




Consultation Regulation Impact Statement: HVRR Phase 2: Independent price regulation of heavy vehicle charges

Submission by Ron Finemore Transport

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EXECUTIVE SUMMARY

Governments in Australian jurisdictions are working to reform the way heavy vehicle charges are set with the aim of improving efficiency and productivity for the heavy vehicle fleet. The reform process has been divided into 4 stages starting with the development of improved data related to expenditure on roads and service delivery (Stage 1). Stage 3 involves hypothecation of heavy vehicle revenues and Stage 4 involves the introduction of more direct user charges.

Stage 2 of the reform process relates to the introduction of independent price regulation of heavy vehicle charges and introduction of a forward-looking cost base. This cost base would be used to develop a building-block model to calculate the revenue required, and hence charges required, to cover the costs incurred in the provision of roads over the regulatory period.

A discussion paper[1] has been released to facilitate analysis of the benefits and costs associated with introduction of the Stage 2 reforms. Two regulatory options are considered in the discussion paper. Option A involves a simple level of price regulation which would involve "minimal change to current settings". Option B involves a more ambitious level of regulation including additional scrutiny of road manager expenditure proposals, introduction of a customer service charter and more formal mechanism for user input into pricing determinations.

Stakeholders have been invited to provide comment on the material covered in the discussion paper. Ron Finemore Transport welcomes the opportunity to comment on the benefits and costs associated with independent price regulation of heavy vehicle charges as detailed in the discussion paper.

Implementation of Stage 2 reforms must be postponed

RFT is concerned that the supply side savings detailed in the RIS discussion paper may prove difficult to achieve for a number of reasons including a lack of robust benchmarking data. If this proves to be the case pushing forward with the reform process would generate mainly demand side benefits. However there are negligible benefits to the Australian economy from demand side benefits driven by more efficient charges. They are estimated at approximately $17 million npv in the RIS discussion paper.

Consequently, RFT believes the Stage 2 reforms should be postponed until there is more certainty of achievement of the identified benefits from heavy vehicle reform, in the form of savings in road construction costs and savings in road maintenance costs.

Conditional support for Option A

Ron Finemore Transport believes that a simple form of independent price regulation utilising a forward looking cost base has the potential to overcome many of problems with current charging practices based on the PAYGO methodology (see Section 3.1). The proposed new charges would be more stable from year to year and there would also be greater certainty surrounding the expected revenue the charges would generate for road owners.

[1] Consultation Regulation Impact Statement: HVRR Phase 2: Independent price regulation of heavy vehicle charges. Available at: http://www.marsdenjacob.com.au/wp-content/uploads/2018/07/C-RIS-IPRFLCB-Final-webversion.pdf

Ron Finemore Transport does not support introduction of economic regulation under Option B because we believe the data required to effectively implement such regulation will not be available in the near future (see Section 3.4).

Scope of reforms need to be extended

Ron Finemore Transport believes that a successful heavy vehicle road reform program must simultaneously introduce full hypothecation of heavy vehicle charges at the same time any independent price regulation is established. That is, the Stage 2 and Stage 3 reforms should be implemented simultaneously. This would enhance the level of revenue certainty for road owners. It would also send a strong signal to industry that Government is fully committed to implementing all 4 steps of the reform process as outlined in the discussion paper.

The reform process must also cover local roads and allow for greater access for higher productivity vehicles (see Section 3.3). These reforms have been estimated to generate approximately $1.7 billion (net present value) in net benefits for the Australian economy.

Unless the above extensions are made to the proposed reform timetable and reform scope, Ron Finemore Transport would not be in a position to support the introduction of independent price regulation as envisaged under Option A in the discussion paper.

1. RON FINEMORE TRANSPORT

Ron Finemore Transport (RFT) was established by Ron Finemore AO in 2004 following his acquisition of Wodonga-based company Lewington's Transport. In 2005 Smith's Transport in Orange was also purchased, forming the foundation of the company today.

