgin - we've found that our full-fare paying economy passenger has fallen away. They've taken them away through cheap tickets, and we are left with more concession travellers - students or people who get some percentage discount off a fare that's already quite low.

But to return to the point about our fares, our fares and the prices for the product we offer, it's quite a premium price. We say we offer a premium service and a service that represents still good value, but we have done market research about our ability to charge more, and the market research is suggesting to us that we would get the same sort of phenomenon; that we'd get a sharp drop in volume if we were to increase our ticket prices by any substantial amount.

We would really challenge the assertions that are being made by other parties that says passenger is not price sensitive. We think it's very price sensitive.

MR BANKS: Just with one eye on the clock, could we move to the next - on page 7 there.

MR BRAXTON-SMITH: Page 7. This is more about passenger priority because there's some comments there about passenger priority. There's a note in your draft report, "Passenger priority is rarely factored into access charges." It's in Addressing Non-Price Impediments, page 10.15. That's not correct. ARTC's schedule of rates applies a premium flag fall for passenger which is higher than the standard flag fall for freight or even the premium flag fall for freight. The way they do it is quite neat. They say, "110 kilometres an hour, 21 tonne axle load, ie a freighter, we'll charge you this flag fall. 115 kilometres an hour maximum track speed, we charge you more." There's little difference between 110 and 115. It's simply masking a premium charge to passenger. We'd be quite happy to accept 110 kilometres an hour as a maximum track operating speed. Our average speed is about 80.

The observation actually refers to an assertion by PN, and this is an interesting observation. What PN say - and you've quoted them - they say:

> The average speed of passenger trains is higher than for freight trains. The outcome is that freight trains are often run down and then have to wait to allow passenger trains to pass before they can proceed. The cost of passenger priority is borne by freight trains, but this is not internalised into any pricing.

This is the same part of the report, page 10.15. The first point, there are a number of classes of freight trains at varying speeds. Some are slower than passenger, yes, and some travel at the same speed. As a general principle, if all freight trains were to operate at the same higher speed, there would be more network capacity and greater efficiency in the overall network. There's an alternative view. At present, passenger trains - our trains - are frequently slowed from their normal operating speed, and there are delays that are built into our timetables in order to fit with and accommodate the overall schedule for the corridor, and that's done to accommodate slower-running freight trains.

Quite contrary to the PN assertion, it really means that the passenger is bearing the cost of the inefficiency of the slower freight train. Consider the scenario in which all trains can operate at a maximum speed for which the track is engineered - 110, 115 kilometres an hour. Logically there's going to be increase in the capacity available over the present limits, and that in turn reduces the unit cost to making capacity available. If you accept that, then it would follow that the present system, the lower trains ought actually to bear the cost of their own inefficiency. It's not all us. There are both freight trains and passenger trains running at 110, and then all this other group running at 80.

They're the ones that are creating the inefficiency, and we'd actually be so bold - some people would call it cheeky, but I prefer the word bold - as to suggest that you could actually achieve having the slower trains bearing the cost of their own efficiency by simply inverting the flag fall scale of charge. Make the flag fall for trains that can operate efficiently at maximum track speed lower and make the flag fall for the slower freight trains higher, because they're the ones that are slowing the system down and reducing its capacity. It's an alternative view. We might ask you if you were to take the PN point of view and note that in your report, you might like to at least consider that alternative point of view from the passenger operator.

The other thing on passenger priority is that the draft report notes - and this is in Rail Infrastructure Costs 5.3, it says:

> The financial viability of rail freight infrastructure may be impeded by factors such as access regulation or preference being given to passenger trains when allocating access paths.

It's particularly that section that I want to touch on, "preference being given to passenger trains when allocating access paths". The premise on which that is based is not strictly correct. LDPR trains are not given preference when allocating a train path. Historically when GSR seeks a timetable change or when we seek a new train path, it's constrained by whatever pre-existing arrangements are in place. We can't go and say, "We're passenger. Give us a path." We don't get any preferential treatment by virtue of our status as a passenger operator, and any change we do get is granted only to the extent that we can accommodate the needs of other network users.

If not, then we're simply forced to accept a sub-optimum timetable, and again I've got a very practical recent example of this. We restructured the timetable for The Overland. It went from a day service Adelaide-Melbourne, night Melbourne-Adelaide back to day in each direction. In the counter-direction, Melbourne to Adelaide, we had a couple of days where we had just clear train paths. We got our slots very easily, but Thursday service I think it was, or Friday service - Thursday service, there were other trains on the network. What happened? We effectively could not find a way to accommodate our needs to have a uniform departure from Melbourne, 7.20 am, without doing something with the timetable. So now what happens is we burn time between Melbourne and Geelong.

We actually spend two hours in transit between Melbourne and Geelong to accommodate freight trains against a possible transit time of about an hour, and we get letters from our guests and we've got letters from various interested parties saying, "What are you doing about this?" The fact is we can do nothing because the freight trains have paths, and no-one is willing to move. We aren't being given any priority. I'm not quite sure where the concept of passenger priority in an absolute sense is being factored, but I'd suggest the assertion that passenger is given preference when allocating a path is not correct.

The area that passenger priority does come in - and I think might be the area where there's some argument - is there is a concept of passenger priority, and the concept of passenger priority is used to establish a decision-making framework for when trains are not running to schedule, and effectively simplistically, what it says is that when two trains are running behind schedule, you give priority to getting the passenger train back on schedule. That's passenger priority and where we use it.

To understand the practical effect of that on the freight network, I'd suggest you have to look at the overall on-time running performance. So ARTC in their annual report, they indicate that freight - they have the concept of healthy trains and unhealthy trains. They have unhealthy trains, ones that are running more than 15 minutes late. In their annual report or 2005, 68 per cent of all trains unhealthy, and only 30 per cent healthy, on time, on schedule.

MR BANKS: Sorry, what was the definition of "unhealthy" again?

MR BRAXTON-SMITH: An unhealthy train is one that's running more than 15 minutes late. A healthy train is one that's on time, and on time is defined within 15 minutes. So the majority of trains, two-thirds of the trains on the ARTC network are not running on time, with the exception of GSR and CountryLink, all their trains are freight. In GSR's case - I don't know about the case of CountryLink, but I've got some figures here. Our on-time performance is usually - our total on-time performance in quarter 3 this year was 88 per cent, and year to date it's 83 per cent. It was adversely impacted by a track speed restriction in quarter 1. It was only 77 per cent.

Passenger has a very high reliability performance compared to freight, light years ahead. So 88 per cent in third quarter, 83 per cent year to date, compared to 31 per cent for freight. Really where's the issue? LDPR accounts for only a small portion of the total network capacity utilisation, less than 10 per cent, and it's very difficult for freight to argue that LDPR or passenger priority is a practical impediment to efficient operation. It probably would be a lot more productive for freight to analyse and deal with the root causes of unhealthy trains. Indeed it would only be when their performance levels approach the level of passenger when they get their on-time performance up to 80 or 90 per cent that they could then contest that there might be some practical impediment by passenger priority rules. I would have to suggest argument about passenger priority needs to be reinterpreted.

PROF WALSH: Probably more involved in the situation when freight meets the urban passenger rail system.

MR BRAXTON-SMITH: When freight meets the urban passenger network, there is an issue for freight, and I can't remember exactly where, but elsewhere in the draft report, you've made an observation about how common infrastructure is much more economically efficient, and I think that holds true. So you wouldn't build a separate rail network for freight and for passenger. That holds true across Australia, but the exception that proves the rule is in the key urban areas. There are curfews that are applied. A curfew is applied in Sydney, as I understand, to freight movements around the passenger peaks as I understand it. That kind of argues for a separate network for freight through the Sydney metro area. So it is unimpeded by it.

As I understand it, and I'm sure David Marchant would be able to give you further detail, there is a proposal around to actually build a bypass around Sydney so that you decongest, but that's not a pricing issue as such. It's just the way the infrastructure is put together. The curfew thing happens for us as well. We have a curfew for The Overland departing out of Melbourne. It must depart before 8 am, because after then, they want the entire - it's actually for Southern Cross station, but they want the entire station for Victorian urban and interurban and country services. We also have a curfew in Sydney where our timetable is constrained by the fact that we have to get in and out between passenger peaks. That's why if you travel on the Indian Pacific, you arrive in Sydney at 11 am and the train departs at 2.30. The timetable is structured because of their curfew.

But I think it's a different thing to passenger priority, and I don't think there's a pricing - it's not a pricing thing. I don't think we could buy for any money the right to arrive at 8.30 am and depart at 5 pm. I appreciate that's kind of a small corner of the overall report, but I appreciate the time to be able to present it.

MR BANKS: No. We're grateful for that.

MR BRAXTON-SMITH: Just to conclude, I've provided a summary of the recommendations.

MR BANKS: Could we take those perhaps as read?

MR BRAXTON-SMITH: Yes.

MR BANKS: Because we have a timetable issue here as well today.

MR BRAXTON-SMITH: Yes, absolutely. I've just provided a final comment there which goes back to the original privatisation, and when the government did privatise in their statements, their announcements and their tender documents, they said in part - and I won't read the whole bit, but in part, the sale of AN was aimed at contributing to the establishment of a viable and competitive rail system in which the Commonwealth intended to divest itself from ongoing responsibility for the operation of rail in Australia, except for its involvement in track access. Because what we bought was what they sold, we suggest that it's in alignment with the intent of the government, the sorts of things that we've been talking about here, and as much as your work is focused principally on freight, we would request that you consider inclusion of the matters that we've talked about today. Thank you for your time.

MR BANKS: Thank you, and also thank you for coming to Melbourne for these hearings as well. We appreciate that. I think you've provided much more information through this process than we probably had available to us in preparing the draft. Thank you for that, and we'll give it due consideration. We'll just break now for a few minutes, please.

MR BANKS: Our next participant is the National Transport Commission. Welcome to the hearings. Could I ask you, please, to give your names and positions with the commission.

MR MOORE: Barry Moore, director policy.

MS NAIDU: Meena Naidu, senior policy analyst, economics.

MR BANKS: Thank you very much for attending the hearings here in Melbourne. I should take this opportunity to thank the NTC for its cooperation and assistance throughout this inquiry so far. You've provided six other submissions prior to the discussion draft being put out, and equally we had access to a number of the papers and so on that you've done. So it's been a valuable source of information, and indeed you've provided now a submission in response to our discussion draft which is very helpful. So perhaps I'll just let you proceed to indicate the main points that you want to make.

MR MOORE: We've got a brief opening statement and are happy to take questions either on the way through or when we've finished. The first thing is to commend the Productivity Commission on its progress in tackling this complex issue head on in a limited time frame. The National Transport Commission believes the discussion draft has successfully drawn a line in the sand on important and often emotive issues such as competitive neutrality, the use of PAYGO and externalities. This allows us to move on and explore potential improvements to infrastructure pricing.

The NTC has valued the extensive input we've had to this inquiry, including the discussion with PC commissioners at a recent meeting of the National Transport Commission. Our CEO and commissioner Nick Dimopoulos has asked me to convey his apologies. He had intended to be here today, but he's ill. We see a key issue facing the PC as how to move from a current system of cost recovery to genuine road pricing. Heavy vehicle charges recover road costs, but it's a blunt instrument because of the averaging and aggregation across vehicles, vehicle classes and road types. The industry has limited influence over how this money is spent. For the most part it goes into consolidated revenue or at the very least is controlled by treasuries.

Not surprisingly then nobody likes to pay which is why, for the NTC, calculating a road user charge sometimes feels more like lighting the fuse on an explosive charge. It can blow up in your face, as we found out earlier this year. We are not aware of another area of infrastructure pricing where the outcome is determined through a similar political process.

The NTC's initial submission to the Productivity Commission made the case for a movement towards direct pricing which reflects the variability of the transport industry and the different roads they use. Better demand side price signals could, for example, encourage freight users to design their logistics networks around purpose-built freight corridors and ensure operators run the most productive trucks along those routes. Direct pricing also promises a more efficient outcome for smaller trucks, low-kilometre applications and volume freight which inherently cause less road damage.

We've also made the case for incremental road pricing as an initial step in this direction. We see incremental pricing as allowing transport operators to choose and pay for the amount of the asset they can productively consume with the revenue flowing direct to the road owner. This would address the current incentive of some areas of road agencies to preserve the asset rather than achieving socially optimal levels of consumption.

Closing the loop between what road users want and what the road asset owners can deliver through pricing is fundamental if Australia is to service the growing freight task efficiently. Currently there is no supply side price signal from the road owner. There is also no financial incentive to improve access for more productive trucks on the network. Evidence of this is in the transport minister's recently expressed concern about road damage caused by emerging truck innovations such as B-triples and quad-axle trucks. Efficiency reviews using KPIs for road quality and use could also provide a measure to ensure road funding is invested in the right places. Of course all this requires institutional reform and a reassessment of how revenue is collected and distributed. We don't underestimate how difficult and complex this really is.

The Productivity Commission's discussion draft acknowledges the potential of direct pricing signals to get the right investment in the right place at the right time. We know the benefits of safer and more productive trucks like B-triples, super B-doubles and quad-axle groups are potentially large, but the Productivity Commission rightly cautions against moving blindly towards an expensive and complex heavy vehicle pricing system. The NTC's response to the discussion draft outlines a responsible cautious plan to move forward and address those concerns. We're proposing to develop the business case for a staged approach to pricing reform with feasibility studies and evaluations every step of the way. The first stages could include piloting and implementing incremental pricing before moving to direct pricing on part of the heavy vehicle fleet where most of the productivity potential lies. This plan provides a low risk route to test attitudes, evaluate the technology, improve the benefits.

The NTC also puts forward some potential improvements to PAYGO. We believe an enhanced approach which averages road expenditure over a longer period is important to iron out the lumpiness caused by cyclical peaks and troughs and would better reflect the underlying trend in road expenditure. Ultimately however it may be that PAYGO is not flexible enough to underpin a direct pricing regime. In summing up, we believe it would be helpful for the Productivity Commission to provide guidance on the objectives and principles for pricing reform, and outline a clear forward plan. We hope the final report will provide the platform for COAG and ATC to drive future pricing and institutional reform perhaps under the governance of a high-level task force. We'd like to thank the Productivity Commission for this opportunity to address the hearing, and with the assistance of my colleague, I'm happy to answer questions.

MR BANKS: Thank you very much. You've covered a lot of territory, and there are probably a couple of things we could focus on. Cliff and I haven't orchestrated this, but I think a major thrust of this submission and indeed earlier work you did was on the incremental pricing approach. You talk here about a staged approach to reform, and I think all sides would say in such a complex area, having staged approaches where you can assess outcomes along the way does sound like a sensible way to go.

In relation to the incremental pricing approach, I know the ATA has raised a question I guess as to whether the objectives of that might be equally achieved through creating a new heavy vehicle class under the existing PAYGO arrangement, so I'd just like you to comment on that if you could.

MR MOORE: There are certainly different steps you could take towards more flexibility in pricing. As long as you're sticking to vehicle classes, you've got the current averaging problems that within any vehicle class, there are going to be those who carry more mass, those who carry less, those that run under different road types and those that do vastly different distances. The attraction of an incremental price is that it provides an opt-in regime where only those who are massing out under the current arrangements would choose to move into incremental pricing. So rather than applying a single price on a specified maximum mass across the whole of a vehicle class, you're actually able to charge only for the incremental road wear incurred and only for those vehicles who opt in. Those vehicles who opt in by definition will be only those who mass out under the current prescriptive regime.

There is certainly the possibility of creating extra classes. All of this complicates the bureaucracy and administration, as does incremental pricing. So we've got to look at I guess the costs and benefits of both, but the real attraction of incremental pricing is that it would only apply to those who opt in and therefore only apply to those who are going to get the benefits. A second attraction is that incremental pricing would be probably implemented through some form of permit regime. There are issues there with national consistency of these regimes which the industry will be very concerned about probably, but the permit payments generally are made direct to the road owner without going through the treasury.

We see that as being a first step towards linkage of infrastructure provision with the road-related revenues, so that by providing that initially very limited revenue flow direct to the road owner, you're going to provide those road owners with a greater incentive to offer the productivity benefit because they know they're being recompensed for additional road wear that's incurred.

PROF WALSH: On that point, money is fungible. If money comes in the bottom end to the road agency, it might just stop coming in the top end so to speak. Have you thought about how that might be managed.

