

Competition and Productivity in the Australian Interstate Freight Market: The Role of Track Access Charges.

- Presentation to the 2020 Track Access Charges Summit
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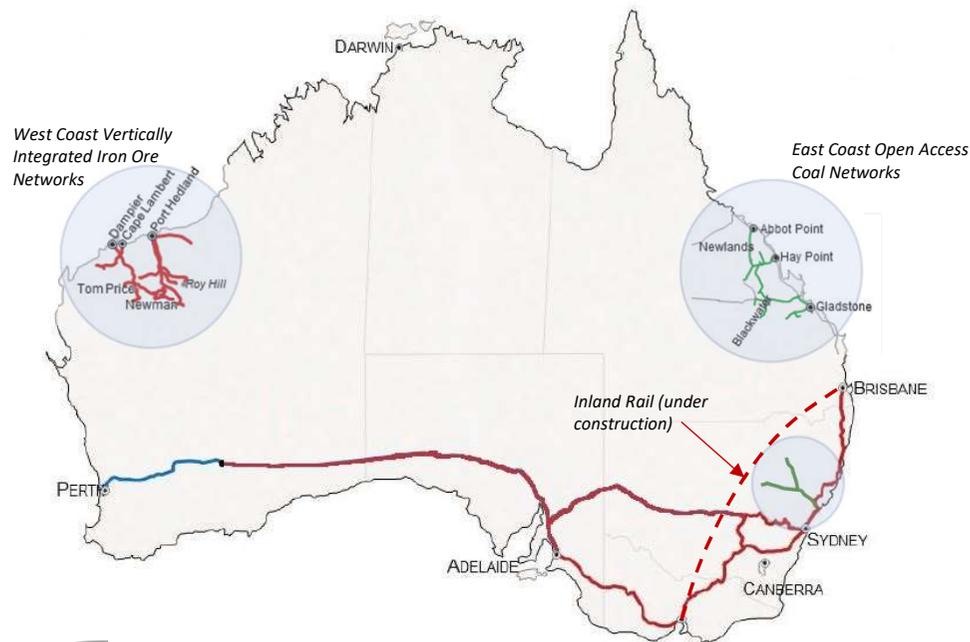


5TH EDITION

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Overview of the Australian Interstate Rail Freight Market

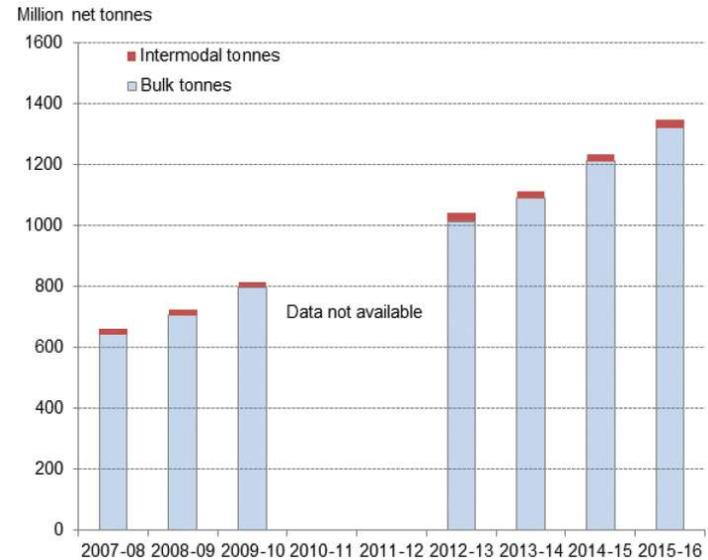
Australian Interstate Rail Freight Network (excl. Darwin to Adelaide)



