# A Single National Land Transport Economic Regulator

## Towards a Safe, Efficient and Sustainable Land Transport System

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AUSTRALASIAN RAILWAY ASSOCIATION INC

# Contents

# 1. Introduction

## The Land Transport Challenge

The land transport industry is a key driver of economic growth in Australia. Transport policy has been identified by the Federal Government as a central plank in attaining the productivity growth needed to maintain Australia's dynamic domestic economy and international competitiveness.

The Federal Government faces many transport related challenges including significant population growth, increasing urban congestion, the move towards a carbon restricted economy, and energy security. These issues must be dealt with in an holistic manner in conjunction with the Government's wider policy objective of ensuring safe, sustainable and liveable communities.

The projected significant growth in Australia's population will increase the number of passenger and freight journeys within Australia. The land freight task is set to double by 2020 and triple by 2050 from 2007 levels. Given the scarcity of urban lands and the lack of new transport corridors, the problem of urban road congestion will be exacerbated if left unaddressed.

The move towards a carbon restricted economy as a result of the need to address greenhouse gas (GHG) emissions, fluctuating energy prices and the need to mitigate energy security risks will necessitate behavioural changes on a micro and macro scale. The transport sector, including private transport, accounts for around 13% of Australia's total GHG emissions and is likely to account for more than 20% by 2020. Reductions in these emissions will necessitate behavioural change in the transport sector from passengers, service providers and policy makers. The way in which this behavioural change is implemented will have significant ramifications on Australia's GDP.

The need to address the social and environmental impacts of economic activity is gaining increasing attention within Australia and globally. To maximise Australia's economic capacity there is increasing calls to take into account the full social/environmental benefits and costs of commercial activities including:

- environmental impacts such as emissions, noise and land use;
- safety costs such as fatalities, injuries and property damage;
- impacts on amenity and liveability; and
- congestion and its associated costs.

Without significant reform and investment in transport infrastructure, the economic and social prosperity of Australia will be under threat. For example, road congestion costs Australia $15 billion p.a.[1] while the cost of road accidents is around $35 billion p.a.[2] These problems will be exacerbated by expected increases in Australia's population, the increased incidence of car ownership, the inadequate state of current transport infrastructure, and the limitations of supply side solutions (given the scarcity of urban land for future transport corridors).

## The Need for Institutional Reform

In recognition of these significant challenges, the Federal Government has provided unprecedented funding for rail and road infrastructure. While this funding is much needed and welcomed, institutional reform at a national level is required in the land transport sector. Importantly, this includes, amongst other things, the identification of a national market for the land transport sector overseen by a national land transport economic regulator. Reforms to establish a national land transport market is a necessity if the productivity growth needed to maintain Australia's economic growth and international competitiveness is to be guaranteed.

In the 1990s the Hilmer Report outlined national reforms in the energy, water, communication and transport industries. As a result of the Hilmer Report recommendations, national markets were created in the energy, communications and water sectors, where greater competition has delivered significant efficiency gains, and lowered utilities prices, for Australia. These reforms have contributed up to a 2.5% ($20 billion) of growth per annum to Australia's GDP since 1990[3]. As a part of these reforms, industry specific national economic regulators were established to govern the emerging national markets.

While significant reforms were undertaken in parts of the transport sector, they have fallen short of creating a national market for the transport sector. The Productivity Commission considers "*that developing nationally coordinated reform frameworks and programs for the freight transport and passenger transport sectors would ... provide a high return to the community.*"[4]

The move towards a national market for transport and the establishment of national economic regulator would yield substantial benefits for Australia including competitive neutrality across transport modes, greater competition at a national level, greater ability to account for the Government's wider policy objectives, more transparent and consistent institutional arrangements

[1] Bureau of Transport and Regional Economics (2007), Estimating urban traffic and congestion cost trends if or Australian cities, *Working Paper no. 79*, Canberra.
[2] LECG Consulting (2010), *The cost of road crashes,* published by the Australasian Railway Association
[3] Productivity Commission (2005), *Review of National Competition Policy Reforms,* The Commonwealth Government
[4] Productivity Commission (2005), *Review of National Competition Policy Reforms,* The Commonwealth Government

for transport service providers, and the subsequent improvements to efficiency and productivity within individual transport modes.

Such reforms have been undertaken, or are in progress, in the United States, European Union and South American countries such as Chile and Argentina.

