

# Export and Infrastructure TaskForce

Submission by  
***pacific national***

## **1.0 Introduction**

Pacific National (PN) is Australia's largest private rail operator, directly servicing many of the country's key export businesses. We are the only rail organisation operating in all States. PN hauls approximately 90 million tonnes of export coal per year (35 percent of Australia's coal exports), and an annual average of 6 million tonnes of export grain to ports in New South Wales and Victoria (28 percent of the national grain export task). In addition, PN's Intermodal Division carries some 85,000 export/import boxes per year on behalf of shipping companies. Our main containerised export products transported are wine, cotton, grain and beef.

PN's Coal, Intermodal and Grain businesses face a common lack of certainty in operation of their supply chains. In particular, we are experiencing:

- misalignment of objectives along the supply chain
- investment inertia, and
- in Intermodal and Grain sectors an underlying competitive distortion created by Government subsidisation of road operators.

These bottleneck issues are stifling rail's performance and continue to have a direct impact on Australia's export industries.

## **2.0 Replicating the Benefits of Integration**

In practice, there are undoubted efficiency benefits when a single entity owns and controls all aspects of a logistics system. Australia boasts a number of examples of world's best practice efficient, integrated logistics operations. Two rail examples are the Pilbara (recognised as the most efficient railway in the world) and the Rio Tinto Hamersley iron ore chain. In these logistics systems, one company owns the mines, all components of the railway, the port and the product. The single decision maker has full knowledge of the system and there is no barrier or delay in addressing operational or investment issues.

While integration in Australia's intrastate rail systems has been the norm, Pacific National largely operates in a separated environment, where the tracks and trains are controlled by different entities. Under these circumstances, we believe the aim should be to replicate where possible the benefits of integration in a structurally separated environment. There is currently significant opportunity for improvement of the systems that govern new investment, maintenance decisions and operational cooperation between above and below rail. Despite informal commitments to consultation, separated track providers are hamstrung by regulatory and policy failings which prevent them from functioning as responsive, proactive service providers to their various supply chains.

The key reform required is for Governments to provide regulatory and policy settings which maximise incentives for cooperation and efficient investments within a relevant export supply chain. Supporting this is the need to ensure competitive neutrality between rail and road – an issue that is directly holding back rail performance in intermodal and grain sectors.

### **3.0 PN's current experience with supply chains**

The level of supply chain cooperation facing PN businesses varies markedly. Our Hunter Valley coal haulage operations are part of a cooperative planning system which involves rail operators, the track provider, the port, and coal producers. Under this system, which has brought parties together in a replication of an integrated chain, output has increased from 69 mtpa to 83 mtpa (20 percent) without any new significant capital investment. The system, however, is not foolproof. One outstanding issue is the track provider's discretion on whether and when to invest, and its ability to vary its level of participation in the cooperative system. This has implications for investment and operational certainty in the longer term.

While there is some above and below rail consultation in intermodal operations, full cooperative planning is a long way off, and efficient, aligned investments have been difficult to achieve. In the last three years, PN's Intermodal Division has invested \$220 million in rollingstock and terminals to cope with growth in demand, compared with \$42 million invested by the ARTC, the track owner. As shown in the performance example detailed below, this lack of alignment is creating an environment in which delays in new track investment are common. PN has plans to invest a further \$650 million in new rollingstock and terminals over the next five years, but will find this hard to justify without greater certainty around below rail management and investment.

#### **Case Study**

##### **Rail's embarrassment at the border**

An extreme example of investment delay in rail is the continuing saga of the signaling upgrade project from Casino (NSW) to Greenbank (Qld). Incredibly, the signalling system on this stretch of track has not changed since the track was first opened in 1930. The driver of every freight train from Melbourne or Sydney to Brisbane enters a bizarre time warp as he approaches the NSW/Queensland border. On five separate occasions in just 149 km of track, the driver has to stop the train, get out of his cabin and manually place a metal rod into a signal box at the side of the track. Overall, these delays add almost one hour to every freight journey, contributing significantly to rail's difficulty in competing with trucks on transit times.

This issue could be solved with an investment of just \$5 million, which makes it one of the clearest rail investment priorities in Australia in terms of relative cost and benefit. But despite years of pressure from rail operators and even embarrassing national media stories, the project remains stalled. It was identified by the ARTC interstate track audit in 2001, listed as a Priority Project in July 2003, promised by RIC for completion in January 2004, then agreed as an urgent priority when ARTC took on the NSW Lease in September 2004. Nine months after ARTC took over the lease, the project is still not underway.

The CTC saga continues against a backdrop of increasing complexity in rail access arrangements. An intermodal freight trip from Sydney to Brisbane, which was previously controlled by a single entity (RIC), now involves separate access arrangements with Railcorp (Sydney metro), ARTC (to the Queensland border) and QR (from the border to Acacia Ridge). It is ironic that arrangements which were meant to simplify access to the interstate track (for example the ARTC/RIC lease) have achieved the opposite result.

