WALGA

WORKING FOR LOCAL GOVERNMENT

17 April 2014 **Our Ref: 05-006-02-0005**

Mr Ian Charles Blayney MLA
Chair
Economics and Industry Standing Committee
Parliament House
PERTH WA 6000

Dear Mr ~~Blayney~~ Ian

INQUIRY INTO THE MANAGEMENT OF WESTERN AUSTRALIA'S FREIGHT RAIL NETWORK

The WA Local Government Association (the Association) is grateful for the opportunity to provide a submission in response to the Inquiry into the Management of Western Australia's Freight Rail Network.

Local Governments have a strong interest in the outcome of this inquiry due to their broad responsibilities in economic development and their specific responsibilities for the provision of road infrastructure. An efficient and funded supply chain is critical to the competitive viability of the grain industry in Western Australia.

As well as this submission, representatives from the Association would like to appear before the Committee to present evidence to the Inquiry.

The Association also suggests that the Committee give some consideration to conducting hearings in Western Australia's grain growing regions given the importance of the rail network to communities in these areas.

Additionally, some Local Governments in Metropolitan Perth, such as the City of Kwinana, are significantly affected by grain transportation issues, so it may also be appropriate for the Committee to also hold hearings in such areas.

If you have any queries please contact Paul Schollum in the first instance (phone: 9213 2096, email: pschollum@walga.asn.au).

Yours sincerely

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Interim Submission to the Economics and Industry Standing Committee

Inquiry into the Management of Western Australia's Freight Rail Network

April 2014

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1. Introduction

The Western Australian Local Government Association (the Association) is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 138 Local Governments in Western Australia.

The Association provides an essential voice for 1,237 elected members and approximately 24,900 Local Government employees as well as over 2 million constituents of Local Governments in Western Australia. The Association also provides professional advice and offers services that provide financial benefits to the Local Governments and the communities they serve.

The Association is grateful for the opportunity to provide a submission in response to the Inquiry into the Management of Western Australia's Freight Rail Network. Local Governments have a strong interest in the outcome of this inquiry due to their broad responsibilities in economic development of the Local Government area and their specific responsibilities for the provision of road infrastructure. An efficient and funded supply chain to enable grain to move from farms through storage and handling facilities to port is a critical component of the competitive viability of the grain industry in Western Australia.

The Economics and Industry Standing Committee has indicated that this Inquiry will focus on:

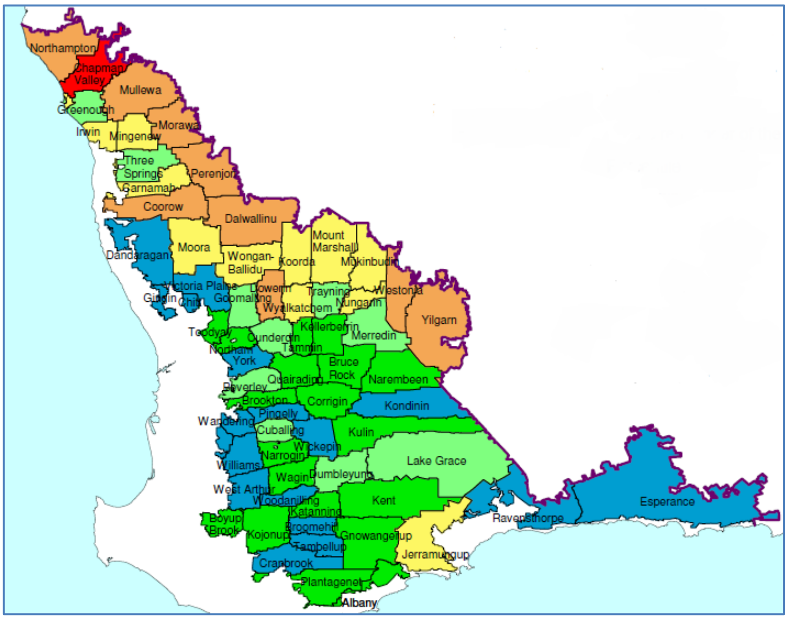
- the recent strategic directions and policy decisions relating to the current network lease, particularly in relation to the low-traffic lines;
- the regulatory arrangements in place for the network; and
- the management of the network by the Public Transport Authority.