RFT provides regional and inter-capital city line-haul road transport services across four major operating divisions; general freight, liquid freight, temperature-controlled, and bulk freight.

RFT employs more than 450 people and utilises a fleet of vehicles consisting of more than 200 prime movers and upwards of 400 pieces of trailing equipment. The fleet of vehicles travels over 50 million kilometres annually.

RFT understands that "Governments are working to reform the way heavy vehicle charges are set with the aim of improving efficiency and productivity for the heavy vehicle".[2] As part of this process a discussion paper[3] has been released to facilitate analysis of the benefits and costs associated with introducing Independent price regulation of heavy vehicle charges. Stakeholders have been invited to provide comment on the material covered in the discussion paper (hereafter called the RIS discussion paper).

RFT welcomes the opportunity to comment on the benefits and costs associated with independent price regulation of heavy vehicle charges. This submission is structured as follows. Section 2 summarises the key data and arguments presented in the RIS discussion paper. Section 3 provides RFT's assessment of the analysis presented in the RIS discussion paper and Section 4 concludes the submission.

2. BACKGROUND

The objective of Heavy Vehicle Road Reform is to "turn the provision of heavy vehicle road infrastructure into an economic service ….

> *This would see a market established that links the needs of heavy vehicle users with the level of service they receive, the charges they pay and the investment of those charges back into road services" (p. 11, RIS consultation paper).*

The reform process has been divided into 4 stages ranging from the development of improved data related to expenditure on roads and service delivery (Stage 1) through to the introduction of more direct user charges (Stage 4) (Chart 1).

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[2] The Honourable Paul Fletcher, Minister for Urban Infrastructure and Cities, (2018), Heavy vehicle industry stakeholders asked for their views on future heavy vehicle road user charges, Media release PF074/2018, 24 July.

[3] Consultation Regulation Impact Statement: HVRR Phase 2: Independent price regulation of heavy vehicle charges. Available at: http://www.marsdenjacob.com.au/wp-content/uploads/2018/07/C-RIS-IPRFLCB-Final-webversion.pdf

Figure 1 Heavy vehicle road reform stages

[a] Source. RIS discussion paper, p.ES1.

Stage 1 of the reform process was largely completed in 2016 (RIS discussion paper, p. 12). Stage 2 of the reform process relates to:

> the establishment of an independent price regulator, which would have powers to set prices independently of government; and
>
> the replacement of the PAYGO methodology with a forward-looking cost base that would be used to develop a building-block model to calculate the revenue that would be required to cover the costs incurred in the provision of roads over the regulatory period. (RIS discussion paper.p. ES ii)

The RIS discussion paper proposed two types of independent price regulation. Option A involves a simple level of price regulation which would involve “minimal change to current settings”. Option B involves a more ambitious level of regulation including additional scrutiny of road manager expenditure proposals, introduction of a customer service charter and more formal mechanism for user input into pricing determinations (RIS discussion paper, pp. 14 – 15)

Rejecting the reforms and retaining the current arrangements was included as a “valid” option (RIS discussion paper, p.14).

To evaluate the possible benefits of implementing stage 2 of the reform process the RIS discussion paper drew on work by Deloitte Access Economics which evaluated the cost and benefits of alternate types of heavy vehicle charges.[4]

Drawing on the Deloitte Access Economics analysis of the introduction of a national fuel-based charging system[5] the benefits (called the end state benefits in the RIS discussion paper) of implementing all 4 Stages of the reform process were estimated at $5.8 billion (2017 prices) in net present value terms (npv) (RIS discussion paper p.ESv). This consists of:

[4] DAE (Deloitte Access Economics) (2017). Economic analysis of potential end-states for heavy vehicle road reform, report for the Department of Infrastructure and Regional Development. Available at: https://infrastructure.gov.au/roads/heavy/files/DIRD-HVRR-reform-CBA-ncic.pdf.