There is a major level of uncertainty surrounding grain haulage operations in both New South Wales and Victoria. Critical medium to long-term investments are required in rollingstock, track, port facilities and silo facilities, and yet no agreed strategic plan or coordinating mechanism exists to ensure these investments are complementary. In New South Wales, decisions on future investment in the track will be pivotal and help to pave the way for investment in other parts of the chain. PN's 48 Class locomotives, for example, came into service in the 1960s, and are in need of refitting or replacement. However, long-term uncertainty means this investment is on hold.

The central issue is that grain on rail lacks the necessary policy framework and commercial incentives to achieve effective coordination between rail operators, track owners and the key participants in marketing, storage and handling including ports. With road an effective competitor for rail, especially over shorter distances, distortions in road pricing add to the challenges facing the industry.

Access regulation affecting PN's rail businesses has tended to be narrowly focussed, and rarely takes account of the operation of the chain as a whole. To replicate the benefits of an integrated chain in a structurally separated environment, regulators need a clear new policy directive to take a wider view of the system, and practical tools to directly encourage cooperative supply chain behaviour.

#### **4.0 Proposed Policy Settings**

PN believes there are three clear reform priorities to improve transport efficiency and export outcomes:

- formal policy and regulatory support for cooperative supply chains;
- competitively neutral pricing between road and rail; and
- competitively neutral transport investment mechanisms.

##### ***4.1 Formal policy and regulatory support for cooperative supply chains***

In all of our supply chains, Pacific National seeks a policy and regulatory environment that ensures:

- efficient investment is delivered in a timely and responsive way;
- investment requirements are determined taking into account the requirements of the whole system;
- the infrastructure owner is appropriately compensated for investments but caps on returns are retained to prevent extraction of monopoly rents; and
- a practical approach to rail infrastructure pricing and investment mechanisms that takes into account the distorting impact of the current undercharging of road operators in the short term. While the distortions are addressed the infrastructure owner should participate in cooperative and coordinated planning processes.

Pacific National supports the Productivity Commission's recommendation of a national review into the requirements for an efficient and sustainable national freight transport system. This review should investigate mechanisms to provide incentives for cooperative supply chain behaviour, including:

- processes to encourage efficient and coordinated investments from different parts of the chain;
- modifications to competition policy and regulation regimes to enable regimes to operate over the whole supply chain instead of individual chain components; and

- options to facilitate long-term investment certainty (for example, PN is only able to secure short term access agreements in some jurisdictions, despite rollingstock investment horizons which are typically 20 years or more).

A major failing of the current regulatory system is the lack of specialist transport and logistics chain knowledge among regulators. Often this lack of knowledge results in regulatory analysis that is too narrowly focused and ignores wider system impacts. This narrow focus can, and has, resulted in inappropriate regulatory outcomes. PN believes that a “Surface Transport Regulator” should be established to regulate nationally significant transport chains, with clear specific policy direction, and dedicated resources. This body could operate as a Centre of Excellence for transport regulation.

A fundamental issue requiring attention is the current regulatory approach to authorising cooperative structures in surface transport. Cooperative models are currently assumed prime facie to be outside of accepted practice and require special authorisation on public interest grounds if they are to proceed. This starting point is inappropriate for surface transport systems, where, as we have identified above, alignment of different parts of the chain is essential to maximising efficiency.

PN believes that there needs to be an explicit policy position supporting cooperative transport models, with individual proposals approved if they meet appropriate public interest assessment criteria designed to promote efficiency of the supply chain and competition among participants in relevant segments of the chain. In other words, competition regulation should explicitly recognise that collaborative export supply are in the public interest, and subject them to clearance against relevant criteria. This would provide direct encouragement for participants to work together, in contrast to the current system in which the public interest presumption is against them, and treats them as an exception to the rule needing to be dealt with through the ACCC’s authorisation process.

The policy reform PN proposes may take some time to implement. In the meantime, the ACCC could deliver some benefits in this regard with a subtle amendment to its access undertaking assessment guidelines. Clearer support for a more cooperative supply chain approach could be achieved by the ACCC modifying its guidelines to:

- acknowledge the importance of taking into account the wider impacts on systems that interact with the infrastructure service subject to the Undertaking.
- encourage the owner to demonstrate that it has prepared the Undertaking jointly with the prospective service customers, and there is a substantial level of agreement between the participants.
- provide for the ACCC to explicitly consider the impacts of an Undertaking on systems within which the service operates and favour those that adequately address such impacts.

#### ***4.2 Competitively neutral pricing between road and rail***

As outlined in the Australasian Railway Association’s The Future of Freight Report, released in February 2005, on an efficient cost basis, rail is the lowest cost mode of transport on all interstate freight corridors. This cost advantage is being masked from transport customers by a distorted heavy vehicle charging system, which ensures that heavy truck operators currently do not pay the full cost of their impact on the nation’s roads. This distortion is now widely acknowledged.