The Association's members have a particular interest in the first of these terms of reference, since the closure of Tier 3 rail lines leads to increases in heavy vehicle traffic on Local Government roads and through communities. Accordingly, while this submission also addresses the other terms of reference, it mostly focuses on recent directions in State Government grain freight policy.

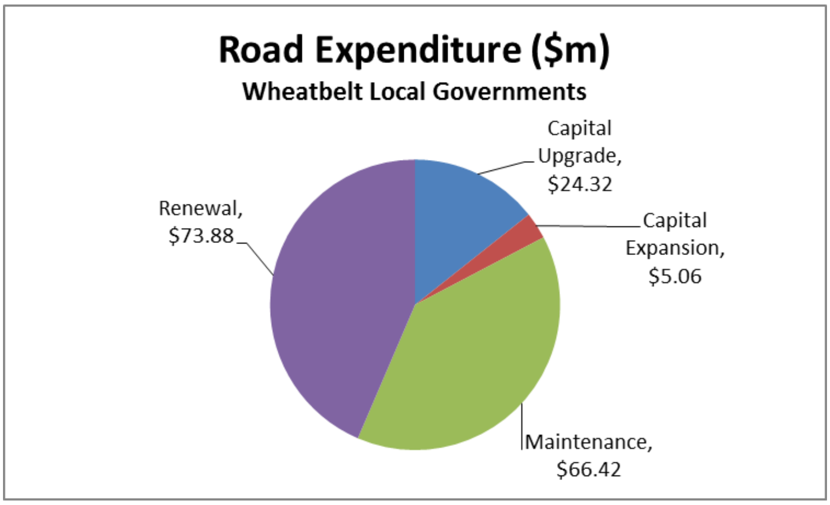
Due to meeting schedules this submission has not yet been endorsed by the Association's State Council. The Economics and Industry Standing Committee will be informed of any changes to the Association's submission following consideration by the Council.

2. Background

Significant grain production occurs in sixty-five Local Governments areas in Western Australia. The map below shows that the grain growing region covers a roughly triangular area stretching from Northampton in the north to Albany in the south and Esperance in the south-east:



These Local Governments provide and manage 66,692 km of road; 97.4% of which is outside of built up areas and primarily used for access to rural properties. These roads provide access for transporting grain and other products to market and enabling delivery of inputs including fertiliser, lime and fuel.[1]



In 2011/12 these 65 Local Governments spent $169.7 million on roads, 83% of this was spent on maintenance (repairing potholes, edges, cracks, signposts, etc.) and renewal (periodic maintenance such as re-sheeting and resealing). Only $29.4 million was spent on

[1] Western Australian Local Government Association (2012). *Report on Local Government Road Assets and Expenditure 2011/12*.

capital projects, most of which was to upgrade the service capacity of the network through widening, realignments, etc.

Included in this capital expenditure was just over $10 million provided by the State Government to upgrade roads identified as needing to be improved in order to carry the additional freight resulting from grain freight services ceasing on Tier 3 rail lines.

Any additional freight transport such as that which occurs when grain is moved by road rather than by rail adds to the road maintenance and renewal costs faced by Local Governments. In 2011/12, 37% of total operating revenue for Wheatbelt Local Governments[2] was spent on Transport (almost entirely on roads)[3].

The Association has examined the ability of Local Governments in the Wheatbelt to fund additional road maintenance and renewal that will arise as a result of increased freight traffic. Wheatbelt Local Governments currently spend approximately 65% of the amount required to preserve the road network in its current condition. To meet net road preservation requirements in 2011/12, Wheatbelt Local Governments would need to spend around 100% of their theoretical revenue raising capacity as assessed by the WA Local Government Grants Commission.

In 2011/12 70% of expenditure on roads by Wheatbelt Local Governments was funded by grants from Federal and State Governments. Any increase in maintenance and renewal costs will need to be funded by State or Federal Governments.

