Introduction

The Victorian Departments of Treasury & Finance (DTF) and Economic Development, Jobs Transport & Resources (DEDJTR) and VicRoads have developed this joint submission in response to the National Transport Commission (NTC) Discussion Paper: Heavy vehicle charges – Options for improving the accuracy and stability of the PAYGO heavy vehicle charges methodology.

Context

The total revenue from Heavy Vehicle Charges (combination of Commonwealth collected fuel excise based Road User Charge and state collected registration charges) has been frozen at 2015-16 levels for two years until 1 July 2018.

In December 2015, the Council of Australian Governments (COAG) asked the Transport and Infrastructure Council (TIC) to lead efforts to improve the efficiency of road services by accelerating heavy vehicle road reform including:

- identifying steps to transition to independent pricing regulation
- considering extension of institutional and governance arrangements to all vehicles – moving from a partial (heavy vehicles only) to a full market.

Summary of submission

There are some measures that can be progressed under the NTC investigations to advance the PAYGO methodology. For example, there is strong support for further work on cost base allocators to provide assurance that current and future heavy vehicle pricing arrangements are built on a sound understanding of how heavy vehicle use impacts on road provision costs.

However, most options detailed in the NTC discussion paper are more appropriately considered in the broader context of the Heavy Vehicle Road Reform (HVRR) process:

- A forward looking costs base and ring fencing of revenues is entirely appropriate to support the provision of roads, like a utility, when all services are being priced.
- However, adopting this pricing for some users (heavy vehicles) and not others does not provide a sustainable source of funding, nor does it provide the certainty required to reduce life cycle costs by enabling the right interventions to be made at the right time.

To support a transition to independent price regulation there must be a high level of confidence that the allocation of costs to heavy vehicles is accurate. If the heavy vehicle cost base allocators are not accurate, any future road pricing approaches will not achieve efficient outcomes and may not be sustainable. The accuracy of cost base allocators is therefore a fundamental issue, and one that deserves priority attention.

Highest Priority – Review of cost base allocators

The cost base allocators are instrumental in the heavy vehicles charge framework. They determine the proportion of road costs attributable to heavy vehicles and subsequently how much should be recovered from the industry. Hence, for the charges to be set appropriately, and for the integrity of the system and the prospective reform, it is important that the cost base allocators accurately reflect the latest data and available research.
However, despite significant changes in the roads network, the increase in the volume of heavy vehicles and improvements in transportation and construction technology, the cost base allocators have not been revised in recent times. The NTC discussion paper noted that some of them have not been revised for more than 20 years.

The Productivity Commission’s 2006 Road and Rail Freight Infrastructure Pricing Public Inquiry (PC Inquiry)\(^1\), the Austroad’s Establishment of a New Pavement Maintenance Database – Stage 1 and 2 Analysis\(^2\), and the European CATRIN report\(^3\) all provide evidence that it is timely to review Australia’s cost base allocators.

More specifically, the PC Inquiry provides a variety of estimates for the B1, B2, C, F1 and F2 categories which differ from the current methodology. Most international estimates attribute a higher proportion of maintenance costs to ESA-km, and bridge capital costs to AGM-km, relative to the current methodology. In terms of common costs, the PC Inquiry has a small discussion on the classification on common costs.

Particular categories where there may be valid arguments for revising the allocation of costs to heavy vehicles include\(^4\):

- New construction (more PCU-km and AGM-km)
- Common costs (PCU-km, not VKM)
- Bridge maintenance (more AGM-km); and
- Rehabilitation and periodic maintenance (more ESA-km)

The proposed review is a necessary pre-cursor to the development of more accurate mass-distance-location based charges in the future.

As indicated in the NTC discussion paper:

> A new methodology for allocating costs between light and heavy vehicles would need to be developed under a forward looking cost base model. This is because the forward looking cost base model uses road asset categories (for example, bridges, pavement, surface, etc.), rather than the PAYGO model’s use of different types of expenditure (e.g. routine maintenance, periodic maintenance, road rehabilitation, etc.).

A review of cost base allocators should address both needs at the same time.


\(^4\) Equivalent standard axles (ESA), average gross mass (AGM), passenger car units (PCU) and vehicle kilometres (VKM) are all aggregate measures of a vehicle’s use of the road network. Allocating more costs via ESA-km and AGM-km tends to increase the portion of costs attributed to heavy vehicles.
Responses to NTC consultation questions

1. When analysing whether government revenues are sufficient to pay for road maintenance and construction, what revenues and expenditure items should be included or excluded

Only fuel excise and registration revenue is relevant. Other fees identified in the NTC discussion paper should more properly be referred to as general taxation measures and/or administrative charges.

2. Is the problem definition accurate? If not, what other problems should the next phase of reform seek to address

The problem definition presented ignores the possibility that the allocation of costs between light vehicles and heavy vehicles may not be accurate.

3. Do you agree with these assessment criteria? Should the options be assessed against other criteria?

One of the objectives of pricing reform is to improve resource allocation decisions. None of the criteria specified are focused on the importance of setting prices that reflect costs and inform model choice, vehicle options, route options, etc.

