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ALC SUBMISSION ON NTC DISCUSSION PAPER

HEAVY VEHICLE CHARGES – OPTIONS FOR IMPROVING THE ACCURACY AND STABILITY OF THE PAYGO HEAVY VEHICLE CHARGES METHODOLOGY



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ALC Submission

Heavy vehicle charges – Options for improving the accuracy and stability of the PAYGO heavy vehicle charges methodology - Discussion paper

The Australian Logistics Council (ALC) welcomes the opportunity to make a submission on the NTC discussion paper *Heavy Vehicle Charges - Options for improving the accuracy and stability of the PAYGO heavy vehicle charges methodology (the discussion paper)*.

Background

Getting Road Pricing Right was one of the high level recommendations contained in ALC's election priorities document 'Getting the Supply Chain Right'. The inclusion of this policy priority reflects ALC's commitment to work with the Government and appropriate federal agencies to advance potential road pricing reform options that improve the productivity, reliability and efficiency of Australia's supply chains.

ALC also recommended a single national economic regulator should be given responsibility to ensure appropriate structures to govern pricing and access conditions are established relating to the broader land transport market identified as being subject to road pricing (including the development of a pricing mechanism to manage the transition from the current Pay As You Go (**PAYGO**) system to the new road pricing model).

Introduction

Improving PAYGO is widely recognised as an important and long overdue reform. It is appropriate to move towards developing a new system of road user charging that gives certainty in outcomes to both governments and logistics operators.

ALC members have identified some of the weaknesses contained in the current system. They are set out in the **Attachment**.

These weaknesses led the Transport and Infrastructure Council to resolve, on 6 November 2015, the following:

The Council agreed on an implementation pathway to introduce the new heavy vehicle charges Determination from 1 July 2016. The Council agreed to freeze revenue which will see heavy vehicle charges revenue held constant at 2015-16 levels for an initial two years. Registration and road use charges will be adjusted appropriately during this period. Ministers requested the National Transport Commission investigate and report back to it with options to advance the methodology to better balance heavy vehicle charges and government revenues. This decision will ensure that governments can maintain the quality of roads and services that support the heavy vehicle industry.

The general ALC position

ALC believes road user charges should be set to generate expected revenue for the provision of service at a level that recovers:

- (a) the efficient cost of providing access to the regulated service;
- (b) a return on investment commensurate with the regulatory and commercial risks involved; and

(c) depreciation.

These charges should be set using approved pricing structure/methodologies developed and supervised by an independent price regulator utilising the 'building block' method of striking prices, used in pricing many utilities, at a pace that does not 'shock' heavy vehicle operators.

ALC understands that the current Heavy Vehicle Road Reform project (**HVRR**) being led by the Commonwealth Department of Infrastructure and Regional Development is moving towards such an outcome.

It is noteworthy that NTC has generally identified that some form or other of the 'building block' approach¹ will be the most likely transition mechanism to bridge PAYGO and the final HVRR road user charge mechanism.

Given this, ALC hopes that at the very least there is a high level of coordination between the process being managed by NTC and that being managed by the Federal Department.

This is because, as ALC observed at a briefing held in Canberra on 6 June 2016 on the contents of the discussion paper, both NTC and HVRR are looking at giving effect to the same concepts.

ALC would be concerned if different government projects proposed implementing the same broad concept in different ways.

Accordingly, ALC would suggest that TIC should consider resolving that the current NTC project should be developed under the direct oversight of the HVRR process.

Issue and problem definition

The issue and problem definition set out in Part 3 of the discussion paper is generally satisfactory.

To give a true estimate of the revenue available for road investment, ALC supports what the discussion paper calls 'scenario 2' which removes general taxation revenue from items such as the luxury car tax and car benefit components of the fringe benefits tax from revenue estimates. These sorts of taxes have never been argued as raising revenue that should be hypothecated for use in road investment.