3. Local Government's role in decision making

Local Governments and their communities will be significantly affected by any decision to close rail lines in the Wheatbelt region. The State Government has adopted a position that the use of rail lines in the Wheatbelt region is a commercial matter between the grain handler, Co-operative Bulk Handling Ltd (CBH) and Brookfield Rail Pty Ltd (Brookfield). This denies the opportunity for Wheatbelt communities to have a say in transport policy that directly affects them. The Association considers this inappropriate because the State Government is the owner of the rail network and determines the level of investment that goes into the network.

The ability of the community to provide input is also compromised by the lack of publicly available information on Brookfield's lease agreement with the Public Transport Authority (PTA). In a 2013 review of the lease arrangements, the WA Auditor General found that 'PTA's capacity to hold the lessee to account would be better served if it had a more comprehensive understanding of the work done and condition of the network'[4]. Similarly,

[2] For simplicity, the use of the term 'Wheatbelt' throughout this submission refers to the area covered by the 65 Local Governments areas in WA with significant grain production. Note this differs to the traditional definition of the Wheatbelt region, which covers 43 Local Government areas in WALGA's Avon-Midland, Central and Great Eastern Country Zones.

[3] WA Local Government Grants Commission data.

[4] Office of the Auditor General (2013). *Management of the Rail Freight Network Lease: Twelve Years Down the Track*. Retrieved from https://audit.wa.gov.au/wp-content/uploads/2013/05/report2013_01.pdf

Local Governments and communities would particularly like to know the network maintenance obligations that were negotiated between the State Government and Brookfield, as this would help to inform the policy debate on the viability of the Tier 3 lines.

4. The link between rail access charges, service levels and investment

According to CBH, grain supply chain costs in Western Australian are significantly higher than in other countries and rail access charges are the highest of all Australian States[5]. Furthermore, while access charges are high, there is evidence that Brookfield Rail has not carried out sufficient routine maintenance on parts of the network to maintain the previously existing level of service. The condition of certain lines means that Brookfield has imposed speed and weight restrictions which then reduce the productivity of any above rail operator[6].

The Association understands that Brookfield's lease agreement contains 'fit for purpose' performance standards to ensure the network remains in the condition required by network users. According to the Auditor General's 2013 report on the lease agreement, the Public Transport Authority interprets the lease to mean that performance standards are set at year 2000 levels[7]. Such performance standards are unlikely to reflect the needs of rail users today and into the future. The productivity of the road transport industry has increased and continues to increase. Rail freight productivity must therefore increase also, if this mode is to remain viable.

The Association believes that Brookfield Rail's access charges should relate to the level of service that is provided. Where maintenance standards have decreased, access charges for these routes should be set at a lower level to reflect this.

Where capital investment in the grain freight network has occurred, it has been heavily subsidised by Federal and State Governments. The current lease agreement between the State Government (Public Transport Authority) and Brookfield appears to allow the network operator to not reinvest in the infrastructure. It is assumed that this situation has not changed and hence there will continue to be calls on government to contribute capital to infrastructure renewal of rail lines. It is important that the determination accurately reflects this public investment and does not enable the leaseholder to charge depreciation or a return on capital that it did not invest.

The Association believes that the separation of above rail and below rail operations contributes to difficulties in establishing the economically optimal service levels for each line. In contrast, a vertically integrated rail company would have an incentive to maintain lines to a

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[5] Co-operative Bulk Handling Ltd (2013). *Rail negotiations to go to independent umpire* [media release]. Retrieved from https://www.cbh.com.au/media-centre/news/2013.aspx

[6] CBH calls in Tier 3 third umpire (2013, November 7). *Farm weekly*. Retrieved from http://www.farmweekly.com.au/news/agriculture/agribusiness/general-news/cbh-calls-in-tier-3-third-umpire/2677555.aspx?storypage=0

[7] Office of the Auditor General (2013). *Management of the Rail Freight Network Lease: Twelve Years Down the Track*. Retrieved from https://audit.wa.gov.au/wp-content/uploads/2013/05/report2013_01.pdf

standard that optimises the returns on the combined investment in below rail infrastructure and rolling stock.