MR MOORE: Yes. Incremental pricing does not get around all of the weaknesses of the current institutional arrangements. What you would be wanting to do in effect is to invite the road agencies to be saying to their treasuries that we have a base set of charges which cover or hope to cover expenditure for a basic set of access to the road network, that for the additional access or the incremental mass, we have defined road wear relationships, and we're recovering that expenditure, and we would see that expenditure as being a separate stream which would be directed towards addressing that road wear.

Treasuries are not going to be unaware of these funding streams and those arrangements are going to have to be made on a state basis, but we would see that as a very useful debate to commence. At the moment I think there are very entrenched attitudes within bureaucracies, within agencies across the whole of the system. We've got to start breaking down those attitudes, and maybe by stirring up - and potentially in some cases a bit of conflict - people will start addressing the fundamental issues that underlie this, and realising that we really do need to close the link between road use and road provision.

PROF WALSH: Obviously the success of that process has got to be fundamental to the acceptability of the incremental pricing itself, isn't it? You're really partway to a kind of formal hypothecated road fund model, aren't you? Not only for the bit at the bottom that's now coming in through incremental pricing, you're asking for that for the budget as a whole, the roads budget as a whole.

MR MOORE: Yes, and we really do see that as a microcosm of the sort of issues that are going to be faced in moving towards direct pricing in any case. They're the issues of allocation of funds across state borders, and then allocation of the funds to the areas of the network that are affected by the incremental pricing, and that may well require the road agencies to become more sophisticated in their planning and prioritisation. You would like to think that there would be more significant industry input to the direction of that road expenditure than we have now, and we would see that as a step towards all the benefits I think that have been spelled out, the theoretical benefits of more direct road pricing.

PROF WALSH: I haven't thought how, but it occurs to me to ask at least, is there any risk that some of the stages that you might contemplate going through might turn out to be dead ends, not taking us in the direction we want to get at.

MR MOORE: You'd like to think that by the time we were getting closer to making recommendations on these issues, we would have thought through it far enough to avoid those dead ends, but certainly there is the potential there. The basic proposition is to allow the industry to purchase the amount of the asset they wish to consume, and to do that initially in a voluntary application. What that ought do is to create a realisation both by the industry and by some elements of the road agencies, that the asset is something that is there to be consumed and replaced in the right sort of manner, and hopefully to bring in other areas of industry that start saying, "Why don't we have this?" and you might have the low volume or low distance operators saying, "They're getting the benefit at the top end, we need the benefit at the bottom end." To do that, you may need further steps towards direct pricing and more sophisticated systems. We know the technology is coming down in price, but we still don't know whether it would be cost-effective in the Australian application.

MR BANKS: How difficult would it be to get agreement on I suppose the engineering of the costs that go into incremental pricing? That's clearly still an area where there are different views.

MR MOORE: I think that's not going to be easy, but it's probably not the most difficult part of the operation. The linkage between road wear or road use and road wear through to road costs is, as you would know by now, not at all scientific. What you've got to do is look at the best scientific evidence and make some what would have to be fairly harsh judgments, and you've got to come up with a view as to whether the rules for deep pavement wear is fourth power or second power or first power or 10th power for example.

That's got to be done in a way that's defensible, but you are never going to get entire consensus in those areas. There's got to be some degree of judgment used there and therefore some sort of - lower case P - political process to determine those judgments. What you need to be doing along the way is testing those judgments against the stakeholders. I mean, this sort of thing is done in the case of the PAYGO methodology currently, and whilst we're not perfect at that, I suspect we're no worse than anyone else.

PROF WALSH: There's an implication that there would have to be national agreement about those relationships, otherwise you end up with a bit of a patchwork quilt, different assumptions applied in different jurisdictions.

MR MOORE: Anything that the NTC does, we would see going through the Australian Transport Council, which means it has to get that national agreement. That process, as you know, is fragile, but in comparison with some of the other ministerial council processes, it has its robustness because there is that formal voting mechanism and a requirement which is not always met, I'd be the first to add; a requirement to implement. I think it is reasonable to speculate that in the sort of time frame we're talking about here, there might be more rigorous COAG mechanisms to hold governments to the outcomes of ministerial decisions so that we would hope that this would be going into fruition in that sort of environment.

MR BANKS: It probably has the advantage, too, that, as you said earlier - I mean, it is ultimately voluntary. So even if there are differences of opinion, presumably the users of the road will make a calculation as to whether it's still worthwhile and proceed on that basis. In that sense, I think it's probably more viable.

PROF WALSH: It would have to be voluntary across jurisdictions as well. Jurisdictions would have to opt in as well as - - -

MR MOORE: I think the - - -

MR BANKS: That's true.

MR MOORE: - - - jurisdictions would have to be forced in.

PROF WALSH: They'd have to be forced in, did you say?

MR MOORE: Yes, I think so. I think you'd have to say, "If we are going to have this system, it has to apply across the board or you're going to go back to the previous regime of vehicles becoming illegal as they cross borders", and that's going to be a crucial element of it. It really has to have - I think not just the key states, but all states there. I mean, you actually have this sort of mechanism currently in Western Australia where they have payment mechanisms. I think they're probably not based on full cost recovery, but payment mechanisms for concessional mass.

MS NAIDU: I think it's fair to say as well that the jurisdictions have given support to this kind of initiative and have really tried to push it forward, particularly over the last 12 months; particularly New South Wales and Queensland.

MR BANKS: You've spoken in the submission about the productivity benefits that are potentially available as being very large. One of the challenges for us is to get some numbers to see what that might flow through to in terms of economic benefits and so on, but did you want to elaborate on that point?

MR MOORE: We don't have very good numbers I'd have to say, but if you go to the performance-based standards area, which is really an approach which is intended to optimise the use of the network, subject to basically safety considerations, the numbers we've got coming out of there - and they're fairly tentative - some of those are our numbers, some of those are coming out of Austroads calculated by ARRB are quite high, and they're sort of measured in billions rather than even hundreds of millions. One of the key elements of any movement forward is to demonstrate benefits in excess of costs at every stage.

The potential has to be very high. The rule of thumb is that infrastructure-related costs are somewhere like 10 per cent of total operating costs, so the potential has to be high if you can run further productivity gains. The rough calculation we did was that the additional road wear costs for a B-triple under a series of I suppose fairly heroic assumptions, the road wear cost is in the order of \$20,000 for a productivity benefit of in the order of \$120,000, and they're the sorts of orders of magnitude you would expect. So it's not just small changes, it's large changes. There's a lot around who think that we really do need the next step change in productivity if we're going to address this doubling of the freight task in the next 15 or 20 years, depending on where you start the calculation from.

Our view is that we're not going to get across the board mass increases in the old way, if you like, any more; that the political concerns would prevent that. Therefore we've got to be more refined, and rather than say, "Here's the prescriptive limit. Let's jack it up," we really need to be looking at removing that prescriptive limit so long as road wear impacts are addressed as well as safety impacts.

PROF WALSH: Presumably it would be just heavy vehicles and, in particular, particular classes of heavy vehicle that are going to be paying these incremental prices.

MR MOORE: I think you're going to be looking at sort of the major workhorse freight vehicles which are going to be demanding these sorts of prices. I mean, in principle, there is no reason why the approach should not apply to any vehicle type. I think the demand will come from the vehicles that have got the lion's share of the freight task.

PROF WALSH: I guess we're not talking about things that are likely to simultaneously benefit other lighter trucks or motor vehicles?

MR MOORE: I think not, but the industry is fairly open and information flows fairly quickly. If someone were to come up with a potential application elsewhere, I think that would be addressed quite quickly.

PROF WALSH: I guess I was thinking it seems a bit unlikely it would. I was thinking if a particular piece of road infrastructure, whether it was a bottleneck or a sort of lengthy piece of road, if that needed to be upgraded in order that B-triples, say, got on there, there aren't any particular flow-on benefits to B-doubles or rigids or like vehicles.

MR MOORE: If there was, for example, a bridge bottleneck which prevented a particular vehicle and other vehicles were not currently prevented, then the answer is probably no. If it were some sort of pavement impact that, for example, led to a smoother pavement which might reduce operating costs for other vehicles, then there could be flow-on benefits.

PROF WALSH: In which case there would be some pressure for them to be included in the charging, and that would complicate things enormously.

MR MOORE: So the relationship between the incremental pricing and the base PAYGO pricing regime needs to be carefully thought through.

PROF WALSH: So you'd see the rest of it being taken into the PAYGO system. It would just be for that particular - you know, whether it's B-triple or B-double in some cases.

MR MOORE: Without having thought through: in principle, I think yes.

MS NAIDU: I think those kind of benefits - what you're paying for with incremental charges is the bringing forward of maintenance that would have otherwise taken place. So in that regard, PAYGO would, as an effect, still be charging those vehicles for that kind of maintenance, but at a time that would have been efficient if it hadn't been for the additional mass. Whilst they may still be benefiting from it coming earlier, arguably that damage wouldn't have been done if those other vehicles hadn't been there in the first place.

The prior maintenance intervals probably would have been okay. So I think our view is if you keep those things separate from PAYGO, you can argue that PAYGO can deal with the base quite well, and anything additional on top of that will be the additional benefit and the additional cost, and it is only the marginal cost of that provision, and it all sort of comes out in the wash because of the PAYGO concept of every year you pay the costs that are incurred in that particular year.

PROF WALSH: There's some risk I take it that jurisdictions might find sort of reasons all over the place for wanting to have incremental pricing, and again taking pressure off other parts of the budget really, is there?

MR MOORE: Yes, and I think that's why you would need to take up to ministers on the way through, as part of the process, a set of principles which would address that sort of issue. There's also always going to be an incentive for agencies to price above reasonable road wear assessments, but that would be a principle you would want to have signed off as well, but this is to recover road wear, not to be sharing the alleged benefits of the process.

MR BANKS: One of the points that's been made - and I think it came up at the roundtable on Friday - is a concern about incremental pricing compounding underlying distortions, and I might just get you to comment on that, and also those underlying distortions - how you would perhaps foresee those being addressed, and the work that the NTC may be doing in terms of improving the PAYGO system itself.

MR MOORE: In terms of the underlying distortions, there is a risk that if you are incrementally pricing the next bit and there is a distortion to the base price, you're providing the wrong price signal by bringing more of the freight task into that vehicle type. So there's two ways of addressing that. One is to remove the underlying distortion, and the second is if you like to overprice for the increment in order to take out the distortion for these - let's call them higher productivity vehicles.

The disadvantage of the second approach is that you're not going to be attracting as much freight away from the base price distorted vehicle as you would like to. On the other hand, in the longer term, it's probably a sounder arrangement, because whilst in the short term you're overpricing for the increment, in the longer term that's a sustainable price once you hopefully remove that underlying distortion. We would see the determination that we are now instructed by ministers to come up with in 2007 as addressing those underlying issues. In terms of potential distortions between vehicle classes rather than within class, because the current methodology won't do that, and we would see that as providing a base for incremental pricing. But certainly the distortions that currently exist need to be either removed or certainly taken into account in the incremental pricing approach.

MR BANKS: I thought it might be worth just talking a little bit about the road fund idea, and there was just a little bit in the submission where the NTC comments on that, raises a few questions about what the objectives of this would be and how well it could work. I might just ask you whether you might just comment on those views.

MR MOORE: I guess in terms of a road fund which is intended to absorb all road-related revenue, so meaning across all vehicle classes, as we don't have a role in pricing for light vehicles, we don't really see ourselves as able to comment on that. I guess our main comment is that there are steps that can be taken and productivity benefits that can be derived for heavy vehicles without having to go all the way towards a complete road fund, and incremental pricing would be an example of that. Another example would be to obtain price fixes, if you like, for higher productivity vehicles like the B-triples and the quad-axles which are something else we need in the short term.

So I guess our basic position on that was that it's really not our game. We think there are institutional changes required to address the heavy vehicles only, but it may be they don't have to be on the same scale, because the heavy vehicle-related revenue is something like 20 per cent of the total revenue stream, and maybe there's a bit more flexibility to operate there whilst taking account of the issues of the margin.

MR BANKS: I think the NTC also made the point that it's not clear that the revenues that accrue to the road fund would necessarily be redirected back in the way that tapped some of the potential benefits for the heavy vehicle class. Is that right?

MR MOORE: Yes.

MS NAIDU: I guess we were unclear as to how the pricing signals would actually flow through the road fund. What we sort of took away from it was that it would still be quite heavily dependent on sort of the deemed process from asset owners to access the funds, and the price signal of the actual usage might get lost along the way, and I guess we're also concerned about the difference about efficient heavy vehicle infrastructure provision as opposed to efficient infrastructure provision of road services, and they can be quite different.

I guess we're particularly concerned about the marginal revenues flowing back through road agencies, because that's where we believe that you can actually target freight infrastructure more usefully, but in any other sense, you might not take a sort of - it might get lost in that sort of holistic evaluation which obviously looks at light vehicles and their infrastructure requirements, and it's just a very different kind of objective about general access and safety as opposed to those sort of commercial infrastructure provision requirements.

MR BANKS: I think an observation was made at the roundtable - and the NTC probably doesn't have a view on this as the NTC - that if you could have a road fund that was focused on heavy vehicles - it was like a heavy vehicle road fund - would that address some of those concerns? Would that add anything?

MR MOORE: There is this I think distorted incentive for the road agencies where, to exaggerate, you get two types of cultures there. You get a service provision culture where there are areas that see themselves as being there to provide a service to their customers, which include the heavy vehicle industry, and in some cases they're set up so that it's entirely the heavy vehicle industry, and another part that sees its incentive as to preserve the infrastructure, and for that group, they see no benefit from increasing the level of access or increasing the mass limits or whatever. All they see is an increase in the road wear costs, an increase in the rate of degradation of their infrastructure, and no guaranteed mechanism where the revenue flows to them to enhance, preserve et cetera, respond to those changes.

Some sort of mechanism to address those incentives I think is fundamental. This is a sort of issue we're facing now with high productivity vehicles where, in some areas, you've got ministers and road agencies saying - almost with a capital N, saying no; no productivity without payment, but then the question is how do you set up the right mechanism to crack that incentive problem. I think that's crucial and I think it's an area where maybe a little bit of incentive could go a long way, and it may be you don't need to redirect the whole of the road-related revenue stream or indeed the whole of the heavy vehicle road-related revenue stream to demonstrate a link.

There's a model in I think Saskatchawan in Canada where for productivity projects, they have a sort of a division of the benefits between the customer, the road agency/government and the transport operator. That's not the model we're looking at, because I think that sort of model really does encourage rent-seeking, but to recompense the road agency for defined additional roadwork and to make that a direct loop, I think would begin to change the culture in those parts of the road agencies, and those cultures are deeply entrenched. Some of those road agencies have very strong engineering cultures, which they need for what they're doing, but from I guess a social or a governmental perspective, what we're looking for is that optimal productivity outcome, and that in some cases is going to occur if you consume an asset more quickly.

PROF WALSH: You're addressing - partly becomes a transitional issue. I think back on getting the signals through into the decisions, if you've already now got a culture which accepts this sort of linkage, I think the idea under the road fund is by having reasonably independent governance arrangements and what the road agencies are doing is basically bidding on the basis of cost benefit analyses they put forward, then those signals now are actually sort of reflected in the cost benefit analysis or you contest against the signals that you're getting, just as an explanation I think of the way you were thinking.

MR MOORE: Yes, and you can certainly see the attractions of that, because the road agencies do have quite rigorous internal cost benefit approaches. They are probably more advanced in that direction than most other government agencies in that they do things like valuing life or valuing saving of lives, valuing safety benefits, putting those into the same matrix as productivity benefits, and that process is currently being strengthened by the AusLink guidelines that are being picked up.

PROF WALSH: Could I just go back to the stepwise process. We talked about going to incremental pricing and testing that out. What's the next step beyond that, so to speak? One obvious thing is perhaps that, even with current technologies, distance-based charging would be a possibility. Do you see that as a possible step?