# 2. Why A Single Economic Regulator?

## The Case for Structural Reform

The vertical unbundling of the rail system has yielded significant productivity improvements in the rail sector. However, the next phase of transport reforms will require a greater focus on institutional and structural challenges impeding the efficient and sustainable functioning of the transport sector. According to the Productivity Commission[5]:

"*...recent initiatives have merely scratched the surface of opportunities for integrated reform in the freight transport sector. In particular, further pricing, access and regulatory reform is needed to achieve a freight transport system that encourages an efficient mix of transport modes and provides for the seamless movement of freight along the entire logistics chain.*"

The potential productivity improvements of such transport reforms would be immense. The Productivity Commission estimates that "*a 10% improvement in productivity in the transport sector alone could see GDP rise by 1.5% or around $12 billion annually.*"

The introduction of competition and a regulatory framework for access in the rail industry has been an important first step in transport reform, however this has only dealt with one segment of the land transport market. The treatment of road and rail as two separate markets has led to separate systems of economic regulations for road and rail. This, in turn, has led to inappropriate and inconsistent economic regulations governing road and rail transportation which has impeded competitive neutrality, inhibited the efficient operation of a national land transport market, and ultimately provided a suboptimal mix of transport modes.

A further barrier to the efficient operation of a single national land transport market is the multi-jurisdictional state based system of governance for access arrangements in the rail industry. A myriad of state based regulators oversee access regimes for Australia's rail network, despite the national nature of rail freight movements. This creates significant compliance and administration costs for governments and industry alike.

[5] Productivity Commission (2005), *Review of National Competition Policy Reforms,* The Commonwealth Government

Similarly road charges are determined, through the Australian Transport Council, by a consensus of state governments. This arrangement again fails to recognise the national, multimodal nature of land transportation.

A single national land transport economic regulator is the most efficient institutional and structural reform to bring about a properly functioning national land transport market.

## Why a National Land Transport Market & Regulator?

A National Land Transport Market

The characterisation of rail and road transportation as separate economic markets is flawed and has lead to sub-optimal economic and competition outcomes[6].

Economic regulations governing rail transport as a discrete transport market may be inappropriate given the existence of intermodal competition. For example, freight forwarders' have the ability to switch modes if they are dissatisfied with their rail or road freight services[7]. Given the low barriers to entry for road transportation, fostering intermodal competition may be more appropriate economic policy in promoting competition than isolated reforms in the rail freight sector.

The failure to recognise the national nature of road and rail transportation, especially in the provision of freight services, has translated into a siloed state based approach to transport regulatory frameworks, especially in the rail sector.

Competitive Neutrality

The establishment of a single national market for land transport, governed by a single national economic regulator would go a long way in promoting the shift from compartmentalised jurisdictional and modal based transport decision-making processes, to a more integrated multi-modal approach.

The primary benefit of such an approach would be the promotion of competitive neutrality between all modes of land transport, a key recommendation of the Productivity Commission. According to the Productivity Commission[8]:

[6] Knieps G. (2005), *Railway (De)Regulation in Germany*, CESifo DICE Report
[7] ACIL Tasman (2010), *"Study into the Perceptions of Rail",* published by the Australasian Railway Association
[8] Productivity Commission (2005), *Review of National Competition Policy Reforms,* The Commonwealth Government

"*The compartmentalised approach to [transport] decision-making that has characterised much of Australia's transport policy to date has left a legacy of distortions that create modal biases in the movement of freight. The most commonly cited example is overuse of, and excessive investment in, road transport at the expense of rail..."*

A regulator that ensures that access and pricing principles are consistent and consistently applied between road and rail will promote the proper functioning of a national multi-modal transport market. This should result in the right mix of transport options being utilised to ensure that the transportation of goods and people in the most efficient, sustainable and safe manner.

The recently released Henry Tax Review[9] has acknowledged that existing institutions have not led to the most efficient use and supply of land transport.

"*The challenge is formidable. It requires coordination across all levels of government. But reform would promote the best investment in and use of our roads, lift national productivity, and improve the lives of millions of Australians."*

The Henry Tax Review also highlights the importance of competition between various modes of freight transport and the need for competitive neutrality. In the absence of consistent and consistently applied pricing principles between road and rail, it is recommended that:

"*On routes where road freight is in direct competition with rail that is required to recover its capital costs, heavy vehicles should face an additional charge in a comparable basis, where this improves the efficient allocation of freight between transport modes."*

A single national land transport regulator would be able to deal with these issues.

Accounting for Wider Government Objectives

A single national economic regulator for land transport would also be beneficial in addressing the Government's wider policy objectives. The regulator would allow transport externalities[10], such as pollution and congestion, to be dealt with in an holistic manner. Mechanisms to deal with transport externalities, such as road pricing, congestion charging or subsidies, can be most efficiently and equitably administered by a central national agency that can look beyond jurisdictional and modal considerations.