4. What are your views on Option 1? Should we transition to a ‘life-cycle’ cost base?

In the discussion paper it is stated that:

*The NTC has undertaken some exploratory work to assess the feasibility of adopting a ‘life cycle’ approach for roads. This work concludes that adopting a forward looking cost base is possible within the existing charging structure (registration and fuel excise), however, further work is required in a number of areas.*

The discussion paper then does not explain how this could work. Our view is that a FLCB approach could not be adopted within the context of the existing charging structure. At minimum, it poses some interesting transitional issues. For example, how would the existing asset base be treated given that, under the existing charging methodology, the investment was paid for in the year in which the expenditure was incurred.

It costs a significant amount to maintain the existing network at a standard that services the ongoing needs of light and heavy vehicle users. The discussion paper does not sufficiently elaborate on how these funding needs will be addressed over time.

In the discussion paper it is noted that:

*Jurisdictions would need to provide expenditure data in a different format to what is currently provided to the NTC. Specifically, jurisdictions would need to provide expenditure forecasts for several years, with capital expenditure allocated to asset categories used in the forward looking cost base model.*

Until there are fundamental changes to how roads are managed and provided it will not be possible to provide expenditure forecasts for several years.
5. **What are your views on option 2?**

In respect to this option it is stated in the NTC discussion paper that:

*We would expect the cost base to remain stable so long as the following conditions are met:*

- The network is neither expanding nor contracting, nor is the pavement or bridge condition changing significantly.
- Network-wide expenditure does not fluctuate markedly over time.
- Traffic growth is relatively steady.

However, earlier in the discussion paper it is made clear that these conditions are not met.

This option is inferior to option 1 and suffers from many of the same drawbacks.

Investments included in budgets are rationally based on benefits to all users. Investments are not driven by, nor justified by reference to, the potential benefits associated with providing improved services to one user group. Accordingly, there is likely to be a disconnect between rational budget and investment decisions and the cost base for heavy vehicles charges. The implication is that under this option heavy vehicles would be asked to pay for services (or service quality) they are not receiving.

6. **What are your views on option 3? Is this a feasible option? Is the ring fencing of funds a worthwhile goal in its own right?**

Ring fencing of revenue is not a worthwhile goal in its own right and only usefully applied in the context of a full market reform.

PAYGO itself is an attempt to ‘ring fence’ heavy vehicle revenues by reverse engineering revenue to equate to past expenditure, instead of allowing expenditure to be constrained by revenue. This is further limited by revenue being divided between two levels of government.

In general, Victoria does not support the hypothecation of revenue collected from one tax to be earmarked for any particular expenditure on a national level. This approach restricts government discretionary spending to deliver key services where it is most needed, and also its key commitments. In effect, this approach discourages governments from efficiently allocating public resources where it is most needed and subdues appetite for large investments in the road network due to state budget constraints.

While the states are required to provide to the NTC data on its annual road expenditure, there is very little transparency around the Commonwealth’s distribution of the Road User Charge. Given this lack of transparency, ring fencing is not viable.

7. **What are your views on option 4? If we introduced an unders and overs account, what period should it cover? Should any over-recover amount be adjusted for the opportunity cost?**

In the absence of measures to reduce volatility, this option will be detrimental, and would only address the issue of cost recovery.
8. **What are your views on Options 5? Should we revert to a general taxation option?**

A taxation option would offer a simpler method of calculating prices, reduce price fluctuations and bring heavy vehicle pricing under the same method that is applied to light vehicles. This method would also provide government with a more stable revenue source to make road management and investment decisions. However, moving away from the principle of setting prices on cost recovery principles is generally considered to be a retrograde step.

This option may provide a means to transition to new pricing arrangements.

9. **What are your views on option 6? Should the status quo continue?**

This option is not supported. The revenue freeze was only intended to be a transitional measure.

10. **What are your views on option 7? Should the cost allocation matrix be re-examined?**

As noted above, Victoria considers a review of the cost base allocators is required as a precursor to the other options presented by the NTC. It would provide a timely assurance that the current cost base allocators are appropriate, and provide a sound base for the HVRR project.

11. **What are your views on option 8? Is there an argument to re-examine the share of local government expenditure included in the cost base?**

Yes, the excluded share should be reconsidered, however, it may be more worthwhile to consider this matter in the context of FLCB work for HVRR rather than investing in time consuming research to support continuation of the current charging framework.

12. **What are your views on option 9? Could the UK model be adopted in Australia? What other forms of independent regulation might work in the Australian context?**

To garner support to proceed with independent price regulation under the current charging framework there would need to be a much higher level of confidence in the refined PAYGO system. In short, support for this option depends on improvements that can be made as part of this review process. **What are your views on the NTC’s assessment of the compatibility of options?**

It potentially would have been more useful to identify combinations of options that potentially provide a solution in the medium to long-term and assess these combinations of options using the identified criteria. Assessing each option by reference to each criteria without regard to how it may be linked to adoption of other options is of limited use.

13. **What is your preferred option, or combination of options?**

Victoria’s preferred option is Option 7. There is insufficient information to make comment on what combination of options may be best.
Conclusion

In the context of a partial market reform, revenue freeze and the current Commonwealth state financial relations in relation to road funding there is not support for NTC progressing most of the options detailed in the discussion paper under the current charging framework. However, combinations of the options are worth consideration under the remit of the broader HVRR process.

In light of new data and research, Victoria considers a review of the cost base allocators should be the highest priority.