MR MOORE: The answer to that has really been the outcome of some form of business case/feasibility study which may be an outcome of COAG consideration or the PC report. But, yes, that is certainly one of the directions you can go. The question is do you break off a part of the network, do you break off a vehicle type, do you break off a technology? What's the way in, and there are advantages and disadvantages on any of those. As soon as you break off anything, you're creating boundary issues and possibly perverse incentives. For example if you say let's go B-doubles because they're the ones that compete most directly with rail, that's the case, but there's a lot of B-doubles that are used only in urban applications as well, and there's a lot of vehicles that aren't B-doubles that compete with rail.

It's making judgments on all of those issues at the same time as judging what is the penetration rate for the sort of technology we're talking about through industry in any case. GPS is widely used in industry. I think - you can ask your industry people this afternoon - it's probably still not dominant, but the rate of uptake of these sorts of technologies is more rapid. Testing of these sorts of technologies for pricing purposes is increasing. We've got experiments going on in Europe for example and we've got a local application which is not directed at pricing at the present, it's directed at compliance.

MS NAIDU: I think when we look at incremental pricing, it's really at the top as opposed to the bottom. That's what we aspire to, and it's at that high productivity level, and when you look at what are the first steps to go forward on, incremental pricing we see as being a combination of mass distance and location. To then go down to the base and think about where do we take that, I guess if you're thinking again that your objective of pricing has something to do with really tapping into productivity of vehicles, then distance pricing alone is possibly not going to do that, because it's just not going to differentiate the network enough in order to enable that kind of access.

So in some combination with location or mass or all three is probably the more meaningful step. You will deal with a bit of cost reflectivity benefit. That will come out of that distance-based pricing alone, and that's certainly beneficial for those who don't do long distances, but in terms of that productivity gain, which is where we think that the biggest benefit is, that's really where you start getting into the locational side of things. If you've got distance, you've got location as well. The technology does provide for that.

So I guess that's where we see the direction, and certainly we see incremental pricing as a testing of attitudes whilst we develop the sort of pricing mechanisms that will meaningfully sit within that, and clearly cost estimation is going to be we feel probably the bigger issue in terms of what the basis of pricing is.

MR BANKS: We didn't really have any further questions. No doubt we'll be interacting at team level in terms of understanding some of the points you've made, more detailed points you've made in the submission and other work you're doing, but did you have any further comments to make?

MR MOORE: I guess only to reinforce the opportunity. This sort of stuff we're talking about and you're addressing has been knocking around in the minds of economists for decades, if not centuries. We're now, as you know, on the verge of having the tools to do something with it which means that those sorts of institutional issues and issues like definition of objectives actually now become relevant, whereas in the past they weren't. It is very important to go forward on a national basis or we're going to get all the sorts of fragmentation problems we’ve had in the past, and we also have to be cognisant of the fact that what we're talking about here spreads beyond the portfolios of transport ministers. As soon as we try to do anything, we're looking at significant revenue streams to treasuries and that obviously attracts the attention of central agencies. I think you've probably got the heroic task in the next six months maybe. It comes back to us after that.

MR BANKS: Thanks very much for that.

PROF WALSH: Six months?

MS NAIDU: Six weeks.

MR MOORE: I think COAG has a bit of deliberation after that, doesn't it?

MR BANKS: We're going to break now for lunch, and we're going to resume at about 2 o'clock with the ARTC.

(Luncheon adjournment)

MR BANKS: Our next participant this afternoon is the Australian Rail Track Corporation Ltd. Welcome to the hearings. Could I ask you, please, to give your names and positions.

MR MARCHANT: David Marchant, chief executive officer Australian Rail Track Corporation Ltd.

MR CAMERON: Jason Cameron, corporate strategist, Australian Rail Track Corporation.

MR BANKS: Thank you very much for attending today and also for your input in the early part of our proceedings. We had a meeting in Adelaide, and a couple of submissions from you, and also participation in some of the forums that we've been involved in. So we appreciate that. I haven't seen your reaction yet to our discussion draft, and I guess that's what this is about this morning. So I'll hand over you to raise whatever points you like.

MR MARCHANT: With regard to the discussion draft, we'll touch on each aspect of the headings raised during the discussion in our preliminary comments with regard to that. We find it interesting the commission appears to assume that heavy vehicle costs recoveries are based on the attribution and allocation methodology used by the NTC, that the approach in fact does produce a true cost incurred by those vehicles. We actually find that a surprising outcome, given the commission itself concedes the total lack of accurate current data to actually rely on such an outcome.

We're the first to concede that the approach and the terms of reference given to the commission are difficult, and the first to concede that the time period provided for the commission to address those terms of reference seem extremely short, given the huge basis on which information is required to actually come to valid conclusions. We've obviously, in the rail industry, questioned the approach for many years with regard to the attribution model, and we were expecting the inquiry would deliver a more of an independent assessment of the elements of that model. Our impression from the draft report is that the acceptance of the database and the framework around it seems to be more like an auditor's acceptance of a set of accounts as distinct to fundamentally understanding whether the set of accounts produce a true and accurate record of what the outgoings, movements and the rest are.

We have no doubt, nor have we ever suggested, that the NTC's assessment of the model it uses is an inaccurate assessment. What we have doubts about is that the model itself is a good model, not that the NTC's use of the model is inappropriate. The only thing arising from the draft report is kind of an auditor's account that the model has been used accurately. What it fails to deal with is whether in fact the data brought upon the model is in fact used in a form which produces a more rational financial and economic cost outcome to the participants.

There continues to be a significant proportion of expenditure excluded from the road cost base. To put that in some perspective, some 30 per cent. It's the kind of elephant in the room that's kind of missed in the report; the non-attributable costs. Just to give some concept of that, 30 per cent is $A3 billion a year. It's not as if it's a small proportion of Australia's overall financing of infrastructure. $3 billion a year unattributable, assumed in the base, based on engineering analysis done years and years ago, may have been appropriate years and years ago, may not be appropriate today, and yet it forms 30 per cent of the non-attributable costs that are brought down to attributes around that. They're not small levels.

We strenuously believe that the commission, to address its terms of reference, either seek further time or indicate that it cannot address the terms of reference in the time available. We would prefer that the situation of an auditor checking a model and saying, "Based on the material provided to us, it's accurate," because that effectively doesn't seem to be what the terms of reference ask. The data collection system and the analysis on road corridor usage which the commission concedes are not adequate enough; that the independent engineering assessment which was used for the criteria for allocation between both heavy vehicles, other vehicles and in fact the unallocated portions the commission concedes are old, and then comes to a conclusion on the basis of all that, it may still be accurate. That strikes us as being way off beam.

The issue here isn't, as the commission has suggested, in the second section of market share and competitive neutrality, that the PC's findings that:

> There's no compelling case to raise road prices as an increase in road prices is unlikely to shift market share.

I wasn't actually aware that the terms of reference were about market share, and certainly - - -

MR BANKS: I think you've misquoted from our report from memory.

MR CAMERON: I don't believe that's a direct quote.

MR MARCHANT: It's in quotes.

MR BANKS: If there's a quote, I would prefer that it was an actual quote in the report.

MR CAMERON: Sorry, that's my handwriting there.

MR MARCHANT: The summary that an increase in road prices are unlikely to shift market share, the ARTC submission about pricing and competitive neutrality is not about ipso facto a movement in market share. That may in fact be an outcome, that may not be. That's not the issue. The issue is about economic understanding or where subsidies and cross-subsidies are or may not be, and the issue comes down to being able to assess one competing economic allocation of resources against another in a number of circumstances.

To actually move to a concept of modal shift being an end as distinct to actually getting competitive neutrality of costings understood and what happens about modal movements then comes to a market situation of a whole range of frameworks. The sustainable efficient pricing in both markets is more a prerequisite for sustainable efficient infrastructure investment. On the PAYGO averaging framework, it would not be possible to actually assess one competing road project against another or one competing road project against one competing rail project on the same basis using those cost models, because they actually do not work on the same economic efficiency allocation framework.

Whether that leads to different decisions about what should be made sustainable or what should be subsidised or from what area they should be, that's a fair call. Governments can make those calls, but on the present system, even the cross-comparison under AusLink of one road project in one part of Australia against another road project doesn't actually get it any further, especially when you add a complication of a rail project somewhere in between those, because the pricings and the economic analysis principles are not in alignment, and yet they're all in the similar logistics markets.

One way of solving that, as the commission hasn't yet proposed, but I expect will raise, is bring the rail into the PAYGO system which would be in fact interesting, except rail is not in the steady state, and on the commission's own analysis, PAYGO only works in a steady state environment. We're not even asserting that the road system is in a steady state because effectively some products of the road system are requiring massive expansion, certainly in Queensland and other areas, where other parts are in fact, in steady states, paying maintenance frameworks. Under the averaging system, people of Victoria are contributing substantially to the upgrades in Queensland etcetera, whether those upgrades could have been done in other forms where they don't get interested in the way this system works.

The PC's conclusions in its draft report based on the current road rail price elasticities have also caused us some concern because there hasn't been a lot of extensive work on road rail price elasticities in this country. Most of the evidence on elasticities has come from the US. Most of it is very out of date, and most of it in fact has not much relevance to the Australian road-rail market which doesn't look anything like the US or anything like Europe. The models that have even been presented with regard to the NTC's consideration of elasticities have been models done by Australian consultants, but working on research from the US and Europe. It has been very difficult to actually get elasticity models that actually are relevant in the Australian context.

Some studies that are presently going on in Curtin University with regard to that are much more up to date, but at this point, it's hard to actually suggest that elasticity issues are actually well-known or well studied in this country between those modes. The very nature of the relevance of that strikes us as being only relevant to the debate being about any change being about modal change as distinct to the changes being about providing transparent cost across frameworks to it. Obviously the elasticities on the north-south corridor - Melbourne-Sydney, Sydney-Brisbane - will change just by ARTC's $2 billion investment program by the very nature of changing transit time and reliability, you'll actually then change the curve in which elasticity occurs. Effectively even that framework is still open to a whole range of other changes that can change the basis on which the curve is developed.

ARTC welcomes the mass distance charging proposals proposed in the draft report. We support the findings that location-based charging on major freight corridors has the potential to bring significant additional efficiency benefits. But we're also of the view that a distance-only measure is a useful starting point, but it's only marginally better than the current pricing mechanisms through diesel fuel excises. Location-based charging should obviously end up being a priority in the end for all the determination of best areas of investment.

There's significant potential for the application of technology to deliver mass distance charging. The commission has reflected on that and indicated there may be some technological problems in doing so. We're actually a little bit confused about what those technological problems may be. Some submissions at various forums the commission has held, people have talked about the cost being 3 to 4 thousand dollars to put the equipment on trucks et cetera. I'm not aware that that's a technological impediment. That sounds like a price issue. The technological impediment is not advanced in any detail in the reports, and we've not seen in all the hearings someone bring forward all the technological difficulties of producing such a system, especially given that you and I can buy it in our Holden car and call Holden Assist for $600 with many of the technological attributes that are more sophisticated than tracking these trucks.

The technological issues have got us a little bit perplexed. They seem to be things that have come up, but we haven't seen any evidentiary basis of that in any of the hearings and all the rest. The tracking frameworks in this country are actually used by many of the trucking businesses in this market, and they'd be aware of how they've actually broken through those technological barriers.

MR BANKS: Do you have information that indicates that technology is now cost-effective and ready to go? In the longer term, we didn't see technology as a problem.

MR MARCHANT: What's the definition of cost-effective?

MR BANKS: Where the benefits would significantly exceed the costs of implementing it. You speak about $3000 being a trivial sum.

MR MARCHANT: No, truck drivers talk about that.

MR BANKS: If you add that up with the number of trucks, you're talking about a billion dollars, and that's just for the capital equipment. That's just the little box that sits in the cab. If you're implying that we shouldn't be worried about the costs of implementing technology, we should just do it, that is an interesting position to put as well I think.

MR MARCHANT: I'm actually not putting that position; I'm actually putting the reverse, and that is you've knocked it back, but on what basis have you knocked it back?

MR BANKS: We haven't knocked it back, no. We've said that technology will take care of itself in the longer term, and has not been a constraint on the way we've seen the future for pricing of roads, not at all. But we've raised some questions about the short-term availability of cost-effective technology. Less so we've said for measuring distance, and, indeed, New Zealand has had some simplistic hubodometer technologies for a long time. But once you come down to location-based technologies, we're not aware of systems that would currently do what we want to do in terms of that technology that are operating anywhere.

MR MARCHANT: Sorry, the commission is not aware of location-based technology using GPS systems?

MR BANKS: Yes, there are such systems, but doing the job that we would want it to do in terms of location-based charging is another matter.

MR MARCHANT: Firstly I have not suggested $3000 a truck. People have suggested that to your inquiry.

MR BANKS: I know, but you're implying that $3000 is a trivial sum to be thinking about.

MR MARCHANT: No. I'm implying that $3000 is an exaggerated sum.

MR BANKS: Whatever your source was, where that number came from, you'll have to check with that person and see what's a reasonable sum or not. You're the one who quoted it.

MR MARCHANT: I actually quoted it in the context of something that was put to the commission last Friday, at a hearing last Friday.

MR BANKS: It wasn't a hearing.

MR MARCHANT: A forum last Friday. If in fact there's 600 to a thousand dollars phased over a period of time, we haven't done the cost analysis. That's part of the reason to have a commission with the economic gravamen this commission has had and shown over many, many years in all its forms to be able to do those assessments. We haven't got the resources to do those assessments. However, we actually do put in technology of GPS tracking in a hell of a lot of our own equipment which actually does track where things actually go to, including vehicles, and the prices of those are nowhere near that level, and in fact there are certainly en masse allocation of those sort of technologies, much lower prices to be gained by the largest volume of economies of scale of people having used them.

Whether they should be used for all vehicles or not, we're not advocating that every truck in Australia have one. It comes down to what areas in the end are best able to be matched against the service provided. As we understand it, there's only 4 per cent of in fact vehicles falling within the population that actually covers most of the intermodal routes. Most of them actually travel much shorter distances and don't go anywhere near intermodal transportation, and many of the submissions to the inquiry from the truck industry tend to reflect a very small percentage of the truck market that would ever get into reasonably long corridor usage competing on those corridors. In fact one of the submissions suggests it was only about 4 per cent of the total trucking movement.

So therefore suggesting that 3000 should be scattered over every vehicle, a billion dollars strikes to be just as much an exaggeration as ours would be in reverse.

PROF WALSH: That presumes that you wouldn't want to do it system-wide, and there would be some who argue that in fact you should, including some of the regional rail people who would make similar points to you that, you know, maybe the current charging system isn't competitively neutral for them, given the costs of using regional roads.

MR MARCHANT: I'm not sure whether it's competitively neutral or not, and there's nothing in any report which actually suggests either way yet, because all reports suggesting that whatever the numbers are, they are; they shouldn't be in any way looked at any further. So we're not better off at the end of this about what really are the prices and the benefits or otherwise, because either time has got away with it or the necessity for detailed research to understand it isn't available in the time required. So the first reaction is there is nothing before anybody it appears that would actually give them to a conclusion of benefit or disbenefit, because there's not enough data to come to that conclusion. That seems to be what everybody is saying in the draft reports and even some of the hearings.

But if you're dealing with distances of 200 to 400 kilometres, and I'm going again on some of the evidence and stuff that's been provided by some of the trucking associations, is that the largest bulk part of the movements are somewhere in the order of 2 to 4 hundred K's; that is, they are short-haul movements either from a farm to a silo or from a production area to another production area within a short distance, and at that point, you're getting into very sub-optimal returns to actually deal with tracking in what may be thousands of movements in less than 200 kilometres or that distance.

There's nothing in this that would actually confirm or deny any of that. There's nothing that actually looks at any of that in any detail. The trucking survey frameworks that are used for the very pricing framework are based on very interesting mathematical formulas that are decades old. Whether they still represent methods of sampling surveys, it's hard to tell in this day and age. So the differentiation of those small movements, if in fact it can be pinned down to a large group doing small movements, then effectively you come down to a very different equation about what are the longer charge bases. If that was the case, that produces a different result. It also produces a situation where the averaging pricing mechanism is disparate because the average pricing mechanisms for trucks deal with average distances.

Yet if the large bulks of trucks don't go anywhere near those average distances, then in fact you do have a mal-distribution between the trucking businesses themselves in their attribution. All of this is kind of assumed that everybody does the mass distance, yet there's a hell of a lot of other submissions that say, no, the great bulk of trucks don't do that. There's one thing to conclude that the totality of the charges seem right if in fact figures in the assumption of average distance and the rest are correct. Are they? There seems to be a hell of a lot of evidence to suggest they might not. But there's actually no method of questioning it outside the NTC figures parameter.