For example, the combined operator may determine that the lowest total cost is achieved with limited investment in track and accepting lower performance standards. Alternatively, higher efficiency may be achieved with increased track investment. Brookfield Rail faces no such incentive to find the optimal service level. While this is not necessarily an argument for a combined above and below rail operator to manage the whole network, it is an important consideration for the more marginal lines. It is quite possible that better outcomes would be achieved for Wheatbelt communities if Government investment was increased on these parts of the network or if management of these lines was transferred to above rail operators with a greater willingness to invest in them.

5. Competitive neutrality between rail and road

The 'price' paid by heavy vehicles for using road infrastructure is set by the 'pay as you go' system (PAYGO) using a combination of fuel excise and vehicle registration charges. These charges are effectively average prices set on a cost recovery basis as PAYGO revenue is used to cover the proportion of road expenditure that is attributable to heavy vehicles.

Because the charges are averaged over the whole (national) road network, this provides a cross subsidy to heavy vehicles that carry heavier than average loads, travel further than average and travel on roads with higher than average marginal costs. Such cross subsidies clearly apply to grain freight by road in WA and have led to over use of road infrastructure relative to rail. This was anticipated by the WA Economic Regulation Authority (ERA) in its submission to the Productivity Commission's 2007 freight inquiry:

> Potentially this cross subsidy could have a significant impact on the competitiveness of rail versus road for grain haulage and/or on the long term sustainability of the rail network. If rail owners do not match the artificially low charge for road haulage they will lose tonnage to road. This would be suboptimal from society's point of view as there would be an over use of road and associated under use of rail. However, if the rail owners do match the road haulage charge in order to maintain tonnage then the revenue generated will not be sufficient to contribute to capital. This will result in a deterioration of the rail network[8].

The Association therefore believes that the current (artificially) low price for road infrastructure is an important consideration in determining relative levels of Government investment in road and rail. The State Government should consider higher levels of investment in rail to counter the inherent subsidy received by road freight operators. However, such investment should not occur at the expense of Local Government road

[8] Economic Regulation Authority (2006). *Road and Rail Freight Infrastructure Pricing: Productivity Commission Discussion Draft* [submission]. Retrieved from http://www.pc.gov.au/__data/assets/pdf_file/0010/48979/subdd106.pdf

funding, since there is already a substantial shortfall between actual preservation expenditure and that required to maintain roads in their current condition.[9]

In addition to the hidden subsidies, the true cost of grain freight by road includes a number of externalities, such as amenity, safety, climate change, pollution and respiratory health impacts. Amenity impacts include the noise and vibrations as heavy vehicles travel through main streets and residential areas. The vibrations from heavy vehicles can also have implications for the integrity of heritage buildings in country towns. Additionally, greater use of heavy vehicles contributes to congestion in urban areas situated along freight routes.

Campaigns in WA have highlighted that many rural roads are unsuitable to accommodate large trucks and local traffic, such as school buses, tourist buses, farm vehicles and light vehicles. This is an important issue in WA's Wheatbelt, since the 'Wheatbelt North' and Wheatbelt South' regions already have the highest rate of serious crashes per 100,000 population in the State[10]. Greater investment in the rail network would therefore improve safety outcomes in the Wheatbelt as well as lessening other externality impacts from grain freight on road.

6. Uncertain future funding and service levels for roads

While the State Government has provided some funding for limited upgrades to local roads so that the increased freight task can be accommodated more safely, this has not been accompanied by an increase in Local Governments' operating revenue. Effectively this shifts freight infrastructure maintenance expenditure from Brookfield Rail and the State Government to ratepayers in the areas affected by line closures and restrictions, unless additional road maintenance grants are provided.

The grain industry appears to assume that road transport options will be available at current or higher service levels in the future. However, if Local Governments cannot adequately maintain these roads, this will lead to unsustainable outcomes, including increased risk of accidents, increasingly costly damage to local roads and increased costs to grain handlers if routes become unavailable. In these circumstances, the current high levels of access provided to large, heavy vehicles may not continue.

7. Uncertainty regarding rail infrastructure

The State Government's 2009 review of grain freight infrastructure suggested the 'Brookton strategy' would lead to efficient transfer of grains from the Kwinana South Zone[11] without leading to excessive use of roads in this and the metropolitan area[12]. The Brookton strategy

[9] This shortfall was estimated to be over $100 million in 2011/12. See: Western Australian Local Government Association (2012). *Report on Local Government Road Assets and Expenditure 2011/12*.