Structurally Separated IMs



Australian National Rail Freight Task, 2007-08 to 2015-16

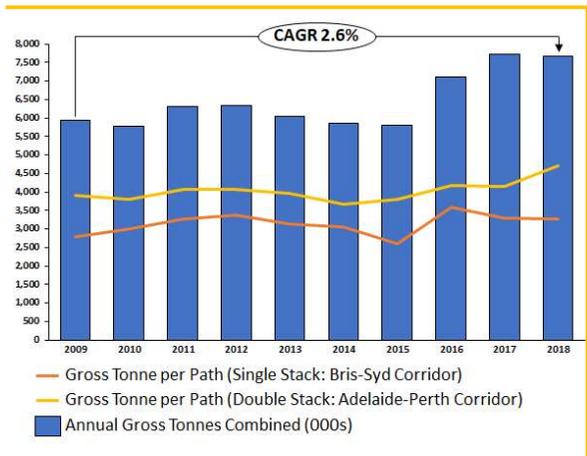
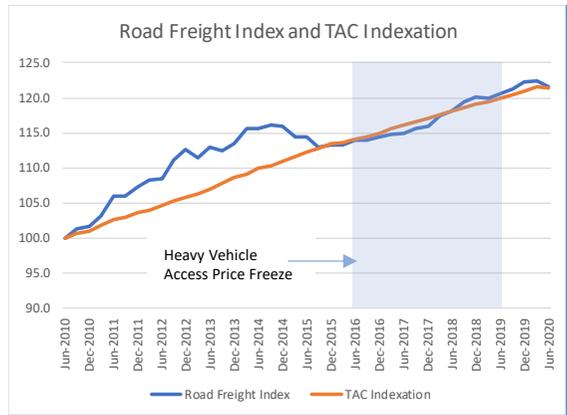


Source: BITRE Statistical Report, Trainline 7. <https://www.bitre.gov.au/publications/2019/trainline-7>

Competition Policy Objective

Provide access to significant infrastructure facilities to promote the economically efficient use of, operation and investment in, significant infrastructure thereby promoting effective competition in upstream or downstream markets.

The competition and productivity gains from access have been limited



The Virtuous Access Cycle



Interstate Intermodal Market Shares[^]



- Lack of publicly available information on rail operator costs impairs productivity analysis
- No substantive market study or industry analysis of rail productivity trends since Productivity Commission in 2000¹

[^] Indicative estimates of author only based on Australian Competition and Consumer Commission v Pacific National Pty Limited (No 2) [2019] FCA 669

1. Productivity Commission (1999) Progress in Rail Reform, Inquiry report no. 6, AusInfo, Canberra Available at https://www.pc.gov.au/_data/assets/pdf_file/0020/34526/rail.pdf

Promoting effective competition needs to address the barriers to entry

Entry into the interstate rail freight market is expected to require a service offering comprising the interstate network with sufficient service frequency. Prior entry into the North-South (Aurizon 2004) and East-West (SCT 2006) corridors suggests the minimum efficient scale is at least three services per week on each corridor.

1 Market Growth and Scale

- BITRE estimates non-bulk interstate freight volumes to grow at 2.8% per annum between 2018 and 2040¹.
- Without material rail productivity gains relative to road reliance on organic growth does not support entrant investment.
- Long term aggressive pricing strategy to capture existing market reduces profits for R&D and innovation.

3 Terminal Access and Investment

- Operations at the minimum efficient scale require access to multi-user or open access terminals across the interstate network. Where these are available they are suboptimal in configuration.
- Operations at full efficient scale are necessary to support integrated investment in optimised high efficiency intermodal terminals.

2 Contestability of Road Freight

- Shorter asset lives and capital replacement promotes faster rate of total factor productivity of road relative to rail.
- Relaxation of heavy vehicle mass and length regulations and favourable access pricing further promotes heavy vehicle utilisation.
- Efficiency gains from automation likely to favour road transport given 110 truck drivers per 2 train drivers.

4 Supply Chain Alignment

- Dominant operator holds ownership of optimal legacy terminal assets across majority of capital cities. Locational position of legacy terminals are co-located with many large freight forwarders.
- Lack of favourable locations for terminal development that aligns with existing supply chains and distribution networks.