The mass distance charging issue to us seems to be one still open to question about its technological or overall economic cost framework because it comes down to who actually would fall within the mass distance definition. Who would actually fall within a group that is worth dealing with mass distance charging. We just think that those things have not even gone near being addressed, and we think that that's probably because of the lack of time and enormous amount of research that would be needed to come to that view, and there has not been any of that research that actually could come to that period. We're kind of arguing how could the commission come to a conclusion. You could pose a number of questions, but couldn't come to a conclusion, except possibly the conclusion to say there should be more research.

Maybe that is the conclusion. Maybe in time that is the best conclusion. We wouldn't dispute that. We think the time period is very difficult to try and break through some of those questions because the databases to enable that segmentation into different types of market frameworks isn't available. It's not homogeneic even between the categories that are presently the NTC categories. The question it poses is whether the NTC categories are even appropriate in the modern logistics market, because the trucks by characterisation are not necessarily reflecting what their economic framework is. A number of people are saying, "I'm that sort of truck, but I don't go anywhere near the average distances." Maybe there's something different about the categorisation. Maybe there's people who could be registered to only travel within 400 K's of their home base or something.

There's a whole range of other attributes that you could come out with a different charging base which may more accurately reflect what their both financial and economic contribution is, but it's difficult to do it from this base of information.

MR BANKS: That's all true, but in terms of the comments we were making about certain corridors and the costs of those trucks, that wasn't based on NTC information. There was information that had come out of other research sources, looking at the costs of those and the unit costs of those routes. Our conclusion that you quoted earlier on about us not finding compelling evidence was based in part on that other work that wasn't NTC-based.

MR MARCHANT: We actually address the costs of those routes in our written submission to actually deal with whether we think they are reflective of those routes and the sampling method that was used and the process to come to those conclusions, because it again comes into what's attributable and what's not attributable, how they actually form the basis of them. What's attributable and what's not attributable produces quite different results between each of the markets. The non-attributable issues for example in the - and this won't come through in the cost basis, but if I can do a comparison of some of the areas in the unattributable areas to road which are in fact fully attributable in rail, which will pose the question who should pay for those things in the rail area? Should they be paid for by government as they are in the road area?

ARTC, for example, is responsible for drainage works on the corridor. They are attributable costs we have to recover from our operators. We're responsible for pedestrian crossings and pedestrian overbridges and underbridges, a non-attributable cost to the road industry. We maintain some 12 airports between Adelaide and Kalgoorlie for emergency services for passenger trains that are actually worried about being charged more than they need in some submissions, but the reality is who pays for airports for emergency services for roads? Does the road industry contribute to those? No, they don't, and they're all attributable costs to us, either through rail safety regulation or through the framework. They're not attributable in the road sector.

MR BANKS: Could I put it to you though in the case of rail, there's no-one else to attribute them to. Effectively when you're talking about road, 80 per cent of the use of roads on average is attributable to passenger cars and not trucks.

MR MARCHANT: Passenger cars contribute to road charges.

MR BANKS: What I'm saying is that road freight has the advantage, inherent advantage if you like, that they're sharing the infrastructure with passenger cars, and that is a fundamental difference between road and rail.

MR MARCHANT: How does that deal with the difference between what's attributable or not attributable between the two sectors?

MR BANKS: All I'm saying is in allocating, in particular, common costs, they can be attributed to two different operators in the road case; trucks and cars, but essentially for rail, there's no-one else to spread those costs over. That's the problem I see rail having unless you want to convert road freight into some rail equivalent where you forced it to go onto a separate road and therefore pay all the costs associated with that separate road.

MR MARCHANT: As I understand it, of the 28 per cent unattributable costs, that 28 per cent isn't actually captured by the fuel surcharge or registration. Am I wrong?

MR BANKS: I'm not sure what you're referring to there.

MR MARCHANT: Unattributed framework was about 20 per cent. Not all of that unattributed framework is gathered by the overall taxing framework of fuel.

MR BANKS: You're talking about local access roads and so on.

MR MARCHANT: There may be a number of things, including the things I've mentioned, such as drainage and the rest, which are not picked up by the totality of the taxes raised through fuel taxes and through registration and other framework.

PROF WALSH: From heavy vehicles?

MR MARCHANT: From vehicles of any form. Before we get into the allocation between vehicles of 28-odd per cent, there's not even - - -

PROF WALSH: If you add up the fuel taxes that are paid by all vehicles on the road and registration, it exceeds the total road spending by a significant margin.

MR MARCHANT: And fuel taxes include the taxes by rail. You're dealing with the total of fuel taxes?

PROF WALSH: The total of taxes on motorists.

MR MARCHANT: The differentiation between the diesel rebate and the fuel tax framework, is it?

PROF WALSH: No. Unless we're talking at cross-purposes, I said that the total revenues collected from motor vehicles, light and heavy, would more than cover all of the expenditures on an annual basis on roads.

MR MARCHANT: The motor vehicle framework - I need to go back, because I think some of the tax gathering includes tax gathering provided by fuel taxes per se which are not always or essentially all on road alone. They all go back to the tax figures. The attributable framework versus the unattributable framework produces a situation where there is a social cost framework with regard to a number of the elements in the cost base for truck versus non-truck which are in fact attributable and paid for by the users of rail. Whether that's right, wrong or indifferent, the point is that there's not an apples for apples comparison to come to a conclusion between who covers their financial or economic costs.

PROF WALSH: I think part of the problem is across the two sectors, it's extremely difficult to make a clear, direct comparison because you've got a road system which is serving multiple purposes, let alone that you've got motor cars, light vehicles and heavy vehicles. Some parts of it are about local access, which is not something that rail provides - urban passenger rail a bit, but not freight rail and so on.

Trying to say one is in - one does it this way and the other does it that way I think is probably inherently capable of being directly compared, if you like.

We could have some debate about precisely what's in and out, but I think the fact that there are large elements that you pay that you don't see heavy vehicles paying I don't think sort of logically leads to the conclusion that heavy vehicles necessarily should pay them, just for argument's sake.

MR MARCHANT: It could mean a conclusion in reverse. It could lead to a conclusion that maybe there should be just an amenity cost the government should pay. I didn't actually assert that one should. I actually posed the question or what do you do about the transparency of it. I wasn't actually suggesting one does pay. The question I'm posing is you can't actually get a situation where you can get transparency of a framework when some of the things are not transparent. When some of the frameworks do not get into an element that you can actually make those cross-comparisons with.

The same comes with a social cost of infrastructure and externalities, and the commission has come to a very quick conclusion that externalities are not that critical in this framework, and I believe externalities are very difficult to measure. I don't have any disagreement with that, and the framework is that we've never had enough evidence to come to a view about whether they're minimal or not minimal. They affect both industries in urban areas and non-urban areas in very similar ways. The difficulty is that obviously one sector has a better or lesser impact on those externalities than the other. The argument is that as urban drop-offs affect that on the basis that externalities are such that they're not worth assessing - I think that's the commission's view - I'm not sure whether it's deciding in the longer term it actually accepts those issue, and they probably will put higher and higher value on it over time, and I expect that will come for other reasons.

MR BANKS: I'll have to read the transcript to see how many times you're actually misrepresenting what we're saying, but on that one, we're not saying that externalities don't matter at all. We're saying externalities are quite important. The issues we raise are to what extent they're internalised and to what extent they can be dealt with through average taxation, an average charge. We raise a number of questions about that.

MR MARCHANT: But in fact you don't make a recommendation.

MR BANKS: One of the recommendations we make is that there be more research precisely into understanding externality impacts.

MR CAMERON: Yes, probably our issue there was there's a draft finding, 6.10, which says there should be more research, but the section on recommendations - - -

MR MARCHANT: Doesn't include the finding.

MR CAMERON: - - - doesn't actually pick it up as a specific recommendation. We're not sure of the definition between "finding" and "recommendation". We just ask that that be considered in the final report.

MR BANKS: We certainly will, yes.

MR MARCHANT: Because it actually doesn't come up in the draft recommendations. It comes up in the observations and the findings in that section, but doesn't get pursued in the recommendations section. That's essentially the point. It is discussed and is observed upon, but never comes into the recommendation framework of getting and doing more research.

MR BANKS: Yes, but the point you made bore on whether we thought that was significant or not. The finding suggests that we do think it's a significant issue. Whether we make that a recommendation in the final report is something for us to look at, and we will.

MR MARCHANT: Rail access regulations, we obviously support:

> The scope to moderate or even revoke access regulations where pricing by vertically separated below-rail operators are significantly constrained by competition from road and sea -

makes absolute sense to us. It's hardly worth having economic regulation with regard to competition when the competition is blatantly obvious and in fact has no impact is hardly worth regulating. It just adds another cost. I agree with all that. The current framework for delivering access regulations in Australia and reducing the regulatory costs associated with each duplication we agree with. The catch-22 is the need for flexibility in different markets and a national approach to some sort of jurisdictional problem is not assisted in this country without having a single regulator.

Effectively if anything was going to make at least some consistent frameworks on a regulatory approach to rail regulation and get that independent from individual government decision-making would be a strong recommendation to bring it under one economic regulator such as the ACCC rather than myriad of different state regulators, all of which have a different method of assessing economic value, economic return and framework, and that in fact with regard to simplifying the excess regulation framework, we'd be strongly suggesting the commission go further than what it's done to support a single regulator for economic regulation across the industry rather than having disparate outcomes state by state.

The vertical operations, ARTC before the commission on at least two previous occasions suggested before that we don't support a situation of separation in low-volume markets, that effectively many of the small regional lines, they would be better to be integrated with the most beneficial user, which may not in fact be a rail operator. It may in fact be the grain market itself, and that the grain market is in fact the very movement of some of those low volumes as part of their production chain.

We will point out in our submission that that probably doesn't make any difference to what the problem is in some of the grain markets, because there in fact are structural impediments and problems as distinct to who operates them, and that many of them suffer from significant under-investment of which the investment will never be recouped on commercial or economic terms, and would either form part of a cost to production process, which isn't presently reflected in pricing, or would need government subsidy.

Our problem is that the issue is that the beneficiary in some of those small lines is never clear. It's usually not the above-rail operator, it's usually not the below-rail operator. It's usually the beneficial user, the grain framework, and it's part of their production process, and that's been confused and muddied between state ownership and between non-state ownership and between vertical and non-vertical integration and the fundamental economics that have been lost in the whole framework of who's what. We'll touch more on that in our written submission, but it's an area that the commission has touched on previously. It's an area which isn't dealt with easily by the economic process without actually getting the clear economic beneficiary of those lines becoming an active part of the very process of those lines.

With regard to the interstate network and the north-south framework, the north-south framework, although we're spending nearly $2 billion and make it more competitive, I would point out it has in fact got more than one rail operator on it now. If it's going to be come vertically integrated, it would be interesting to know which of the operators should be the vertically integrated owner. It's highly unlikely to be of any economic benefit to vertically integrate it in the framework. I'm actually not sure on what basis the commission was even thinking about doing it.

PROF WALSH: I think we only asked the question, but I just wondered on that point - - -

MR MARCHANT: I don't think the question takes anywhere or has any economic foundation to it.

PROF WALSH: - - - that I think the international community now is a little less confident that that reform - - -

MR MARCHANT: Who in the international community would that be?

MR BANKS: I think OECD has done quite a bit of work in this area, and I think some of the more - - -

PROF WALSH: Drawing on all of the country experts.

MR MARCHANT: Really?

PROF WALSH: Let's be clear, we're not actually saying you should. We're just saying it's a question.

MR MARCHANT: I'm just surprised how, apart from factoring, you could actually come to any particular view on it. There have only been two major countries in the world who have even tried it - Australia and the United Kingdom. The issues in the United Kingdom didn't have much to do with vertical integration. I note it's still not vertically integrated. The issues in the US - having just spent the last two months over there and Europe looking at the framework, there isn't a lot of economic framework to support it, but while we're there and we're dealing with intermodal stuff, one of the real difficulties in dealing with intermodal competition in this country doesn't deal with vertical integration or otherwise.

You'd be aware that in every North American federal highway, there is in fact a strong limit on truck size and weights - a strong limit. There is no federal highway that allows B-doubles or B-triples on it in any of North America. You'd be aware that's the case in the whole of Europe under EU guidelines. You'd be aware that in fact that produces a massively different economic outcome between road and rail competition in the intermodal markets. You'd be aware that in fact the toll roads and the tolling of trucks across Europe has become much more extensive. You go from the western side of Spain, as I did, following through Italy, through - you go at least through nine to 10 major toll frameworks of which a truck is hit about 50 euro per toll. That's a hell a lot of tolling framework, on top of the fuel taxes and the rest.

The difference between markets in this country and road and rail markets in North America and Europe are dramatic; dramatic with regard to the price and economics of competition. The difference in debates between above and below-rail separation is hardly for an OECD report to do with any substance, given there's hardly been any separation mechanisms anywhere except in the UK and here, and in fact in the US, there's every step in the world to make sure there is competition between different rail operators. I don't know how you could come to that view based on one report.

The Curtin University report, obviously you're aware that that's coming through. That actually tends to show in the Australian context pre and post 1997 that in fact the theoretical basis appears to be that in fact there have been efficiencies, rather than inefficiencies brought about by separation, the exact opposite to the economic model, which probably only goes to demonstrate the significant inefficiency that existed pre that period.

PROF WALSH: It's the inefficiencies ‘pre’ that really produces that result rather than the one that you might otherwise predict. What you're saying on separation, I'm slightly interested because you, in a perhaps slightly muted way, but nonetheless I think in your original submissions when you talked about you making the investment in the rail, you were slightly critical of above-rail operators who you thought weren't making or at least didn't seem to be making complementary investments. That's one of the costs, if you like, of having separation. You no longer have that power of coordination over the above and below-rail investment.

MR MARCHANT: The observation we made is that the investments being made will need to be matched by above-rail investment to get the benefits at some point in the future. The difference between the Hunter Valley network and the rest of the network and other networks constrain network, and effectively we don't make any investments there unless the coal industry and the beneficial users actually prove it going to the regulatory regime. In the rest of the network, we take full economic risks. You're not guaranteed even getting a floor price, let alone an economic price. So there's a difference to the nature of investment.

The economies of scale argument that comes from vertical integration would be the same argument that would come by actually having one owner of every airport in this country. We would actually have the one airport owner also own all the planes. We would actually have every port being operated by one port operator and every ship being - that's the only economies of scale investment. The issues of risk versus reward doesn't come from anything other than at which stage in the market does someone actually invest in picking up the volume brought about by capacity investment in rolling stock, and all our commentary says that the investment was taking place. It would be interesting to see when the rolling stock investments come from the above-rail operators.

We've had a few hiccups in our market because, just when we do get an operator, we end up getting mergers, acquisitions and the rest that actually diminish the very element of competition you're trying to create. Just as every time we get to commencing a competitive reform basis, it gets slightly retarded by one decision after another. One was two big government railways being sold together; Freight

Australia and Freight Corporation in New South Wales and National Rail sold together. So if one group had all the assets sold separately, we would have a very different market outcome.

We then have a situation where when PN moves and it buys up Freight Australia and ATN Access, the two small competitors taking up their market, then you have some tensions between those players and you have one person bought out. So we have a stalling effect on getting competitive reforms, but I don't think the economies of scale argument and the vertical integration argument and therefore the investment actually hang together very well. If you follow the economies of scale argument through, you wouldn't have competitive markets. The maximum economies will come by having one simplified person optimising the economy of scale. I'm not sure where that argument comes from.

The evidence doesn't show that there's diseconomies on major markets. In fact the only likely study to come out on that in Australia is going to show where in fact our efficiency is coming from. There haven't been any cross-studies of that anywhere else in the world yet. Europeans haven't been doing any, the Americans definitely don't do any because they're working on a franchise basis where they're actually protected from competition. In fact they're exempt from the anti-trust provisions; that is, they're exempt from having a competitive base or getting a dominant base.

We'll touch on some of that in our framework, but I'm not sure it takes the debate on economies and efficiencies anywhere, and I saw it in the draft report and I thought, "Where does this take us?"