[5] A national fuel-based charging system is known as Option 1 in the Deloitte Access Economics analysis.

8.6% lower road maintenance costs ($1.5 billion npv);

7% lower road construction costs ($3.2 billion npv);

0.4% per year improvement in road quality ($1.1 billion npv); and

Lower vehicle costs and financing costs ($17 million npv).

The estimated end state benefit of $5.8 billion used in the RIS discussion paper is lower than the $10.8 billion npv benefit estimated by Deloitte Access Economics. This is because local roads, improved vehicle access, externalities and improvements in the supply chain are excluded from the analysis (RIS discussion paper page 30).

The incremental cost of implementing Stage 2 of the reform process was estimated at between $9 million npv for a more simple form of price regulation (Option A) up to $92 million for a more ambitious form of price regulation (Option B) (RIS discussion paper p. 61)

It is noted in the RIS discussion paper that it is difficult to estimate the contribution towards the estimated $5.8 billion npv end state benefit that can be attributed to each of the 4 reform steps. Consequently, no firm recommendations were provided in the RIS discussion paper. Rather it is stated that:

> *As the reform costs have been estimated, a threshold analysis has been used to identify the point at which benefits would be greater than the costs. This threshold has been identified as being met if Option A delivers more than 0.16% of the estimated end-state benefits and if Option B delivers more than 1.3% of the estimated end-state benefits. (RIS discussion paper, p.ESvii)*

The RIS discussion paper then evaluates the factors that may impact on the size of the identified Stage 2 benefits derived from improvements in road maintenance, road construction, better quality roads and truck costs. The key conclusions reached were that (RIS discussion paper pp.65 – 66):

Additional regulatory scrutiny of maintenance expenditure coupled with provision of benchmarking information may encourage lower maintenance costs;

▪ A regulator would enhance public scrutiny of road investments. Such scrutiny would be assisted by comparative benchmarking of expenditure across states and territories and would be supported by new data and analytical systems; ▪

Introduction of a more formal industry consultation process has the potential to alter investment priorities and service levels; and

Introduction of a customer service charter may result in some roads receiving a higher level of service than they would otherwise receive.

With the above material as background Section 3 of this submission provides RFT's assessment of the analysis presented in the RIS discussion paper.

3. RFT'S ASSESMENT OF THE RIS DISCUSSION PAPER ANALYSIS

RFT believes that the reforms documented in the RIS discussion paper have the potential to be beneficial for the Australian economy. However, RFT has concerns regarding the time frame envisaged for the reforms and the scope of the proposed reforms. These issues are explored in the following sections of this submission.

3.1. IN PRINCIPLE SUPPORT FOR INDEPENDENT PRICE REGULATION UTILISING A FORWARD LOOKING COST BASE

RFT believes that a simple form of independent price regulation utilising a forward looking cost base has the potential to overcome problems with current charging practices. In particular the National Transport Commission has noted that under the current PAYGO methodology:[6]

There are persistent mismatches in any given year between actual revenue and the cost base;

Revenue uncertainty for governments exists because charges are set based on historic costs and averaged across jurisdictions. Consequently revenues are not directly linked to future road investment needs;

PAYGO outcomes lack sufficient predictability and stability, which hampers planning and decision-making by governments and heavy vehicle operators; and

Charges recommendations made by the National Transport Commission are not technically binding on jurisdictions.

Independent price regulation in which charges are calculated using a building block model, utilising estimates of costs over the regulatory period, will reduce the magnitude of these problems because such an approach smooths the effects on charges of lumpy investments and the charges recover the variable costs road owners anticipate incurring over the regulatory period.

RFT does not support introduction of economic regulation under Option B because RFT believes the data required to effectively implement such regulation will not be available in the near future (see Section 3.4.