Options

ALC believes it is important that the likelihood of producing productivity improvements should be included as a criterion to be taken into account when considering options for improving PAYGO methodology. This is because enhanced productivity is one of the things that road operators seek to obtain from a transparent road user charging system.

Given this policy position, ALC would support the adoption of Option 1 (adopting a life cycle approach using forward looking costs).

This is because a forward looking cost base requires road providers to set out their proposed work plans for the near term. This is required for the purpose of contributing to the establishment of both operational and capital cost forecasts.

¹ Along with other of the options identified in the paper

A by-product of this requirement is that it provides near term certainty for the freight logistics industry as participants have confidence in the service level of the network. A regulatory approach based only on historical costs is not able to deliver this confidence to industry.

It is to be trusted that any learnings picked up by NTC in developing this option are passed on to the HVRR.

Option 2 (adopt a forward looking cost base using forecast budgets) is not favoured if this means establishing a principle of recovering capital costs when they are expected to be incurred, rather than being recovered through depreciation over their useful economic life.

ALC also supports the concept of Option 3 (ring-fencing heavy vehicle charges revenue). It is certainly true that, as the discussion paper says, the benefits of 'ring fencing' (a form of hypothecation) will only be fully realised if applied to both heavy and light vehicle revenues, and that it would be difficult to demonstrate that upgrading a bridge to allow access to heavy vehicles only occurred because of 'ring-fencing'.

Nevertheless, it is a confidence building measure worthy of further examination.

The introduction of an 'unders and overs' account (option 4) is also worthy of further consideration, particularly if it forms part of a system that is based on a forward looking cost base approach.

Given the changes to PAYGO methodology over the years, and the decision by the Transport and Infrastructure Council to freeze total revenue from RUC and registration charges at financial year 2015-16 levels for two years until 1 July 2018, it would probably be appropriate to commence the account with a zero opening value.

ALC does not support option 5 (turn heavy vehicle charge into a tax).

As the discussion paper says, the idea takes road charging further away from reforms recommended by the Henry Review, the Harper Competition Review, the Productivity Commission reports on public infrastructure and the work being done by HVRR.

Option 6 (continue freezing revenues) is also not supported as it is incompatible with the move towards road charging reform.

ALC notes the option of re-examining heavy vehicle cost base allocators used under the current system (option 7). As the discussion paper says, the allocators for road rehabilitation and new pavements have not changed since 1994 and that the ARRB has recommended measurement should be used for maintenance related applications, and it is the fact that in the US State of Oregon, cost base allocators are reviewed every two years.²

That said, should there be a review, care must be taken to ensure that changes to cost base allocators are made on the basis of proof that particular costs are incurred by heavy vehicles and not on the basis that it is 'easier' to collect money from heavy vehicles through a reformed RUC mechanism.

ALC also believes that it is appropriate to re-examine the amount of local government expenditure excluded from the PAYGO cost base (option 8) given that the current deduction processes are based on research from the late 1990s.

² State of Oregon *Highway Cost Allocation Study 2015-2017*: 4
<https://www.oregon.gov/das/OEA/Documents/2015report.pdf>

Finally, ALC strongly supports a change in the heavy vehicle charge setting process and the introduction of independent price regulation (option 9).

The current process that requires the Transport and Infrastructure Council to unanimously agree to an outcome is inherently political.

The use of an independent price regulator is an integral part of moving towards a forward looking cost base approach.

To that extent, it is noted in passing that in its response to the Harper Competition Policy Review, the Federal Government agreed that the Transport and Infrastructure Council should report to COAG on 'steps to transition to independent heavy vehicle price regulation by 2017-18'³ and so as a matter of policy, ALC believes it would be desirable to have a decision on the appointment of an independent pricing regulator before the end of 2016.

It follows that ALC believes that the most suitable national independent regulator with experience in assessing funding applications prepared utilising the building block approach (which could be the ACCC, if the proposed utilities economic regulator proposed by the Harper competition review not be ready) should be tasked with making the interim determination(s) once the revised mechanism has been designed.