MR BANKS: The only comment I'd make is that, as you'd be aware, there's inherent tension I guess between the kind of production-side benefits of integration versus the potential for competition benefits, and there's a trade-off between those which goes right back to the Hilmer report and the way reform was looked at at that time. So I think it's only reasonable to look at some of those regulatory structure-type issues in thinking about the way forward for rail. We've raised it, as Cliff said. We haven't pronounced on it, but we've raised it in part to get reaction from people in the business such as yourself. So if you can say more in your submission on that, that would be helpful to us.

MR MARCHANT: The commission has done some research on the productivity gains between the two options and come to a view on it. Is there some research being undertaken on that?

MR BANKS: We haven't come to a view. We've raised it as a potentially relevant issue responding to the last of our terms of reference and we're seeking input which you're now providing. When we get that input, we'll decide what we do.

MR MARCHANT: Yes. I understand you're testing the water on it. I'm trying to work out on what basis the evidence is to test the water. It's interesting that even in the branch line areas which we think will be better in the hands of the most beneficial production user, but in a matter of weeks between taking some evidence, Pacific National has actually sold it back to the state of Victoria. That's one example in one area a matter of weeks ago that thought vertically integrated would have been wonderful, and yet a matter of weeks later, it's something not wonderful. For $133 million it becomes un-wonderful which strikes me as kind of a bit counter-intuitive because the catch-22 in that debate has little to do with the interstate networks and much more to do with the lower body networks.

The catch-22 as well is it's got little to do with above and below operations. It's really got to do with who is the beneficial user and how does it fit in their production chain, and that's where the whole thing gets lost, because it gets into a debate about whether it should be with the above-rail operator or the below-rail operator, all of which is fascinating, but none of them are going to get an economic benefit because it's the beneficial user's production process which determines where the benefit really lays. Part of the problem in this country is the debate between the grain companies, the grain train operators, and in some case the below-rail operators, the track owners, confuses the reality of who subsidises what. It's a catch-22 in New South Wales for example. It costs about $110 million a year to maintain some of these networks of which the total revenue is $10 million a year.

In any rational framework, the production process would be a lot more actively involved in assessing, and they're things that are worth actually looking at, because there is an economic failure in the way each of the systems work in that area, but none of that actually is touched on, and yet that is primarily something which is blatantly obvious has failed. To that degree, we think it is worthwhile to pursue those things, because it's going to create a burden on the company, both in production and efficiency outcomes.

The bottom line of our submission coming back in more detail is we haven't been advocating transparency on road-rail pricing for the purposes of just getting a situation of possible movement between modes, but basically starting to get transparency between land infrastructure assets. Governments will determine economic movements if it wishes, subsidised and non-subsidised, but the reality is there's no transparency with regard to economic assessment as distinct to financial assessment. The PAYGO system certainly deals with the financial frameworks, but it does it on an averaging basis, and the averaging basis distorts in the end the area between growth and non-growth, and the area of distribution of economic benefits and who should contribute and pay for those benefits.

In fact there's an averaging system only distorted by the nature of the classifications of how the averaging system is used between the different classificational users, and we don't think the report goes into those classifications of economic analysis in enough detail to see whether in fact there are better ways to move forward, rather than the present system. It becomes a separate issue about whether that is good for intermodal competition or bad for intermodal competition, but the averaging system doesn't help anybody in the end making economic choices. All it does is ensure there's a financial return; that is, the financial choices come back, but they may have been the wrong economic choices or they could have been better used in other economic grounds. That seems to get missed through the whole process.

The long-term issues and our expectation of the reason why governments have asked for this is that if they've come out with an AusLink strategy and they actually want to look at their investments in land transport, they want to start to look at them on criteria of economic outcomes which are rational where the present system, whether it's overpaid for by car users or vehicle users or transport users or underpaid for is a different debate about whether it's a tax or whether it's a pay system. That's not a debate we've ever got into. That's a government debate, but the issue of investing in one form of infrastructure and land transport over another in certain circumstances and the degree in which one should be subsidised against another can only happen in an AusLink program when they have tools that enable them to work out economic outcomes, not just financial ones.

We think that the draft report touches on that, but doesn't go much further because of the lack of ability to get the data together to look to see whether even the classifications are accurate or inaccurate, let alone the presumptions about how their spread is accurate or inaccurate, and we think that that's brought about by lack of time, not by a desire to just confirm or otherwise, because the systems are adequate against the criteria used. It's the issue of whether the criteria are adequate for the medium term. We don't know. We doubt very much that the outcomes will do anything about intermodal competition in reality, because there's a high chance in some areas that pricing between certain modes would in fact be disadvantageous to rail, but so be it. That is actually better to know and then work on those economic criteria moving forward than not know about it, and end up finding that people do the worst thing; invest in rail infrastructure in an irrational form, if that makes sense.

MR BANKS: You've probably ended up in agreement with us actually because I think that's where we got to in our own report. There were three dimensions to the task we were given, and the middle one, which is really about looking forward to ways of getting better pricing of roads, is the part that I guess we would raise most questions, but nevertheless have argued, as you've argued, that there are potentially great advantages in doing that. I think where we've snagged each other along the way has been more on the intermodal stuff, but as you say, at the end of the day, it's not the intermodal that should be driving the considerations about the way forward. So we agree with you on that.

MR MARCHANT: In fact most of my comments on the intermodal stuff were not to make that the feature. Our issue, although presented as a political issue of, you know, let's get road pricing right, and rail pricing follows it, and therefore rail will do much better. There are a lot of other reasons for why rail may do better or worse in some markets. What there isn't is an understanding of what the economic outcomes on very large investments are with regard to getting the best benefit in the longer term. That will become a bigger issue the more and more we have both environmental and other outcomes that have to be weighed in.

To a large degree, each of those will have a bigger bearing, and the relative benefits and different forms of investment. But the present system doesn't provide any of that in a form which is transparent to decision-makers, because the averaging system actually ensures that people pay; some would say overpay. Road industry overpays before it gets an outcome in the totality as an industry, but whether in fact it does in a form which actually provides an economic outcome against the investment made is a question that none of the systems answer. It's basically - we think that's where the PC has come to. We just don't think it's come to it in a very transparently clear way. We think it's got muddied in some of the dialogue in the report.

MR BANKS: We'll obviously try and clarify that. I know you're putting in a written submission which will give us an opportunity to see some of your detailed argument. You might allow us to get back to you once we've seen that. I have a couple of questions though which would be helpful to us immediately while you're here. One of them is just this question - and we had it this morning with the Great Southern Railway representative talking about the scope, I suppose, for price differentiation within the regulatory regime, and I wouldn't mind just getting you to comment on the extent to which you feel constrained to differentiate your prices in a way that would promote both efficiency and profitability.

MR MARCHANT: In our regime, we provide the ACCC with an indicative service as being the base service from which everything else is measured. The indicative service is in fact a Superfreighter. That is the most common of the freight services; Superfreighter, 110 K's an hour, average of 80, and effectively 1800 metres long, east-west double-stacked et cetera is the Superfreighter framework, but length about 1800 metres between Adelaide and Perth, and 1500 metres between Melbourne and Adelaide. So that's effectively the indicative service, and all the pricing goes from that.

The pricing for a passenger service is in fact a pricing which goes relative to that service. The passenger service is in fact about 8 or 9 hundred metres long. It has a very low axle load, but actually runs at a much higher speed, and it purchased the service as a premium service. As a premium service, it actually gets the benefit of being planned first. Its path gets planned and then everybody else's paths get planned around it. You don't have to be a passenger service to be a premium service. You can be a very fast freight service such as a postal service issue, and you can run at 130 K's or whatever else, and you get your pathing done before the Superfreighters and then your slower freighters. So you get the benefit of your preferential path framework which passenger services tend to buy because they want to be certain that they'll get to their platform areas or otherwise to the best degree of certain times.

The difficulty is that we sell capacity, and the capacity is the number of trains that fit between signals, and if you're a much faster service, you actually run down the number of paths we could sell for Superfreighters. That is you use up more paths, because your faster time over distance means you consume the capacity we can sell between signals, and our capacity is constrained by the signals. So we have signals that may be 20 K's away from each other, but the reality is that we can only put one train in those. If you're a small train going very fast, you may take up three or four times that capacity, and therefore your charge is slightly higher because you use more of our capacity which we cannot sell to another Superfreighter or otherwise, even if they ask for it at another date. So the charge differential is they consume greater capacity, simple as that. Any other premium service gets charged the same, not just a passenger service.

MR BANKS: The notion of a premium service and so on, is that something that's - - -

MR MARCHANT: Highest fee, lower - - -

MR BANKS: Yes, but is that something that the regulator has signed off on or is it something that you can simply decide? All of this is presumably below the prices you could charge.

MR MARCHANT: Absolutely, yes. The indicative service is what we take to the regulator, and what we also took to the regulator were indicative access terms which broke down and showed that there was a premium service with these attributes, a Superfreighter service with these attributes, a standard service with these attributes et cetera, but our indicative terms dealt with the Superfreighter, and then we charge relative to that. Could we make a lower charge? Absolutely. If we wish, we could make it a lower charge. Why should we?

If you did the straight economic model, the charge would be much greater than we are charging because they consume a lot more capacity than we are charging. What the argument really is is ‘we're a passenger service, and we know we use up more capacity’. I don't argue that. They know by any model they use up more capacity. They know they travel slightly faster. They also know that we have greater safety requirements on the operation of our line because we do have passenger services. There are a lot more regulatory hurdles we have to have because we didn't have the passenger service operating Melbourne-Adelaide-Perth, we could actually lower the amount of costs we have in the system. We don't attribute all those costs. So we actually don't charge them anywhere near what we could charge if we attributed all the costs to them.

But the real argument isn't about all that. The real argument is ‘we can't compete with buses and the rest, and we needed subsidy from government’, and the reality is if you want a subsidy from government, then go and ask government for a subsidy, not us. We haven't been established to provide subsidies. We're not there for social redistribution. Social redistribution is done by governments.

MR BANKS: You're not saying that rail infrastructure has never benefited from subsidies.

MR MARCHANT: Absolutely not. Of course it has. What I'm saying is it's not for us to determine those subsidies. It's a matter for government to determine those. That's a public policy issue. I'm not suggesting that government shouldn't consider giving a subsidy, but it's not for us to give them. Does that make sense?

MR BANKS: I think you've answered the in-principle question about to what extent you're constrained by the regulator in price differentiating.

MR MARCHANT: If we wanted to, we could make the discretionary decision and say, "We're going to charge a lot less." The question is on what basis do we do that, and there is no basis on which we could do that that actually goes with any of the economic principles on which we're trying to operate the system.

PROF WALSH: If I could ask just one question. One of the things that puzzled me as we've engaged in conversations with the rail sector is what volumes you actually would need to be getting to be commercially sustainable, covering your economic costs. I understand that on the east-west line where you've achieved quite high levels of share of the task currently being undertaken across the east-west corridor, you're still not covering economic costs. Is that right? If you got to a hundred per cent on there, would you be covering the economic costs or are you talking about - - -

MR MARCHANT: Have I got to a hundred per cent market share, hundred per cent east-west, no. In the short term I wouldn't. The models we've provided to the ACCC - and I'm happy to provide them to you, and they're all graphed and on public record - show that on the east-west network, if we continue on our present framework - and as you know, we've been providing prices on a discounted CPI since we started on that network, I think that we probably won't continue to in our next undertaking east-west, because our road prices/rail prices are about 35 per cent - rail is about 35 per cent cheaper than road per tonne delivered PED.

I'm not sure that we're going to be providing discounted CPI in the longer haul on that framework, but even on that model, the graphs we've shown with the underlying growth going forward, a period 25, 26 years from when started - now 28 years out - we would start to make an economic return. We would start to be making full economic cost. Let me put this in some perspective. These are 60, 80 to 90-year-old assets. It's not unusual to take a longer-term view of that framework before you get to economic cost recovery on a long-haul asset base. It would be different if your asset was 20 or 25 years.

The view of full economic recovery is an economist's view and it's a regulatory view. It's not actually, with all respect to economists, regulators and the commission - the theory of economists and assets is a flawed theory because effectively it deals with assets having a 30-year economic life or a 50-year economic life, and at the end of 50 years they hit a cliff, and they all disappear over the edge of the cliff. As you know in long-haul institutional assets, it's much more a bell curve going out which keeps on getting stretched out by MPM and other renewal frameworks.

So even the economic cost model is more an economic theory, but we've always said it's about 20, 25 years before you get full economic cost recovery. I'm not sure - I mean, some people say that means it's being subsidised. It doesn't mean that at all. It depends on your view of the asset life and at which point in which those recoveries are made and who should be paying for them. We're about to make a $2 billion investment - more than $2 billion investment - between Melbourne and Sydney, Sydney and Brisbane. 3 or 4 hundred million of that is in fact maintenance deficit from our predecessors that we're trying to catch up on. The remainder of it is more traditional capital investment improvement.

If the rail industry was working on a PAYGO system, the present rail operators would pay for all that up-front, and yet a large part of it is for users in 15 years' time. But unless it's done up-front, you don't actually get the performance value of transit time, reliability and capacity which would actually enable you to change the elasticity with regard to its attractiveness to the market. Some would say that's a subsidised investment. Others would say, no, if we're going to get to our market view in 15 years' time, and that market view moving forward on that investment is likely to get closer to an economic return within 20 years' time and the asset actually fundamentally has a 60 to 90-year life on it and the next investments are incremental and the increments are paid for in a shorter life, then that actually is a reasonably good economic return for a sunken investment.

PROF WALSH: Is this $2 billion all your money or you're getting funding from the Commonwealth?

MR MARCHANT: The Commonwealth is contributing $750 million. The remainder is ours and we're not seeking a return on the $750 million. We will depreciate it because that's replenished, but we're not seeking a leveraged cost of capital return. So 1-point-something billion of it is ours at risk - more than 1-point-something billion. All I'm getting at is the long-haul economic view of a sunken asset versus the shorter haul view of asset utility - we'll send you copies of the graphs we've done for the ACCC in the past, and it does show a long-haul economic view but if I were doing a road framework - heaven forbid, because it would be a difficult thing to do, but just say we're doing it - you would expect a very similar outcome. You wouldn't expect to get your economic return all in the first few years because a road investment is a long-haul investment for maintenance costs.

If you were doing a gas pipeline, you wouldn't expect early fast investment, but if you were building the Hilton Hotel, you'd want it all paid back and replenished in less than 20 years because it needs to be gutted and rebuilt because you and I won't stay in an old hotel - possibly we might, but we're on a lower bed rate subsidy.

MR BANKS: We can only afford to stay in older hotels as well. Gentlemen, thank you very much for that. As I said, we look forward to receiving your written submission and may well come back to you if there's some further comments or questions at that point. I'd like to break now, please, before our next participants.

PROF WALSH: Michael, would you like to give us your name and tell us the role in which you're appearing here today.

MR ISAACHSEN: I'm Michael Isaachsen, and I'm the honorary director of Balance Research, which is a registered non-profit organisation that looks into the future of transport.

PROF WALSH: Thank you. You have a statement you'd like to make.

MR ISAACHSEN: Indeed. Firstly just addressing my very brief second submission, which you probably received recently, I was disappointed that there didn't appear to be anything in your draft report which gave me hope that governments who may follow your recommendations would be trying hard to reduce the rate of growths of road traffic. It seems to me that the basis on which your recommendations revolve deals with the costs, including externalities, in a very rarefied manner which is not likely to result in any substantial change, and the result of that, as I see it, is that by the time the total task of transport probably for passenger as well as freight, by the time it doubles and then doubles again in perhaps 50 or 80 years' time, rail may just be carrying a share similar to the share it carries today, not very much difference.

So we could be looking in that time frame at four times the rail traffic and probably four times the road traffic, but I think it's really important that the road industry is vibrant and strong and able to go about its business and do its share of transporting, particularly to areas where rail is not available, but I don't think anyone really can anticipate how we will have sufficient road capacity for four times the road traffic in 80 years' time. My own feeling about that, and it's informed by talking to lots of people in the community, is that I can't find anyone who would like to see four times the road traffic.