[9] Australian Treasury (2010), *Australia's Future Tax System,* The Commonwealth Government of Australia
[10] Transport externalities refer to the positive and negative impacts of transport options that are not captured in the pricing mechanism

The Henry Tax Review recommendations acknowledge the need for a network wide approach to transport economic regulations to ensure sufficient revenues for future infrastructure investments, addressing externalities and maximising efficiency.

Efficiency Gains & Compliance Cost Reductions

In addition to the benefits of addressing the Government's broader policy objectives, the economic regulator can simplify and consolidate the myriad of, often inconsistent and duplicative economic regulations governing transportation.

Separate state economic regulations and the need for many state and modal based regulators create a significant compliance cost for national freight carriers and additional implementation costs for governments. Modal based economic regulations for multi-modal freight service providers further increase compliance costs. Any unnecessary additional costs reduce Australia's ability to compete internationally and increases costs to domestic consumers.

## The Need for Independence

Institutionally, independent regulators have many advantages over other institutional arrangements. An independent regulator:

- could be a powerful catalyst for further economic reform and liberalisation in the land transport sector;
- can execute often complex and controversial reform in a bi-partisan manner[11];
- can create long-term regulatory stability, which gives certainty to industry, where their agenda is determined outside the shorter-term policy imperatives; and
- often hold greater subject area expertise than generalist government departments, given the specialised role of such regulators[12].

[11] Thatcher M. (2002), *Delegation to Independent Regulatory Agencies: Pressures, Functions and Contextual Mediation*, Journal of West European Politics, Vol 25/1
[12] Thatcher M. (2002), *Regulation after delegation: independent regulatory agencies*, Journal of European Public Policy, Vol 9/6

# 3. International Experiences

While Australian reforms have gone no further than vertically unbundling the rail industry, other jurisdictions have created national markets for land transportation through the establishment of national economic regulatory frameworks.

### The United States Surface Transport Board[13]

The United Sates Surface Transport Board (STB) was constituted in 1995 to oversee the economic regulations governing rail and national freight movements within the United States. The STB provides a forum for the resolution of surface-transportation disputes and other matters within its jurisdiction. It has the authority to limit or remove regulatory requirements where appropriate.

The STB is an independent body that sits within the United States Department of Transport. The STB has jurisdiction over railroad rate and service issues and rail restructuring transactions (mergers, line sales, line construction, and line abandonments); certain trucking company, moving vans, and non-contiguous ocean shipping company rate matters; certain intercity passenger bus company structure, financial, and operational matters; and rates and services of certain pipelines not regulated by the Federal Energy Regulatory Commission.

A single land transport regulator allows for a consistent approach to economic regulations across jurisdictions and across transport modes. The regulator could ensure competitive neutrality between modes ensuring a functioning multi-modal national market for land transport.

In Argentina, The National Commission for Transport Regulation (CNRT) determines rail access and pricing by taking into account externalities of road and rail, road pricing determinations and relative Government funding of road and rail. The general rule underpinning access and pricing determinations by the CNRT is that operators of transportation (regardless of the mode) should not be unduly disadvantaged by competitors who enjoy direct or indirect benefits from externalities or Government funding.

[13] See URL: http://www.stb.dot.gov/stb/index.html

## Argentina's National Commission for Transport Regulation[14]

In the 1990s, Argentina underwent significant reforms within the country's rail industry. Similar to Australian rail reforms, Argentina's rail industry was vertically unbundled. Vertical unbundling involves the separation of ownership of rail infrastructure from rail service operations.

Under the reforms, track infrastructure became the sole responsibility of the Government. Rail service operations have been opened up to competition, where public and private firms compete to provide freight and passenger services.

The reforms necessitated the administration of new economic regulations as a result of the need to govern access to, and pricing of, monopoly rail infrastructure. The National Commission for Transport Regulation (CNRT) was established to administer these new economic regulations. In recognition of the need to provide competitive neutrality between all transport service providers, the CNRT was afforded the role of overseeing the performance of the broader transport sector, including road transportation.

Rail access and pricing regimes in Argentina take into account externalities, including the impacts of road transportation, in setting access conditions and prices. The general rule underpinning access and pricing determinations by the CNRT is that operators of transportation (regardless of the mode) should not be unduly disadvantaged by competitors who enjoy direct or indirect benefits from externalities or Government funding, such as those enjoyed by freight transporters through the cross subsidisation of heavy-vehicle freight movements by smaller vehicles.