3.2. HYPOTHECATION OF HEAVY VEHICLE ROAD USE FEES REQUIRED

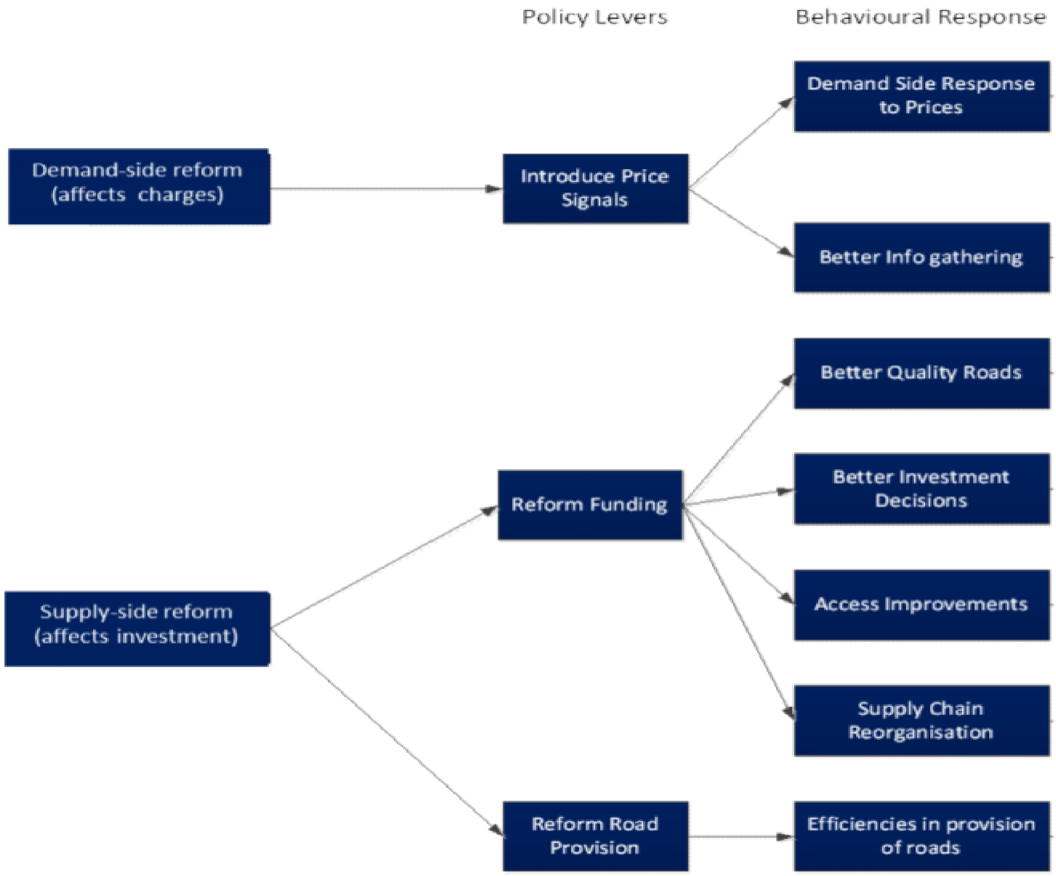
In the original Deloitte Access Economics analysis the benefits of heavy vehicle road reform were split between demand side and supply side reforms (Figure2). The supply side reforms were driven by funding reform (Figure2).

Funding reform includes price regulation utilising a forward looking cost base to set charges which recover road owner's costs over the regulatory period, including a return on and of capital. Hypothecation of the revenue then ensures the owners of roads are able to cover the costs they incur.

As documented by Deloitte Access Economics failure to provide revenue to cover costs incurred by road owners can lead road owners to act contrary to what is in Australia's best interests. They cite the example of access to local government roads and note that have no guarantee of receiving any benefits from allowing access for larger vehicles they adopt an asset protection approach rather than an access utilisation approach.