In my submissions I'm trying to envisage some way in which the natural growth of transport tasks would be absorbed largely by rail. There would never be less road traffic. You hear people say, "Take the trucks off the road." I think that's totally irrelevant and never going to happen, but I would see that if the rail track owners and railway operators could be properly motivated to do it, they could conceivably take an amount of traffic equal to the total amount of growth leaving the road system about its present level of traffic, but with road expenditure on improving the quality and safety of the road system.

Once the rail system was at a point that it could do this, then the road system could just be allowed to congest, and if the rail system is effective, it will attract a lot of tasks that would otherwise have naturally gone to the road because that's all we know in ordinary suburbia and a lot of country areas where there may be a rail line, but it's not used for general traffic. That's all we know. So people who have goods to move could find, in some decades time, that there is a very good rail service to move their goods, probably not with the same speed and flexibility as the road, and the road will always have that advantage, but the people who finish up using the road service or sending their goods by road will be those who really value, particularly value, the flexibility and door-to-door service that you can only get with a road service.

But there seems to me, as I look around the road system, there's an awful lot of material which is not obviously urgent that's just day-to-day supplies of materials that go in all directions around the road network which is quite feasible to move by rail if the rail network were reconfigured. When I say "reconfigured", it's only 50 years ago that every major industry that had a substantial amount of transport requirements had their own rail siding, and goods could move from one factory to another, not by intermodal transport, but by dock-to-dock - or however you want to call it - rail transport, and that is of course the most efficient transport there is other than probably pipeline if that's the rare case that it suits, because the wagon is loaded in the factory and unloaded in the factory, much as a container would be. So the emphasis in my work is not really about intermodal, but direct rail service with intermodal as a very necessary backstop.

PROF WALSH: You're begging the question why is it that the goods that don't need to go on road go on road.

MR ISAACHSEN: Yes, I have thought of that, and that's quite correct. The reasons are discernible in the history of the transport network, and however those reasons are described, when the road system began to develop into a modern road system, it appeared to almost everyone, probably even to me, that the road system would take over from rail because it's very efficient, and you've got two lanes or four lanes of road, and you can drive a truck from A to B very easily not realising perhaps that by the time the road system got congested, which might have taken many decades, congested to the point where it becomes very expensive to expand the road system, that we'd be willing to view the road network as a mature network and not really wanting to grow it any more.

But because by that time the rail system, as far as, say, suburban movements and movements to near country areas, had been downgraded substantially because you've got this road system, why would you need trains any more, and that's what happened. The trains to so many country towns ceased. The track in many cases remains for certain bulk traffic, but there is no service. In other cases the track has been ripped up because there was no bulk traffic. There's quite a bit of this that could be reversed if there was sufficiently strong signals, and I do believe that the community, society in general if they were able to think through these issues, would send governments a very strong signal that they do not want to see double the road traffic, let alone double again - well after my time I guess, but I can look forward to see current expectations that there will be four times the amount of traffic, and I don't particularly like the idea.

PROF WALSH: There's potentially a fair bit of money in catering to this growth of traffic. Why wouldn't an ARTC or whatever reinvest in rail to bring it up to the point where they're going to capture a reasonable share of this growth.

MR ISAACHSEN: Indeed, and I think the reason is because there is a big hurdle to jump, because the system has decayed so much. If it had not decayed as it has, then to just update it, increase its capacity every so often as required with better tracks or better trains or better signalling, that is what would happen. Now I believe that governments - and I think all levels of government would have to act together in this - could consider some scheme to motivate the track owners and the operators to provide innovative services and more services and better services, but it's something that couldn't happen overnight, and I see that it's taken 50 years for the system to decay. It might take 50 years to put it back, and that's about the time that you would need to have it back and working well, because by that time we might well be looking at four times the present traffic.

PROF WALSH: You heard David Marchant just then saying they take a very long view in the rail industry.

MR ISAACHSEN: That's correct.

PROF WALSH: I'm sitting on the board of ARTC saying, "Should we invest in trying to capture some of that? Yes, it's going to take 50 years before it sort of yields decent returns but, yes, we'll do it." Why isn't that sort of happening?

MR ISAACHSEN: I don't think they would have the finances to make the very substantial investments, and it's not only the track owner, but operators, because trains are lumpy, not like a truck. If you have a train with only two containers on it, it's not a proposition unless you do it in order to rebuild the market and are prepared to run at a loss for 20 years or some time. It would have to be underwritten by the potential savings to government and other parts of the community from not having doubling and redoublings of the road traffic.

Of course I'm not able to carefully analyse it, but when I think about the cost to the government, to all governments, and the cost to the community of doubling the road traffic, let alone doubling it again, I think it's just going to be an enormous cost, and the cost of putting down the new pavements is only a fraction of it. One of the things about the road industry, of course everyone is well aware that there are accidents, and the accident rate of course has improved greatly and hopefully it will continue to improve greatly, but the accident rate - and of course I'm not just talking about fatalities. In fact the cost to the community of a fatality, although it's very emotional, is probably far less than the cost to the community of a serious injury that puts people out of action for the rest of their lives or any way for a substantial time.

The rate of accidents per some unit are 100 million vehicle kilometres or something like that will hopefully continue to fall. I like to describe the scenario of a base case which is in some future time when the total task is four times today's level, and more or less the same conditions apply policy-wise so that rail may more or less have the same share that it has now, and so will road. So they will both be four times today's traffic in some decades' time, and an enhanced case where rail, by some kind of - well, let's say financial engineering, manages to capture most of the growth and so the road network is regarded as stable, mature, just needs to be improved for quality, and the rail network absorbs the growth, and it means, depending on the percentage that you start with - if rail has got, say, 25 per cent of a certain market or certain corridor, and in that corridor in 80 years' time, there's four times the traffic, but the road traffic is the same, the rail traffic is I think seven times what it is today. You can do the arithmetic.

So the cost of putting the extra rail capacity in is possibly a lot less than putting in the extra road capacity and possibly about the same. The real difference is the cost, not to the governments, not to the owners, but to society generally, because like it or not, the accident rate and other ill effects of road transport can't be denied. I've got off the track for a moment.

The accident rate in the base case will be four times today's accident rate, less whatever the improvement is in the number of accidents per unit of traffic, but in the enhanced case, the absolute number of accidents in that distant time will be a quarter if the enhanced case is totally successfully in absorbing all the traffic growth and task growth. So that's an enormous difference if you look to that future time. So say there's 10,000 accidents, serious injury or death accidents in Australia now per annum - I don't know what the figure is, but supposing it was. So when the traffic is four times, it will be 40,000 serious injuries less whatever improvement. But in the enhanced case it will still be 10,000 less the improvement plus any additional accidents that occur on the railway network. You can't rule that out, but it's likely to be a lot smaller.

PROF WALSH: Sorry, were you just saying then that on the rail side, we're going to more than quadruple the volume.

MR ISAACHSEN: In the base case it would be quadruple, in the enhanced case it would be probably at least double that, depending on the percentage you start with on each corridor. So in terms of accidents, the rail system like the road system is always improving, and every accident is learnt from, but you can't rule out there would be some. So for completeness, I'd have to say there would be a component of increased accidents due to the rail activities. But hopefully that would always be a lot less than on the road.

I went through the draft report and just looked at the key points that were in the overview, and if it's all right, I'd just like to make some comments on some of the key points that you've mentioned.

PROF WALSH: Please.

MR ISAACHSEN: One of the points, you mentioned how important it is to have efficient use and provision of infrastructure, and of course one must ask what you mean by "efficient". Do you mean reducing the total resources used per unit of task or just reducing the financial costs of the shipper and the end user of the goods? I do see that you define "efficiency" quite widely, but then in parts of your report as I go through it, you seem to go a bit cold on valuing all the resources that are used, particularly what are called externalities, and in the previous session, I heard that that was a bit tentative.

Although you seemed to be downplaying the pricing of externalities and including that in road pricing, that might be not the case in your final report. So I encourage you to think that way. The externalities must be included because otherwise what happens if, as many would claim, significant resources remain underpriced or ignored, and what is the effect on allocative efficiency if these underpriced resources, such as human lives, but that's an extreme case - if these underpriced resources are more intensively engaged by one of the competing modes as a result of being underpriced.

PROF WALSH: We certainly have rather a lot to say about that. In fact, as I recall, chapter 6 and an appendix go into it at great length. We're not in any sense in conflict I think with what you're saying. Things that are not appropriately priced should be as close to appropriately priced as we can get them, externalities included, but there's a lot in the system that is already taking those into account. Whether that's legal liability that sort of covers some of the accident issues, but then there's regulations that are associated with safety and regulations hat control emission standards on trucks and so on. So there's kind of a lot happening out there.

MR ISAACHSEN: If they're internalised, I've got no argument. But if they're not internalised and they're not treated as externalities and charged, then it doesn't seem to be giving the best outcome for society. In regard to provision of infrastructure, as the total task doubles - I am just referring here to the - explaining what is the base case and the enhanced case, but I've just covered that.

You mentioned then about competitive neutrality. This is still in the key points. I believe you do provide a description of pricing of infrastructure services that allows for charging of these effects, the ill-effects of vehicles using mainly road infrastructure. Society would benefit greatly from that if you do or if governments do include those, but these items that you have to look at - I mean, one that doesn't mention anywhere that I have seen is families and businesses who lose someone because of an accident. They don't get any compensation. I don't think that can ever be internalised, and yet it's an enormous cost to the community, and one would always hope that the governments can find some way in the process of charging to include those items that cannot be internalised.

PROF WALSH: We do get some. Actually there is one area in which I think we concede that we've got more work to do which you might find of some interest, and that's something that's increasingly being called the intrusion effect; the fact that people are pretty antagonistic to sharing the road with very large trucks does seem to be having some sort of an impact on policy-makers that are increasingly wanting to get stuff on rail.

MR ISAACHSEN: But competitive neutrality to be meaningful can only result from a combination of user choices being informed by true and total costs or cost differentials. If you can't charge the whole cost, you get the correct differential between costs of each mode and the availability of infrastructure and services in each mode and, of course, that's where rail has been allowed to go downhill and there's a big gap there to be filled. Competitive neutrality cannot result from charging only for those externalities whose use by trucks is sought to be elastic. In some parts of your report you've said, "Well, here's a certain externality and if we charge for it, we don't think it will make any difference. We don't think it will make a substantial number of people make a different choice." If you take them one by one, that's probably fair enough, but if you add them all together, I don't think it would be right to exclude the ones that you thought were elastic.

The costs to all parties of all resources uses and all damages done must be assessed for each mode and each class of transport - when I say "class" I'm talking about large truck, small truck, I'm talking about metropolitan and country and interstate and all passenger and freight - and these should be charged in full or charged in full less any politically-necessary rebate. I mean, you can't just suddenly say, "Well, as from tomorrow, we're going to suddenly charge everything that exists." Obviously it's not going to work politically. Non-neutrality - a bit of history in my narrow way of putting it - started in a major way when governments became unable to charge interstate road hauliers for the cost of the road network. The non-competitive neutrality was compounded when governments went ahead and made many desired improvements to the road network with no expectation of a return and non-neutrality was cemented when the policy towards rail systems ceased to provide major improvements. For example, the non-progression of the proposed electrification of the Melbourne to Sydney line in the early 1980s.

PROF WALSH: I'm a bit puzzled about a couple of things there, Michael, if you don't mind. Governments have for quite some time now been charging heavy vehicles for estimates of the costs, not only the damage cost but also the capital costs in - - -

MR ISAACHSEN: But was there not a time when they ceased to do that and that it eventually sorted itself out? I can't remember the detail.

PROF WALSH: I've got the history right here and there are others who are probably more expert than me sitting around here. But basically from some time in the early 50s there was a diesel fuel excise introduced and it's introduction was quite explicitly "because trucks should make a contribution to the costs of roads," then we converted in the early 90s to the current heavy vehicle charging regime which is a logical extension of that. Trucks as well as motor cars, motorists in general have been paying rather a lot for roads, in fact in aggregate more than it costs to provide roads but that's largely because the motor cars are being overcharged.

MR ISAACHSEN: Yes.

PROF WALSH: Presumably the non-electrification, it must have reflected some sort of economic and political evaluation.

MR ISAACHSEN: I'm sure it did, yes. But because of those events however well they're described otherwise, I see that what has really cemented what I call the non-neutrality which now people are seeking to review that. You go on to say that, "While rail has broadly maintained its share of the overall freight task" - particularly bulk freight, they've lost ground in some other areas, I just feel it could be confusing to many citizens to read that rail has maintained its share, even broadly, of the overall freight task. I mean, it's not only in your draft report but it's often quoted. It's not wrong, of course, it's quite correct. But the thing is the bulk task such as coal and grains they are or should be largely non-contestable by road. So it's not very relevant to claim that rail share of these has been maintained.

Society is not by and large interested to know that railways are having a good time and they're healthy, rather society wants to know that road traffic will not forever expand and use up more land and cause more damage. That rail has lost and is still losing ground to road in the plainly contestable areas, even where rail infrastructure is, I claim, a matter of great concern, in my experience to many in the community. If this trend is not reversed, as the total task continues to increase, the cost to the community will become more and more burdensome. These costs, as I touched on earlier, do include the greater number of deaths and severe impairments in the base case compared to what it could have been in the enhanced case, looking at the future time.

Our insurance, of course, internalises quite a bit of the cost of accidents, but families and employers suffer substantially beyond any compensation. Yet in some way this community suffering fails to be properly quantified and translated into singles that would prompt authorities to seek alternative policies, policies which would limit road traffic growth by making public transport and rail freight sufficiently good and keenly priced and well understood. These policies would not need and certainly must not include any kind of prohibition on trucking or driving cars, but critical elements for policy consideration could include government's contracting with rail track owners and rail operators to provide that capacity and services in some ways that the road component of the natural growth is reduced and that's part of the contract.

The contractors would be rewarded according to their success in reducing road traffic growth, possibly even to zero growth. Also, once that's in place, then allowing the highway system to congest and improving it for safety and quality but not capacity. But a critical element would be public education, especially at all levels of school, about the true and total cost of using motor vehicles and this would be done with a view to diminishing the strengths of car culture and truck culture. The assessed costs within the PAYGO system it appears that it's not the same as the true and total cost to society. It seems to be largely the financial cost of providing and maintaining pavements. It doesn't appear that it goes much beyond that.

Also the question of local access roads. I do believe that the cost of local roads is just as important as result of road traffic, car traffic but certainly in the country from heavy vehicles on local roads and it seems a bit unfortunate that you are saying that the council should raise this money from ratepayers and developers who then raise it from people who buy houses. You could have a company who is a ratepayer and they pay their little bit of rates every year, but they are using local roads that everyone else in their suburb has to pay for or their country district is paying for the road that they use. Rail generally doesn't have local access, but the rail user, if it's an intermodal journey, is still using the local road and if the truck was paying for the use of the local road, so the shipper who uses intermodal will have an incentive, if he's a big enough player, to have his own siding and they he will be paying for local access on the road.

PROF WALSH: I think I position on the local roads is essentially that where the roads are essentially for access for light vehicles, not for the heavy vehicles, then it's perfectly appropriate that our rates are there to pay for the local roads, aren't they? So I've got a road to my front door and so on. But if you've got heavy vehicle use, whether that's an arterial road in an urban area or essentially the main road through a country town then, sure, you would include that in the calculations. Anyway, carry on, sorry.

MR ISAACHSEN: That's all right, thank you. One of the points that you made, you said the level of policy-relevant externalities generated by trucks using major corridors is likely to be low and already been dealt with more or less. So when you say "using major corridors", it seems you might mean major, non-urban corridors, where it's likely to be low.

PROF WALSH: We're saying that the major corridor, say, from Melbourne to Sydney predominantly consists of a non-urban stretch. You've got urban bits at the end.

MR ISAACHSEN: But in my way of thinking, you know, the freeway that goes through the eastern suburbs is a major corridor and if you live near it, you suffer, so I just wasn't sure what you meant by that.

PROF WALSH: We meant the interstate - - -

MR ISAACHSEN: Yes, okay. But even in the non-urban corridors, any external negative effects are still relevant. I'm not clear which externalities are considered by you not to be policy relevant. I don't know what they would be.

PROF WALSH: It's the bits left over after you've internalised. If something is internalised, a regulation that improves safety and that's at a cost to the truck operator, then to that extent, the externality is no longer policy relevant. That's what we mean.

MR ISAACHSEN: Right. Then it becomes an internality and it disappears.