While the move towards a single national economic regulator will inevitably pose some implementation challenges, these are by no means insurmountable, and the benefits of such institutional reforms immense. Supplanting a multi-jurisdictional economic regulatory system with a single economic regulator has the following benefits:

- efficiency gains through uniform principles underpinning economic regulations;
- correction of market distortions created by arbitrary inconsistent regulations based on geographical location; and
- increased competition through the mitigation of regulatory barriers to entry for new participants.

[14] Campos J., Cantos P. (1999), *"Rail Transport Regulations"*, The Economic Development Institute of the World Bank, World Bank Policy Research Working Paper No. 2064, February 1999

In recognition of the significant benefits of a single trans-national market for transport, European Union (EU) countries have moved towards an EU wide open access regime for freight rail and will extend the open access principles to passenger services.

### The European Union's Railway Reforms[15]

The European Union (EU) has begun reforms towards the establishment of a European wide open access regime for rail freight services, where greater competition is likely to bring significant efficiency gains in the transport sector.

The establishment of the European open access regime came into force on 15 March 2003. EU Member States who had granted exclusive rights to their national rail companies on their rail networks are required to roll back these agreements and open track access to European competition. The European Commission (EC) can make rulings on economic regulatory frameworks, where state based regulatory frameworks are seen to be inconsistent with EC directives.

The establishment of a European wide access regime has been achieved through EC directives setting out principles for economic regulations governing rail. The EC has left it up to national governments to adhere to its principles. However, the EC has placed pressure on national governments to introduce reforms to liberalise and open markets to competition and to move towards the creation of independent economic regulatory authorities[16] .

[15] Di Pietrantonio L., Pelkmans J. (2004), "*The Economics of EU Railway Reform",* College of Europe : Bruges, Bruges European Economic Policy Briefings, September 2004
[16] Thatcher M. (2006), "*Europe and the Reform of National Regulatory Institutions: A Comparison of Britain, France and Germany",* Paper for the Council of European Studies' 15th Conference: Chicago, April 2006

# 4. Australian Experiences in Other Industries

In the 1990s, the Federal Government initiated National Competition Policy (NCP) reforms, where national markets were created in the energy, communications and water sectors. These reforms have encouraged greater competition that has delivered significant efficiency gains and lower utilities prices for Australia. As a part of these reforms, industry specific national economic regulators were established to govern the emerging national markets. These reforms have contributed up to a 2.5% ($20 billion) of growth per annum to Australia's GDP since 1990[17].

Reforms in the domestic energy sector are the most advanced and have been implemented over two phases. Phase one focused on the establishment of the market. Legislation was passed to establish the national gas market and the national electricity market. As part of the reforms the Ministerial Council on Energy (MCE) was created, the National Electricity Code Administrator (NECA) was established and given responsibility for administering the National Electricity Code and the National Electricity Market Management Company (NEMMCO) was established to manage the financial market and system security. The vertically integrated electricity and gas utilities, mainly owned and run in state jurisdictions, were broken up into generation, transmission and distribution entities. Competition was introduced at the generation and distribution level. Electricity and gas transmission are natural monopolies. State based regulators were responsible for electricity transmission, distribution and retail regulation and for gas distribution and retail. Gas transmission regulation was accorded to the ACCC.

However, this multi-institutional approach to energy regulations led to perceived inconsistencies between jurisdictions causing impediments to the proper functioning of the national markets. As a result the Council of Australian Governments (COAG) initiated phase two of the reforms, resolving to streamline economic regulation to reduce the barriers to competition inherent in state-based approach.

In 2004, the MCE reviewed and implemented further reforms to the economic regulations relating to the electricity and gas markets. The MCE established the Australian Energy Market Commission (AEMC) which implements changes to the legislation and regulations governing the energy market and the Australian Energy Regulator (AER) which regulates the market. That is, the AEMC has been

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established as the rule making body for the NEM while the AER has been set up as the national economic regulator for energy, administering regulations made by the AEMC. The aim of the MCE reforms was to ensure a truly national approach to regulating the National Energy Market.

### The Australian Energy Regulator[18]

In December 2003, the Ministerial Council on Energy (MCE) announced the establishment of the Australian Energy Regulator (AER). The AER was established in 2008, with responsibility for regulating and enforcing economic regulations in the national energy market. The AER is an independent body and has replaced the regulatory functions performed by the National Electricity Code Administrator (NECA) and the Australian Competition and Consumer Commission (ACCC) in the national energy market.

The AER's regulatory responsibility over electricity and gas ensures consistent economic regulatory regimes for the national energy market and consistent national approach to energy access and pricing. Consistent national approach to energy access, covering both electricity and gas, was a key agreement of the MCE.