[6] National Transport Commission. (2016). Heavy vehicle charges – options for improving the accuracy and stability of the PAYGO heavy vehicle charges methodology – Discussion Paper, June 2016. P 1. Available at: https://www.ntc.gov.au/Media/Reports/(F7C6683D-89FF-40F7-974A-5B3D5227FC9D).pdf

Figure 2 Deloitte Access Economics classification of benefits from heavy vehicle road reform



[a] Source. DAE (Deloitte Access Economics) (2017). Economic analysis of potential end-states for heavy vehicle road reform, report for the Department of Infrastructure and Regional Development., p.27.

RFT believes that simultaneous implementation of stage 2 and Stage 3 reforms would greatly enhance the level of revenue certainty for road owners. It would also send a strong signal to industry that Government is fully committed to implementing all 4 steps of the reform process as outlined in the discussion paper.

For these reasons RFT believes that, at a minimum, the Stage 3 reforms (i.e. full hypothecation of heavy vehicle road use fees) would need to be implemented at the same time as the Stage 2 reforms were to be implemented.

3.3. LOCAL ROADS AND IMPROVED ACCESS FOR HEAVY VEHICLES EXCLUDED FROM THE ANALYSIS

The RIS discussion paper indicates that local roads were excluded from the analysis as were gains associated with improving road access for users by allowing higher productivity vehicles to operate on existing roads (RIS discussion paper p.30). The RIS discussion paper does not provide an explanation for these exclusions.

Deloitte Access Economics has previously noted that restrictions on access for heavy vehicles on local government roads are a significant problem. They noted that[7]:

> *At the moment there are significant last-kilometre problems in Australia (although these vary from state to state and from region to region) as well as mass and vehicle restrictions on some major highways. …….. consultations indicate that the main cause of access restrictions is that road providers (particularly local governments) have no guarantee of receiving any benefits from allowing access for larger vehicles but are certain of bearing the costs from having to maintain their roads. This leads to an asset protection rather than asset utilisation mentality when considering whether to allow access for heavy vehicles.*

Relaxing mass and vehicle restrictions has previously been shown to significantly boost the productivity of heavy vehicle trucking operations. For example, an incremental pricing trial in Victoria involved a transporter of grain paying a per journey access fee of $20 to allow two full weight containers to be transported per trip. Under these arrangements the operator claims to have saved $450 in the total cost of transporting the two containers. Similarly an incremental pricing trial at a New South Wales abattoir involved an increase in weight on 40 foot containers being moved 750 meters from the abattoir to a rail head in exchange for the payment of a per trip access fee of less than $1.00. Productivity gains of 15% to 18% are understood to have been achieved.

Overall, Deloitte Access Economics estimated that improved access for heavy vehicles would provide a net benefit to the Australian economy of $1.7 billion npv. (RIS discussion paper p. 30)

RFT strongly believes that the heavy vehicle road reform process must include local roads and the reform process must incorporate mechanisms to allow greater access for higher productivity vehicles where such access would boost productivity of road freight operations. If the reform process is not extended in these areas RFT would have difficulty supporting the introduction of independent price regulation.

3.4. IMPROVEMENTS IN BENCHMARKING DATA REQUIRED

The analysis provided in the RIS consultation paper indicates that reduced road maintenance costs and reduced road construction costs account for the vast majority of the $5.8 billion npv in benefits from the modelled reforms. In contrast, the benefits from more efficient pricing leading to lower vehicle operating cost are estimated at only $17 million npv.

The calculated savings in road maintenance costs and in road construction costs are calculated using percentage savings that were derived from a literature survey undertaken by Deloitte Access Economics. Such a survey is a legitimate methodology to use to derive savings for modelling purposes especially when there is limited benchmarking data or where benchmarking data yields inconclusive results. While such a methodology may be the best methodology available at the present time it must be recognised that the percentage cost savings derived from such an analysis would have a wide margin of error.

As noted in the RIS discussion paper, benchmarking studies have the potential to provide more accurate estimates of the construction cost savings that may be available to road managers. However, available Australian road construction cost benchmarking studies have encountered problems in isolating what drives cost differences across the road projects examined.