PROF WALSH: The bit left over - - -

MR ISAACHSEN: Right, okay. But the thing is, they're not all going to be internalised and certainly haven't been at this stage. One would be looking for ways to do that of course.

PROF WALSH: As we mentioned, when talking to David Marchant, we do have a finding that hasn't yet been converted into a recommendation that more work needs to be done in understanding the costs of these externalities and which bits of them aren't yet internalised.

MR ISAACHSEN: But in terms of the non-urban, some of the externalities like local pollution or noise, it would have a lower effect than in urban areas but you couldn't totally ignore them. These rural long-distance corridors still go through towns and they go past wetlands and agriculture. They still cause global pollution. There's an example of one that can be internalised but I don't think has been yet, the carbon. But within urban areas, the volume of trucking tasks is such that many citizens complain strongly about them, even if they are on freeways or tollways. This indicates to me that there are effects on the community that must be quantified and considered when assessing policies around roads and infrastructure charging.

Some negative effects of trucking have been or are being dealt with, as you point out, but the benefits on the ground are minimal. Society, plausibly, does not want more trucks on local roads or on highways. They don't want them dealt with, they want the traffic at least not to grow. You also commented that a uniform externalities tax would be an ineffective and costly way of dealing with the remaining externalities. There would be a good reason to prefer that the externalities component be variable to some degree, particularly as between urban and non-urban highways, depending on location. A purely rural task should rightly attract a lower fee for some factors than a purely urban task. It may be that at an early stage of systems development, it may be difficult to make such a distinction with confidence. But that is not to say that no externality component should be included. If you can identify it, it's got to be, I say, included on some basis.

So long as the charge for external damages is reasonably related to reality and is added into an overall user pays fee structure, not described as a tax in its own right, it should be effective in refining the price signals to freight companies and shippers about that choice of mode, and if it is true, as many seem to say, that the externalities per unit of task for rail are lower than for road, this process would go some way in meeting the expressed needs of society.

Where you talk about government financial contributions to rail infrastructure, putting the charges below the economic cost of providing some rail freight services, despite any payments from governments for rail infrastructure, there are still many freight tasks rail operators can no longer carry, even though they're getting the payments. They can't carry these without a loss because they are price takers. These tasks now go on road and arguably use more resources and cause more damage than if they went by rail.

Rail traffic in general goods has been depressed progressively over decades, leading to loss of the steady volume that would make it efficient and this is partly because of the provision of highway capacity with no specific charge for using it. Even though that has begun to charge, the railway, the lower resource mode, cannot spring back to efficient levels without a deliberate policy by governments. You also said that if road charges were to rise, any shift to rail is unlikely to be large. This reflects different service characteristics of the two modes. So I described these different service characteristics of the two modes as an artefact; it's not something inherent, it's something that's been made.

It's often stated, not only by yourselves, that rail is suited to tasks of a longer haul or larger volumes with the implication that for local trips, across town, for example, and even intrastate trips of non-bulk freight, rail generally cannot compete and such tasks are not contestable. I noticed the South Australian government submission mentioning that in terms of not wanting to see freight charges rise on road trips in the country because there is no rail alternative. That wasn't always so. There was an extensive rail network through the populated areas of South Australia and it's all but gone, a little bit left for wheat, but it's not a given for all time.

So one factor here is that almost all of the industries that formerly had private signings have abandoned them over the last few decades as road freight became more attractive. So rail must now compete on the basis of intermodal transfer, usually at both ends of a rail journey. In the long run, as society begins to require governments to do something other than build more rail lanes, direct dock-to-dock rail freight will again be feasible. Within the next 50 years, if governments and experts gave the right signals, the most efficient form of freighting could return. But even for those firms that will never have their own rail dock, an intermodal transfer is needed at least at one end of the trip. The other end might be a major warehouse. Even for them, substantial road-related resources and damage will be able to be avoided by ensuring that every major industrial area has an intermodal freight station within a modest distance. A place like Sydney would need about 30 of these and they could together handle most of the non-urgent industrial flows like garbage could go by train - it's not very urgent - leaving highways less congested and available for the higher value and time-critical tasks.

Another artefact is the need for just in time and exactly on time logistics. There are of course many situations that will warrant JIT operations no matter what the cost of transport but it is apparent that there are also many whose goods go door to door and use JIT just because they can do so with no price penalty. As roads become congested and governments baulk at forever expanding capacity, just in time delivery may become more expensive if rail, direct or intermodal, if it's available and working well, it may be decided by some shippers who now use JIT as a matter of course to accept overnight delivery by rail as the best value solution. So that brings me to the end of my notes.

PROF WALSH: I appreciate you putting those together for us and the passion with which you obviously feel about this subject. Some of the things that you're saying I think you will find are probably better reflected in the report than you're currently thinking and we're certainly rethinking some of those issues. When I think about what's happening out there and some of what we're hearing and seeing it is that although we're not asked to develop a grand land transport policy, that's the job of governments. I think you can see signs that governments are rethinking rail, including the fact that AusLink was, according to some, created essentially to provide a vehicle for investment by government in rail to give it a boost. We have heard from the rail transport sector that they don't think it would be a great idea if all of the additional freight went on to road over time. They have no interest in seeing rail fall over. Those ought to be things that are relatively comforting to your point of view.

MR ISAACHSEN: My hope for the trucking industry is that it will regard itself as a transport industry and use rail links wherever it can and by coordinating even dock-to-dock rail, it never goes on a truck, but a transport logistics operator can organise the trains to be marshalled and the factory at 5 am its daily input to there and at 5 pm its daily outputs are ready to be taken away overnight and they can still make money.

PROF WALSH: Thank you very much for that.

MR ISAACHSEN: I'm sure they'll find a way. Thanks, Mike.

PROF WALSH: Thank you. We now have a phone hook up. Good afternoon, Ken, I'm Cliff Walsh. I'm the associate commissioner on this road and rail freight infrastructure inquiry. Unfortunately, Gary, the chairman of the commission and the presiding commissioner, has been taken away on other business so you've just got me to talk to.

MR WAKEFIELD: That's fine.

PROF WALSH: Obviously I should let you know this is being recorded for transcript and we do have 10 or so people in the room who are tuning in to hear what you have to say too.

MR WAKEFIELD: Okay.

PROF WALSH: To start off with can I get you to for the record state your name and the organisation that you're representing in making this submission to us.

MR WAKEFIELD: It's Ken Wakefield from Wakefield Transport in Merbein.

PROF WALSH: Thank you. Have you got some particular things you want to say to us?

MR WAKEFIELD: I think it was outlined in the email that I sent to Andrea just where my feelings about road and rail and infrastructure and maintenance recovery as opposed to infrastructure funding where my position is that the state and the federal government, whether it's done through a funding regime like the Transurban one or whatever should own and fund any new infrastructure related to road and rail and then the maintenance for those assets should be recovered from the users as opposed to trying to recover the project costs of new infrastructure as well as maintenance from the users.

PROF WALSH: So you're saying the government shouldn't expect to get the capital costs recovered in some way?

MR WAKEFIELD: No, I think that these road and rail assets are public assets and the public benefit from the improvements to that infrastructure and they are benefiting in quicker transit times, lower unit costs, competitive international exports and the government and the state need to make those assets or improve those assets or build those assets to make the country more globally and nationally competitive and the maintenance of those assets should be recovered from the users but I don't think the capital costs should be.

PROF WALSH: But somebody has to pay and if it isn't the users, then it's people who aren't users and that doesn't seem terribly fair, does it?

MR WAKEFIELD: If it got public assets being built, parklands, whatever state - what do we call them - forests or reserves or whatever - they were purchased from existing landholders and turned into state parks for people to enjoy. They don't pay anything for that. Anyone that wants to go and use that doesn't pay anything for that.

PROF WALSH: But as a taxpayer I do. I'm paying for it.

MR WAKEFIELD: That's right, and you'll be paying for the roads and the rail infrastructure as well.

PROF WALSH: I guess I'm just asking the question, is it fair that those who aren't users should pay for the provision of the infrastructure.

MR WAKEFIELD: I consider they're direct benefits or they directly benefit every time they go to the supermarket and buy something if the infrastructure is made available that makes the unit costs cheaper, they benefit at the supermarket shelf or they benefit when they want to go on holidays and use the infrastructure. They are the direct beneficiaries all the way down the path the way I see it. I might be wrong, but that's just my view.

PROF WALSH: I understand, and thank you for sharing it with us. One response I might make is it's pretty much inconceivable that the government is going to give away its petrol excise and as a result us, as motorists, are actually paying for the road system directly already, aren't we?

MR WAKEFIELD: Yes.

PROF WALSH: I'm not quite sure how - - -

MR WAKEFIELD: Like I say, I haven't read the report but my understanding - there has to be some payback. But what I'm saying is that it shouldn't be any more onerous than it currently is.

PROF WALSH: Right.

MR WAKEFIELD: Yes, there needs to be some capital put into road funding or rail funding or whatever, but it shouldn't be another grab, like the Productivity Commission for road and rail shouldn't see this as another opportunity to grab more funding off existing infrastructure users to totally cover the cost and the maintenance. There is fuel taxes on every user. It is hard when you haven't read the report to try and understand where this paper is going to.

PROF WALSH: I think it would be fair to say we weren't actually asked to determine what the charges should be, we were just asked to figure out whether the current system recoups what it should from trucks and think about whether there might be some more efficient ways of doing it. I would like to explore that in a particular way. My understanding is that you actually have a fairly substantial truck fleet with a wide variety of trucks and so on within it.

MR WAKEFIELD: Can I just go back one step?

PROF WALSH: Yes, please do.

MR WAKEFIELD: As far as infrastructure costs and recoveries, who is going to pay for the Darwin line? Do you expect every user to pay for that, or the users that are using it to totally cover the capital and ongoing maintenance cost of that line?

PROF WALSH: I'd like not to have to answer that question.

MR WAKEFIELD: But you understand where I'm - - -

PROF WALSH: Of course I do, and there are a lot of people in this room who are smiling at the question and the fact that I'm refusing to answer.

MR WAKEFIELD: There's one way that you can answer it and you don't want to answer it that way.

PROF WALSH: I mean, the reality is that there are some decisions made by governments for reasons that are kind of hard to figure out, but they make them and we have to pay for them. But you would rather that they didn't make decisions like that on the whole, wouldn't you?

MR WAKEFIELD: I'm not adverse to paying tolls to get better infrastructure and that is a way that the user pays, but what I suppose I'm saying is there's a significant need for infrastructure upgrades because we have inherited - especially on the rail side anyway - years of degradation of the tracks and limited maintenance and nowhere near enough funding to be able to make our rail system what it should be for the size of our country. You know, I mean, it's sea, rail, road, air, as far as moving freight. The cheapest is sea and then it's rail. We have an enormous country and I don't feel that we're putting the amount of investment back into the rail so that it is a world-class rail system that actually does reduce our costs and provide those benefits to the general public, I suppose.

PROF WALSH: The previous speaker here, Michael Isaachsen, just put his thumb up. He's a great rail fan and was trying to persuade us that more should go on rail. Now, you're reflecting in part I guess that your business is actually intermodal. Is that right?

MR WAKEFIELD: Correct, yes. As far as road transport goes, it will always be there. Even if we do have a massive modal shift, there still needs to be the trucks, whether it's in large truck format or a small truck format that's got to deliver to a railhead or removed from the railhead. There will always be critical freight that has to get there on a certain deadline where trucks achieve that from point to point. Trucks are very mobile; that's why we have a fleet. You know, today it can be going from Sydney to Brisbane and the next day it can be going from Brisbane to Kununurra. It's mobile transport and very efficient at that for that sort of demand, whereas rail infrastructure is point to point and we need to ensure that that point to point is the most efficient world class that we can have, given the size of our country.

PROF WALSH: What is it within your business that would shift to rail if it were more efficient, providing a better service or whatever?

MR WAKEFIELD: It's all cost driven. We run the intermodal terminal here and we chose to run the intermodal terminal when the V/Line freight was still around and it was a fully public domain and it was very, very difficult to move freight with a government entity that didn't have any commercial - whether they carted the freight or they didn't cart the freight, they didn't really care and it was very hard to try and make it commercial by changing the times that the train run and trying to get them more customer focused. Then it was sold to Freight Australia, but they were more commercially focused. They wanted to know what the customer wanted, so we changed timetables that better suited the freight that we were trying to attract and that was great. But now we've got to a stage, at least on our line, where the weight restrictions, the actual weight loadings that we're allowed to carry which is 19 tonne - which should be 23 or 25 tonne - and our speed limits that are basically 65 but we don't achieve that in a lot of areas on this track, just makes it very, very difficult to compete against road.

The trip from here to Melbourne is five and a half hours by road and it's 14 hours by rail, so what we do is we pitch ourselves in a certain market I suppose where we can only really go to the high end users of export commodities where they're trying to ship a movement for one vessel for, say, 60 TUs which is perfect for us because they don't care how long it takes to get there, as long as it gets there and the complete consignment is left here, shipped to there and then put onto the vessel. Road can't offer that, but rail can.

PROF WALSH: One of the things obviously that's benefited road over recent decades has been the emergence of much more productive vehicles on the road, the B-doubles and so on. I gather that you've got a pretty new fleet, despite having operated for a long time. What's actually been influencing your decisions to upgrade and modernise your fleet? Is it just you came to a point where lots had to be done at once or these are deliberate decisions to retire relatively inefficient vehicles early?

MR WAKEFIELD: I think you've sort of hit the nail on the head. Unless you're up with the most modern technology and you have the advantages of the best fuel economy and you have the reliability, which is what we're after - reliability, fuel economy, driver comfort - you're not going to be there in the long term. The government can change the Euro 3, Euro 4. We've got a planned roll-out for that. The longer you hold on to equipment, the more exposed you become to old equipment that is virtually unsaleable unless you sell it to a farmer that gets it all back.

PROF WALSH: You mentioned drivers there. I gather that getting drivers nowadays is increasingly difficult. Are you experiencing that?

MR WAKEFIELD: It is. I suppose we're lucky because our road fleet is mainly based around point-to-point full load operation which is easier than the general loading format, a one-drop, one pick-up scenario, so we don't suffer as much as general carriers in relation to finding drivers but that's not to say that it's easy. There's plenty of drivers out there that want a job but there's very few that are good.

PROF WALSH: I see. What differences have you made in recent years by the sort of increasing attention of regulators and so on to safety requirements?

MR WAKEFIELD: I think it's all good and I think it's the way that we need to go, but the regulation does make it difficult for older drivers and I'd call them more professional drivers that understand their limitations and have good - not peripheral vision but you know what I mean, they can foresee things happening on the road and say, "Listen, this guy looks like he's going to pull out here, I'd better slow down." Those guys are leaving the workforce in droves because they just cannot keep up with the continual documentary requirements of the new legislation. They just can't cope with it. We have a number of drivers that - you know, put them in a truck and point them in the right way and they will make sure that the freight gets there. They don't overextend themselves, they look after the gear and they're polite to the customers, excellent drivers, but they can't read or write. So you give them a manifest and you say, "This is where you're going," and you show them on the map and that's where they go. But as far as filling out the things that need to be filled out these days to meet chain of responsibility legislation, meet your fatigue legislation, you know, they're not interested in that. Most of them are coming back to the yard now and just doing local work for us because they just can't meet it. They can't do it.

PROF WALSH: Does the structure of your fleet reflect the way in which registration charges and fuel charges are structured at the moment, or does that not really have much bearing?

MR WAKEFIELD: It does have a bearing. Obviously we'd like to see stamp duty gone for the obvious reason that we put a new B-double configuration on the road and it costs about 22,000 in stamp duty if we register it locally. So we definitely use that equipment. When it's brand new it goes on interstate haulage where we don't have to suffer that because under FIRS we don't have to pay stamp duty and then we migrate that across to intrastate traffic later on when the stamp duty doesn't hit us so hard.

PROF WALSH: Does the current charging regime actually have - let me flip it around. Are the restrictions on the use of roads that have an impact on you like mass limits and so on?

MR WAKEFIELD: As soon as they bury New South Wales underneath Tasmania or something like that. We have a nation where we can travel with the same legislation through each, it will be fantastic. We provide services from Adelaide, Melbourne and Brisbane to Sydney and we have to download our vehicles by tonne to conform with legislation in New South Wales. It's just ridiculous that the New South Wales government can hold the federal government to ransom by stopping the introduction of significant productivity gains for their state.