The establishment of the AER was a continuation of whole-sale reforms in the energy sector, where state based vertically integrated energy sector was transformed into an open access national market.

[18] Australian Government Productivity Commission (2005), *"Review of National Competition Policy Reforms"*, Productivity Commission Inquiry Report, No 33, 28 February 2005

# 5. How Would the Regulator Operate?

The national land transport economic regulator should be responsible for implementing economic regulations dealing with competition, pricing and access in the land transport sector. The make-up and mandate of the single economic regulator would be a matter for Federal and State governments. There are a number of models that can be used, however some key principles must be adhered to ensure successful institutional reform. These principles include[19]:

Independence: The regulator should be impartial and should be independent of the government. This can be achieved by fixed terms (up to 5 years) for members of the regulator. The Council of Australian Governments (COAG) could be responsible for their appointments.

Openness: Given the complex nature of microeconomic reform in the transport sector, transparency and openness of the decision making process of the regulator is vital. All decisions made by the regulator must be available to the public and contain detailed analysis and reasons for the decision. This will ensure that all decisions are reviewable by way of a merits review.

Broad economic mandate: The regulator should have a broad economic mandate to enable it to take into account whole-of-transport issues and address the Government's wider policy objectives such as environmental stewardship and energy security. However, this does not imply that the scope of the regulator should be broadened outside determination of economic regulations (competition, access, pricing etc.), it suggests that economic regulations should take into account the Government's wider policy objectives[20].

Adequate State and Federal government input and collaboration: State and Federal governments should work collaboratively with the regulator to ensure the success of the regulatory process. While the regulator should be impartial and independent, it should make available its reports and recommendations to COAG and its constitution periodically reviewed and ratified by COAG.

One suggestion is establishing the national regulator as an independent arm of the Australian Competition & Consumer Commission (ACCC). The regulator would take over the economic regulations of interstate rail, state rail networks and pricing regimes for road infrastructure. Placing

[19] Banks G. (2005), "*Structural Reform Australian-Style: Lessons for Others*", Presentation to IMF and World Bank, May 2005
[20] Decker C. (2010), *"The Objective of Economic Regulations: Old Tensions and New Challenges"*, The ACCC's Network Publication, Issue 36 June 2010

the independent regulator as an arm of the ACCC would ensure the required expertise and knowledge is immediately available within the new regulator (see box below). The regulator would report to and be accountable to the COAG.

### ACCC and the Australian Rail Track Corporation[21]

The ACCC is responsible for the administering of the National Access Regime as set out in Part IIIA of the Trade Practices Act 1974. The Transport Branch administers the ACCC's work in the rail area, including:

- assessing Part IIIA codes or undertakings submitted by rail access providers in relation to rail (track) infrastructure;
- arbitrating access disputes between train operators and rail infrastructure providers; and
- providing economic analysis and assistance to other areas of the ACCC, related to mergers, authorisations and other regulatory matters associated with the Australian rail industry.

At present only the Australian Rail Track Corporation (ARTC) is the only track provider under the authority of the ACCC.

The Australian Rail Track Corporation (ARTC) was established out of a 1997 Inter-Governmental Agreement entered into between the Commonwealth, New South Wales, Victoria, Queensland, Western Australia and South Australia.

ARTC provides a single point of rail access to providers of above-rail services using the ARTC standard gauge network (part of the Interstate Rail Network). ARTC's track links Kalgoorlie in Western Australia, Adelaide, Wolseley and Crystal Brook in South Australia, Broken Hill and Cootamundra in NSW, Melbourne and Wodonga in Victoria, Albury to Macarthur and Newcastle in NSW to the NSW Queensland border.

[21] Australian Government Productivity Commission (2005), *"Review of National Competition Policy Reforms"*, Productivity Commission Inquiry Report, No 33, 28 February 2005

# 6. Conclusion

There are significant efficiency gains that can be realised from further economic reforms in the land transport sector. As stated by the Productivity Commission, a 10% improvement in productivity in the transport sector alone could see GDP rise by 1.5% or around $12 billion annually.[22]

The vertical unbundling of the rail sector has been a positive first step in the reform process. The next step is the establishment of a single national market for land transport governed by a single national regulator. This would ensure competitive neutrality across modes and jurisdiction, and an holistic approach to transport economic regulations that takes into account wider Government policy objectives.

Such reforms have successfully taken place in other countries such as the United States, European Union countries and South American countries such as Argentina and Chile. Similar sucessful reforms have been initiated in other Australian sectors such as the energy market.

[22] Productivity Commission (2005), *Review of National Competition Policy Reforms,* The Commonwealth Government