[7] Deloitte Access Economics (2017). Economic analysis of potential end-states for heavy vehicle road reform, report for the Department of Infrastructure and Regional Development., p.29.

For example the 2015 infrastructure benchmarking report prepared by the Bureau of Infrastructure, Transport and Regional Economics (BITRE) included data on overseas road construction costs.[8] The report concluded that:

> *Experience from this initial benchmarking highlighted the need to collect additional information about projects (such as project type, construction methodologies, terrain, pavement type) to better understand the causes of cost variations, particularly for the small number of projects that had costs that differed significantly from averages for the class of road…*
>
> *and….*
>
> *Preliminary international comparison provided mixed results – suggesting that average Australian road project costs are below equivalent project costs in the United Kingdom, but above project costs in four continental European countries. It is not clear that overseas and Australian costs used, however, are strictly comparable and further analysis is required for any definitive conclusion.*

BITRE's 2017 benchmarking study is a significant advance on the 2015 study. The benchmarking examined the construction cost of 32 road projects. After undertaking a very detailed analysis of road construction costs across road types and across Australian jurisdictions BITRE concluded[9]

> *The variability of costs within road classes is also quite large. While BITRE attempted to explain that variability, the small sample size and qualitative nature of same information made robust assessment impossible. Collecting a wider range of information on projects may increase our understanding of the factors affecting costs. Deciding what information to collect will require some investigation. (p. 21)*

As noted by BITRE benchmarking road construction costs are problematic because the construction cost can be influenced by so many variables including the type of terrain the road is constructed on. Thus it is difficult to obtain like with like comparisons and adjustments must be made to measured cost differences to remove from the cost comparison the effects on costs of differences in terrain and other factors. Typically such adjustments are undertaken using regression analysis. However, as noted by BITRE, such analysis is constrained by the small number of road projects covered by the benchmarking exercise.

RFT strongly supports the continuing benchmarking efforts being undertaken by BITRE. However, RFT believes that it will be some time before such benchmarking is sufficiently robust to enable the quantification of any inefficiency in road construction costs for particular road construction projects.

RFT believes that more work is required before sufficient data would be available to allow effective implementation of economic regulation as envisaged under Option B.

RFT is concerned that the supply side savings detailed in the RIS discussion paper may prove difficult to achieve for a number of reasons including a lack of robust benchmarking data. If this proves to be the case pushing forward with the reform process would generate negligible net benefits to the Australian economy as indicated by the fact that the demand side benefits from more efficient charges is estimated at only $17 million npv in the RIS discussion paper. (RIS discussion paper p. ES v)

[8] BITRE (2015), Infrastructure benchmarking report. Available at: https://bitre.gov.au/publications/2015/cr_003.aspx

[9] BITRE (2018), Road construction cost and infrastructure procurement: 2017 update. Available at: https://bitre.gov.au/publications/2018/rr_148.aspx.

4. CONCLUSIONS

RFT is also concerned that the majority of the identified benefits from heavy vehicle reform, in the form of savings in road construction costs and savings in road maintenance costs, may prove difficult to achieve in the near future. This is mainly because it may take a considerable period of time to develop benchmarking methodologies that would be sufficiently robust so as to allow a regulator and/or road owners to identify inefficiencies in road maintenance and road construction costs.

If this is the case pushing forward with the reform process would only generate demand side benefits. But the net gains from the introduction of more efficient heavy vehicle charges are likely to be very small and should only be implemented when there is more certainty of the achievement of the identified benefits from heavy vehicle reform, in the form of savings in road construction costs and savings in road maintenance costs.

RFT believes that a successful heavy vehicle road reform program must simultaneously introduce full hypothecation of heavy vehicle road use fees at the same time any independent price regulation is established. The reform process must also cover local roads and allow for greater access for higher productivity vehicles.