PROF WALSH: How would you feel if you could get the limits raised if you were willing to pay?

MR WAKEFIELD: New South Wales are a prime example of that with their introduction or they were trying to introduce IAP. It's all based around trying to ping everyone for everything and increase revenues. The user pays system through fuel - as far as if we needed to upload the weights and pay for that additional weight personally I think we already do. Every time we try and increase our productivity we have to buy new trailers, we have to conform to new laws and we sell our old equipment at far-reduced prices to get that extra benefit and the truck and trailer manufacturers all benefit from that. So Australia benefits from that because of this continual change that we suffer. Then the transport industry is expected to have another burden placed on it because it wants to be efficient. I don't accept that.

PROF WALSH: I can tell you that a couple of people from the ATA here were nodding vigorously as you were talking then.

MR WAKEFIELD: The transport industry is its own worst enemy. We go out there and we continually strive to make things cheaper for everyone that we carry out services for and we get bashed up for it. The New South Wales government is a perfect example. We try and introduce new technology to make it cheaper for everybody and then because we are at the leading edge of logistics transport on the world, we have to pay a penalty for that, yet we're only trying to make it better for everyone that buys something from the supermarket or we're trying to reduce - B-doubles as opposed to singles we're reducing the emissions that we're putting out for the units that we cart or the tonnes that we cart. But, yes, we seem to be penalised every time we try and do something new.

PROF WALSH: Understandably you haven't read our report, but at least one of the questions we're trying to get an answer to is how we can free up some of those sorts of restrictions that you're meeting, because road managers aren't getting funds that reflect the costs, if you like, of maintaining or upgrading roads, they kind of tend to preserve the asset rather than to look to see how they can improve its productivity. If we could find some better funding mechanisms that gets the money into the hands of the agencies, that might help to relieve some of those burdens.

MR WAKEFIELD: That will be nice. Wakefields have always been innovators. I mean, we had quad axle trailers 1998 or 1998 and the Victorian government were very good, we used it as an intermodal incentive. So 80 kilometres from the hub we're allowed to use quad axle trailers with 30.5 tonne axle weight loadings to bring heavy containers in. But we're already travelling down the road illegally and we brought them back in here. So there was a two-prong benefit, I suppose. There was the benefit because the roads weren't being excessively damaged by three axles running illegally to deliver it and there was another benefit that we introduced a four axle set that was better than the rear-steer axle that was better on the pavement.

I can't personally understand why we can't run four axles and get a little bit more on if the pavement damage is not going to be dissimilar to three axles. But you're increasing the mass, why wouldn't we do that?

PROF WALSH: Don't ask me.

MR WAKEFIELD: I shouldn't be asking you questions, should I, I should be answering them.

PROF WALSH: You have obviously got a very impressive story to tell and I'm really grateful to you for sharing your knowledge and insights with us. Is there anything else that you'd like to get off your chest while you'd like a group of people listening?

MR WAKEFIELD: I just suppose that with the announcement that the government is going to take the track back in Victoria - I know this is a national thing - but in Victoria and have the ownership and that asset and be able to upgrade, maintain to a level that makes rail competitive against road on this corridor that's fantastic. But we're just one isolated - and I think the amount of time that I spend lobbying and trying to get that to happen there's not everyone in every regional area that can afford the time to do that. But once you get outside, say, a 400-kilometre radius rail can be competitive with road and the further out we go the more competitive rail becomes and it's just hard for me to sit back and see our rail infrastructure degraded and when there is the opportunity there to ship freight out of Brisbane to Melbourne or Brisbane to Sydney or offload imports in Brisbane and reposition them to the outside of Sydney instead of creating a bottleneck in Sydney Harbour. I just don't see how people can't see that, how people of power can't see that. I suppose that's all I need to get off my chest.

PROF WALSH: That was great, Ken. Thank you very much for sharing that all with us and can I apologise again on behalf of Gary Banks, the chairman, I'm sure he would have loved to hear it and he will really enjoy reading the transcript.

MR WAKEFIELD: Okay.

PROF WALSH: Thank you, Ken.

MR WAKEFIELD: No problem. Thank you.

PROF WALSH: That's all that we have formally scheduled for today. Provision is made for people who points of view that they want to record to come along. I do know that we have a representative of the ATA who would like to say a few things.

MS WILLIAMS: I won't take up too much of your time.

PROF WALSH: Can I ask you, for the tape, to give us your full name and the position that you occupy or who you're representing.

MS WILLIAMS: I'm Kathleen Williams. I'm chair of the Australian Trucking Association Taxes, Charges and Roads Committee, also past chair of the ATA. In my real life I'm the general manager of Bunker Freight Lines. We're a freight company. We work for the multinational freight forwarders. We own and operate about 120 of our own trucks and about 400 trailers and we travel about 60 million kilometres a year on Australia roads. So we have a very real interest in this, as well the ATA activities. I must say I'm not an economist but I can offer the perspective of an operator and Neil will hopefully will be able to give any technical answers that you may have.

PROF WALSH: Perhaps, Neil, we should get you to also acknowledge you're here.

MR GOW: Neil Gow, National Manager of Government Relations in the ATA Secretariat.

PROF WALSH: Thank you. Kathy, what do you want to say, please.

MS WILLIAMS: Firstly, I want to congratulate the commission on the draft report. The ATA has responded, I believe, in the last week but the key findings. From our perspective the industry does pay its way and in fact there is over recovery on an aggregate basis. The PAYGO system delivers that outcome. In contrast rail freight infrastructure is subsidised. Charging for externalities is not economically efficient and we think that is a key issue. There is an opportunity for considerable productivity benefits from regulatory reform that encourages national consistency and innovation. From my perspective I would say that it's more than PBS that we should be looking for here. PBS would deliver some outcomes, but I think we should be looking for more than PBS. This industry has grown up with being able to be innovative and I don't think that should be stifled.

In relation to the road fund, it will apply, as I understand it, to all road users.

The ATA is cautious about the road fund. We believe that the current partnership arrangements are delivering significant benefits to the road infrastructure and we see AusLink as a key driver of this reform and it does reflect the government responsibility in relation to the road infrastructure. A specific heavy vehicle road fund would encourage or allow free riders and then that would also raise equity issues. So we are very cautious about that proposal. In relation to incremental charging, at this point the ATA is unclear whether it is proposed for the network costs or just for marginal costs and apparent dependence on technology.

I would like to say that we're not afraid of technology and again, this is from an operator's perspective, and I think in many respects we're ahead of the regulators. But the regulators seem to me to be focused on anti-avoidance and what we as an industry are focused on, and as a company from our own perspective, we've focused on productivity and a tool to deliver a benefit to our customers and public safety and that is what we're using our technical advances for. We've been asking for technical solutions for many years and I recall I went to one of the first meetings that was held here in Melbourne when they were looking at satellite tracking and I went along with what we carry in relation to permits, telephone book size permit folders for each truck, and I said to them, "This is what we need to replace. We need to have something in the truck that will tell the driver, tell the officer on the road that this truck is in the right place at the right time."

We still are carrying four or five telephone books in each truck and we are still being penalised if one of them happens to be out of date. We travel on the same roads every day at the same time but we would still be penalised if one of them is out of date. I think there is a long way to go.

PROF WALSH: Sorry, what's in these telephone books?

MS WILLIAMS: Permits to travel on a road. It tells you where you can travel. We had one the other day in New South Wales and it was out of date, there was a new edition in July of this year and we had the April edition, we didn't have the July edition. We were fined $375 for not having the July edition. We travel on the same road and we have been for the last - we don't go off route, we're on the main highways. Nothing had changed, but we just had the wrong one. We rang them and said, "How do we get the new edition?" You have to download it off the web. They don't even provide it any longer. We then have to download it and print it for 120 trucks and somehow get it into them across the country. It's just a silly thing that makes no sense to me at all.

PROF WALSH: Sorry, I interrupted your flow there.

MS WILLIAMS: I think there's a need for the regulators to talk to industry before setting the rules and imposing a system that is sold to them by a very new industry that is still sorting itself out in relation to delivering a public service as opposed to a commercial gain. I think there is a very real issue here that the regulators need to be talking to industry because a lot of what they're proposing to do with technology we are already doing and yet there is still a reluctance because they think all we're about is trying to avoid something which is not the issue at all.

Then there are just some specific issues I just wanted to raise from an operator's perspective and I thought some numbers may assist just to get a bit of a feel for what we're currently paying. On a fleet average of 375,000 kilometres per annum which is what we do under the current system with PAYGO for a single articulated truck, 20-tonne payload, we're using about 188,000 litres per annum and contributing $37,000 in the net diesel excise that we pay, the road user charge part of the charges. A B-double uses 221,000 litres for 375,000 kilometres and we're contributing $43,000. A double road train uses 250,000 litres of fuel and contributes $49,000 and a triple road train uses 375,000 litres of fuel and contributes $73,000. So my argument in the Taxes and Charges and Roads Committee at the ATA has always been, the further you travel and the heavier you are, the more you pay. So we are already paying for - the heavier the load, the more we pay because we're using more fuel and we're paying more in excise.

It's simple for me and, as I said, I'm not economist. We believe the fuel excise is fair. It is the ultimate level playing field. Everyone pays it. You can't avoid it. You can't avoid having fuel in your trucks. Some people do avoid paying the registration charge part of it, but you cannot avoid running a truck without fuel and it does deliver to government a regular, steady flow of funds. A few of the other issues that we're currently facing in the industry from an operator's perspective - and I think it is important to note that all productivity increases that we gain and have gained over the past few years have been passed on to our customers. We haven't kept them for ourselves. I think if you have a look at the results of the publicly listed companies that are in transport, you will see that they're operating at pretty low margins and that's fairly consistent throughout the industry.

We are currently faced with Euro 4 and Euro 5 engine emission regulations, starting from 1 January 2007. This is going to impose additional costs on purchasing vehicles on the capital cost and then we believe that there will be some loss of fuel efficiency, so there is going to be an additional cost. These costs have to be passed on so ultimately it ends up that the public end up paying more for their goods and services that we're carrying. We've got new fuel standards coming in in conjunction with Euro 4 and Euro 5 and again we believe there will be some loss of efficiency in the fuel. We have got changes to the mass limits. We've got CML and HML and, for example, a CML truck can use super singles tyres, but an HML truck can't. I don't quite know where the sense in that is, but that is currently some of the confusion of regulation that we have to try and deal with.

We have got the driver shortage issues which you have talked to Ken about. We have got WorkCover and the new IR laws that we have to try and work our way through. We've got new fatigue regulations coming in next year and now we've got this threat of the interim heavy vehicle charges which is going to be another diversion for us because we're going to have to go back and argue again what we've done very successfully this year, but these interim charges are another threat and from an industry perspective, we're going to have to throw a lot of resources at that to get our arguments back to the NTC so that they can flow them back to the ministers. That's just a few of the issues that I see that we're facing, but you've had our response and as I said, the industry is very pleased with the position that so far has been reached by the commission.

PROF WALSH: Thank you for making that presentation. There's a lot of very valuable information you've put out in the midst of doing so. Just if I could ask, you mention, in relation to Euro 4/5, capital costs, do you have a feel now for what the capital costs are going to be in meeting that - - -

MS WILLIAMS: The truck manufacturers are still being very coy about it. I'm led to believe it's going to be somewhere in the vicinity of 15 to 25 thousand per truck.

PROF WALSH: Are they able to tell you anything about this fuel efficiency question?

MR GOW: We're currently trialing the various technology that is going to be part of the Euro 4/5. We are seeing a small decline, not as much as we had actually anticipated but we're very early in the trial, so it's a little early, and there's longevity issues that we don't know about either. We do know some of the components will have to be replaced earlier with the Euro 4, Euro 5 technology. Turbos, for example, will have to be replaced at up to 250,000 kilometres and at the moment, we replace them after 500,000, so there are issues. Then we're not sure about the catalytic converters and things like that, what life expectancy they're going to have, so there's some trial and error stuff still to happen.

PROF WALSH: With the cleaner diesel, is that also going to require some sort of changes in technology or will it just affect fuel efficiency or something?

MS WILLIAMS: I don't think there is any loss of fuel efficiency with a cleaner diesel. When we went from Euro 2 to Euro 3 there was a big loss. We had a significant loss in fuel economy. We're not expecting to have the same loss moving from Euro 3 to 4, but we do anticipate there will be some and the cleaner diesel is part of that. The same thing happened back with Euro 2.

MR GOW: If I could just add please, there was a taxation issue in moving from the 500 to the 50 ppm level of sulphur in diesel where an additional 2 cents excise was paid by the industry and by private consumers to fund that cleaner fuel standard. The government recently announced, in fact only last Monday week, that the move to the zero sulphur level will be funded from consolidated revenue rather than an excise differential.

PROF WALSH: Is that right?

MR GOW: So we're pleased about that outcome. But nonetheless there are other costs involved in the change to the cleaner engine technology, as has been mentioned.

PROF WALSH: Early on in your presentation, Kathy, you were saying it's more than just PBS or more than just is currently contained in PBS. What more?

MS WILLIAMS: For example, B-triples which I believe are being touted as a PBS vehicle, we're currently running B-triples out of Adelaide every day of the week to Perth and it is just a little bit longer vehicle. There's nothing special about it. It works within the same turning circles, there are no more axles on the road than there is with a road train. There is nothing special about it. What I'm saying is, PBS shouldn't be just about a B-triple as we're currently hearing, it should be about really allowing the industry to go out and look at the more innovative vehicles that can do the freight task or whatever it may be efficiently. Everyone talks about quads these days, but we've had a quad design that would turn a road train into two 45-foot trailers in a B-double-type arrangement with a liftable axle so that you just use the quad axle when you're doing whatever you do with it - not that I'm a technician in any way, shape or form. No-one wants to talk to us about that. We've had experience of running B-triples but we can't run many other than between Adelaide and Perth because none of the network has opened up for them and yet they would very easily run in the same areas that double road trains run now.

PROF WALSH: Just one final observation, you were saying about incremental charging and there are some puzzles for you about that. I think the latest submission by the NTC which will be digested by your technicians soon no doubt might help to at least unpack it a bit more than they have so far. Have you seen that, Neil?

MR GOW: We have obtained the submission from your web site and it's some 68 pages. I haven't digested it yet fully but we're working on that. But there is an implicit link to technology which was mentioned before by Mrs Williams and she, from an operator's point of view, elaborated the concerns in that direction. In terms of the difference between actually a marginal cost of incremental pricing applied to those higher productive vehicles which, as Mrs Williams has mentioned, are already running out there on the road, it's a bit like some of the evidence provided by the prior respondent, Mr Wakefield from Merbein, that industry knows and is comfortable with operating this stuff, it almost seems like these issues of pricing are following along rather than leading things. We don't want them to drag those innovations back.

PROF WALSH: Point taken. Have either of you got any other points you want to make?

MS WILLIAMS: The only one that I did miss when we were talking about the technology and it is an issue that I've been hammering really hard and everyone has heard from the TCA downward. It's the cost of noncompliance and the effect of turning an as-of-right vehicle into a complying vehicle for part of a journey or for part of a trip or part of a task and then when it becomes a so-called noncomplying vehicle the cost of actually proving that I think is horrendous. Having had some experience with Safe-T-Cam because we run a shuttle system with our trucks, we try to make them as productive as possible. So we don't stop the trucks, we change the drivers and I know the cost of that compliance for the Safe-T-Cam system has been just horrendous for us. My real note of caution is the cost of noncompliance. It's all very well to say you can put this in or you can do that and you can or you can put a switch in and you poke a switch when you're in the right frame of mind. But to prove it is another thing and I am very, very concerned about the cost of noncompliance.

PROF WALSH: Thank you very much to you both. I think between you and Ken we got a really interesting addition to our perspectives this afternoon. Thank you. That concludes the proceedings for today, though for the record I should ask if there is anybody else who actually wants to appear today? Those others are shaking their heads. Can I remind anybody for whom its relevant that we would appreciate receiving any further submissions or supplementary submissions as soon as is possible. Thank you to those who have already made submissions to us. This is the end of the public hearing series and I now adjourn the hearing.

AT 4.59 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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