As has been recognised, the NTC is an advisory body that makes non-binding recommendations to ministers, and does not have experience with the application of the building block regulatory model. Therefore it would not be an option to consider the NTC undertaking responsibilities relating to independent price regulation.

Under this timeframe for reform, it should be made clear that the current PAYGO model will only be part of an interim arrangement until the independent regulator commences responsibility for heavy vehicle price regulation.

It may be advisable to use an amended PAYGO model to determine heavy vehicle charges for this interim period, with the time limit to be specified. The ALC proposes that the interim period should end with the completion of a transition to independent price regulation in 2017-18.

Australian Logistics Council

July 2016

Att.

³ Australian Government Response to the Competition Policy Review, November 2015, page 5.

ATTACHMENT A

Flaws with the PAYGO model of heavy vehicle charging

The Transport and Infrastructure Council has stated that “increasingly, road providers have neither the funds nor the incentives to expand road access”. As a result, “both road network and heavy vehicle productivity has plateaued and in some cases has fallen”⁴.

Transparency is lacking, in part, because there is not a direct link between revenue and investment, due to current heavy vehicle charges going into government consolidated revenue.

In addition, the current arrangements for road infrastructure planning and investment are not responsive to the current and future requirements of the freight industry. There is a need for improved planning, involving consultation with industry, and for road agencies to be accountable for the delivery of infrastructure improvements and standards.

These impediments to the efficient provision and use of road infrastructure that is responsive to the requirements of freight transport are due to a large number of flaws with the current PAYGO charging framework for heavy vehicles. These flaws include:

- Because the charges are calculated for the national network as a whole, there is no direct connection between the amount of road user charge paid per kilometre, and the condition or capability of the road being used (noting the higher standards of road infrastructure required to accommodate heavy vehicle use);
- There is a lack of price signals to inform investment decisions and, therefore, where the next ‘increment’ of land freight transport infrastructure capacity should come from;
- The lack of price signals results in a framework that fails to promote the optimal allocation of resources and fails to promote improved productivity and efficiency in land freight transport;
- There is also a lack of direct accountability from road providers to heavy vehicle users for meeting the specific infrastructure and infrastructure service requirements of heavy freight vehicles;
- The lack of price signals also results in the inefficient utilisation of road infrastructure.
- The current price determination methodology does not deal adequately with the timing and subsequent recovery of expenditure, with a significant lag between spending by governments and recovery;
- There is inherent cross-subsidy between roads (for example, because charges are calculated for the network as a whole) ;
- There is uncertainty and volatility in the cost base, which has resulted in the decision of the Transport and Infrastructure Council to freeze the level of revenue generated under PAYGO;
- A lack of predictability, which adversely affects the ability of road agencies to plan infrastructure investments;

⁴ Transport and Infrastructure Council, *Heavy Vehicle Road Reform – What we are doing and why we are doing it*, May 2015

- The reliance on fuel excise for the largest proportion of heavy vehicle charges is a risk to government revenue for road infrastructure due to advances in the fuel efficiency of engines used by heavy vehicles; and
- A lack of transparency in both pricing and investment in infrastructure.

These conclusions are consistent with Infrastructure Australia's assessment is that charges under PAYGO bear "a very limited relationship to actual use and costs of the road network"⁵.

As a result, the PAYGO model does not provide for the efficient allocation of resources, and does not promote improved productivity and competitiveness in the development and use of transport infrastructure.

Added to this, the current reliance on indirect diesel excise means that there are concerns about the sustainability of revenue for investment in road infrastructure, particularly given the anticipated advances in both engine technology allowing improved fuel efficiency, and the development of alternative technologies.

This large number of flaws with the PAYGO framework combined with concerns over its sustainability as an adequate source of investment for future infrastructure requirements reinforces the importance of introducing comprehensive heavy vehicle pricing and infrastructure investment reforms to replace the PAYGO model.

⁵ Infrastructure Australian, Australian Infrastructure Plan, February 2016, page 8