“This charging structure does not closely match the amounts paid to the individual vehicle’s marginal cost of road use. Highly utilized vehicles and those with good fuel consumption rates pay too little.”

*NRTC 3<sup>rd</sup> Heavy Vehicle Pricing Determination Issues Paper, 2003*

“BTE results indicate that heavily laden vehicles are currently undercharged, lightly laden vehicles are overcharged and the current imputed fuel excise credit does not recover the road wear costs caused by heavy vehicles. Some form of mass distance charge would be more efficient.”

*BTRE Working Paper 40 “Competitive Neutrality between Road and Rail”, 1999*

“...The pricing arrangements for such infrastructure should ensure that the freight task flows to the transport mode which in the long run will deliver the transport services concerned at the lowest overall cost to the community. Further, prices should desirably reflect not only the financial cost of providing these services, but also any externalities associated with their provision and use. Non-neutrality in the pricing of road and rail infrastructure is a particular issue in this regard.”

*Productivity Commission Inquiry Report, Review of National Competition Policy Reforms, 2005*

While the competitive impact of the road subsidy on intermodal rail is clear, undercharged heavy vehicles are also effective competitors for grain, particularly over shorter distances. While the pricing distortions remain unaddressed, we will see progressively more grain diverted to road. This process will be accelerated if the road transport industry succeeds in two key policy proposals – the introduction of incremental pricing (higher mass limits under a new name) and approval for B-Triples. The broad-based introduction of B-Triples in Victoria, where haulage distances are generally shorter, would see substantial volumes of grain transferred to road.

The Productivity Commission-recommended national freight transport review is again a suitable forum to tackle road pricing reform. As the Commission argues in its National Competition Policy report, “this review should map out what is required to achieve competitive neutrality across all transport modes.”

The PC describes two basic options for moving forward in relation to road pricing. The first is to continue with the current system, while the second involves a firm commitment to “introducing a mass distance road pricing regime in Australia within a clearly defined timeframe, accepting the need for some policy experimentation and uncertainty of outcome”. Pacific National supports the second option, and believes that the road pricing agenda should include three key reforms:

- removal of cross subsidy from light to heavy vehicles (by June 2006);
- incorporation of externalities in cost calculations for both road and rail (by December 2006); and
- introduction of mass distance charging along the lines described by the PC (by June 2007).

### ***4.3 Competitively neutral transport funding***

Pacific National supports the introduction of the single approach to transport funding under AusLink, but with some important modifications. Unfortunately, the new arrangements will effectively not begin for another five years, when funding allocations are made for years 5-10, informed by fully developed AusLink corridor strategies.

The significant difference in relative quality of rail and road infrastructure, created by years of inconsistent investment in rail, is in itself a major obstacle in achieving equal footing between transport modes. As noted by the Productivity Commission, again in its NCP Report, “a potentially significant barrier to achieving competitive neutrality across transport modes is the marked disparity in the quality of road and rail infrastructure along some transport corridors.”

Pacific National believes that the AusLink emphasis on national corridor strategies needs to be revisited. We propose that transport planning and funding should focus on Australia’s various supply chains, rather than Origin-Destination sets. In this way, the AusLink planning processes will complement other supply chain reforms, in line with a common objective of creating maximum efficiency and capacity in each chain.

Regional rail networks also need to have a higher priority within the national plan. AusLink’s first five years of funding contains a \$4 billion commitment to local and regional roads, with a significant proportion distributed in untied grants to local Councils. No comparable mechanism currently exists for regional rail infrastructure.

By focusing transport planning and funding on export chains, rather than corridors, such regional anomalies as the parlous lack of infrastructure investment in New South Wales branchlines can be addressed strategically.

There is also an opportunity through AusLink to tackle previously neglected port connections. In Tasmania, for example, none of the northern ports has modern, efficient intermodal connections to the Tasmanian rail network. This problem has been exacerbated by running each of the Tasmanian intermodal ports as separate businesses, resulting in resources and capital being spread across all facilities. The answer is a rationalisation of Tasmanian container ports so that one facility provides all of the state’s intermodal needs, and Commonwealth and State Government assistance to improve the rail interface with that port.

## **5.0 Summary**

Freight transport efficiency is central to overcoming many of Australia’s current export performance obstacles. Despite good intentions, the current policy and regulatory settings impacting on Pacific National’s main businesses are preventing achievement of an efficient transport and logistics chain.

Three reforms are critical to stripping away the major barriers to transport efficiency:

- formal policy and regulatory support for cooperative supply chains;
- competitively neutral pricing between road and rail; and
- competitively neutral transport investment mechanisms.

Pacific National welcomes the opportunity to provide further input to the Taskforce.