1. https://www.bitre.gov.au/sites/default/files/documents/research_report_152-final.pdf

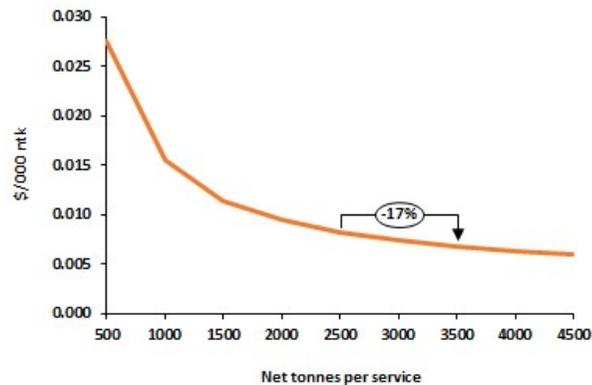
Track access charges are an overlooked barrier to entry

IM mark-ups with fixed flagfall charges competitively disadvantage new market entrants who lack scale

E-W Corridor

Flagfall: \$4.292/tkm
Variable: \$3.329/000 gtk

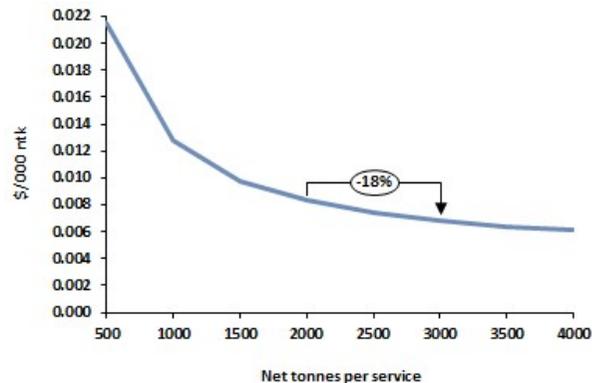
Modal share est: 70-80%



N-S Corridor

Flagfall: \$1.121/tkm
Variable: \$3.879/000 gtk

Modal share est: 15-25%



- Track access charges with large non-volumetric fixed charges will promote utilisation but reduce the competitiveness of a new entrant on a TEU unit cost basis.
- A market entrant will not be able to achieve the minimum efficient scale on entry and will need to endure a period of sustained losses.
- Competition regulator approved access arrangements which include *most favoured nation clauses* and *non-discrimination for like services* (competing in the same geographical market for the same commodity) prevent price discounting for low volume operators.
- Price differentiation to support low volume operators in ramp-up risks subsidising inefficient market entry.
- Significant challenges for a government owned structurally separated IM to determine the correct efficient price when the downstream rail haulage market is not workably competitive.
 - Information asymmetry regarding dominant rail operator costs and margins means the IM will either:
 - Under-price the service and there will be a significant wealth transfer from tax payers funding IM investment to foreign owned dominant operator; or
 - Over-price the service and:
 - Increase the barriers to entry for a new rail operator;
 - Reduce the margins of existing rail operators and the competitiveness against the contestable road service.
- Even where the publicly owned IM is able to determine an efficient price it faces the risk of under or over-pricing due to the horizontal price decision of the adjoining privately owned and profit maximising IM.

Conclusions

In summary:

- The competition and productivity benefits from application of open access to the interstate rail freight market have not produced the desired policy objectives;
- The barriers to entry to promote competition require a broader policy suite than providing open access, including consideration of TAC structures; and
- Policy shortcomings did not adequately address the inherent advantages of incumbency and legacy assets funded by governments prior to privatisation.

“If the rail industry is to continue growing and thrive into the mid-century, the longer-term outlook indicates a need for rail to evolve in tandem with the changing economic and transportation landscape.

*These changes need to be groundbreaking, involving adaptation on multiple fronts, from a more aggressive focus on resilience and **better use of the rail network to productivity improvements** and long overdue technology innovation”. (Oliver Wyman 2018)*