[10] Thompson P E, Hill D L, Beidatsch K P, & Bramwell J (2011). *Reported Road Crashes in Western Australia*. Retrieved from http://www.ors.wa.gov.au/Stats/Annual/annual-crash-stats-2011.aspx

[11] The area bounded by the area bounded by Northam, Narrogin, Kondinin and Merredin

[12] Strategic Design and Development Pty Ltd (2009). *Report prepared for Freight and Logistics Council of WA on behalf of the Strategic Grain Network Committee*. Retrieved from http://www.transport.wa.gov.au/mediaFiles/rail-freight/freight_Strategic_Grain_Network_Report.pdf

involves investment in increasing the efficiency of rail loading at Brookton and Kellerberrin to achieve a high concentration of grain freight volume from using the rail lines connecting these bins via Avon to Kwinana.

However, this strategy has not been fully implemented due to the lack of investment in rapid loading facilities at Brookton and Kellerberrin. It would appear that the viability of this investment is contingent on the closure of Tier 3 lines. Similarly, there has been no investment in road out loading at bins served by Tier 3 rail. Therefore, the continued uncertainty regarding Tier 3 rail lines is clearly hindering investment in grain freight infrastructure.

The grain supply chain has changed since 2009 when the Strategic Grain Network Review was completed; primarily as a result of a change in the major above rail operator on the grain rail network. Bunge's recent entrance in the grain handling market and their construction of port and storage facilities in Bunbury are also important developments. While the private operators, CBH, WATCO and Brookfield have adapted their investment decisions and operating arrangements to reflect the emerging situation, the policy position has not been publicly reviewed. This Inquiry provides a catalyst to examine one of the key questions in defining the optimal grain supply chain, which is to better understand the required sustainable investment in the grain rail network and how this is funded.

8. Access to and use of the asset

The Association believes that agreements entered into by the State need to encourage the use of State-owned assets where this is viable and avoid private entities being able to retain control without using the asset. According to CBH this is not happening:

> Earlier this year, the CBH Group presented Brookfield twice with offers, one to lease the Tier 3 lines and another to maintain these lines on behalf of Brookfield. Both offers were rejected. CBH cannot justify spending growers' money on an asset they do not control, or at the very least have clear oversight over how the money is spent[13].

Brookfield should not be able to prevent the use of a publicly owned asset such as Tier 3 rail lines where other private entities believe the lines can be used profitably and are willing to pay for this usage. It is difficult to see how the well-being of the community is enhanced by Brookfield's ability to block such proposals.

In the United States, a number of low traffic rural rail lines have been preserved by larger operators selling or leasing the lines to smaller rail firms. The US Department of Agriculture stated that 'many of these new short line railroads have been able to operate profitably on rail lines abandoned by the major railroads and have generally provided more individualized

[13] Co-operative Bulk Handling Ltd (2014). *Freight Rate Estimates 2013-14: Frequently Asked Questions*. Retrieved from https://www.cbh.com.au/media/316958/faq%202013-14%20freight%20rate%20estimates.pdf.

service to shippers'[14]. This suggests there may be benefits to the community if other entities are permitted to manage rail lines that Brookfield are not interested in operating.

9. The marginal cost of heavy vehicle operations on local roads

The additional cost impact on Local Government roads is difficult to quantify, as it depends on the types and numbers of vehicles used to transport the grain, the mass to which they are loaded, the strength of the road on which they are operating and the moisture conditions of the road at the time of the operation. The following is indicative only, and could not be applied to a specific section of road.

In 2013/14 CBH advise that 1.2 million tonnes of grain has been delivered to receival facilities served by Tier 3 rail lines (some of which are still operating and some of which are not). For a pocket road train, which is a commonly used vehicle combination, loaded to standard axle weights (no concessional mass loading), a 1 million tonne freight task equates to 170,000 Equivalent Standard Axles (ESA). On-going work being undertaken by the Australian Road Research Board (ARRB) for WALGA indicates that for a typical rural distributor road in the WA Wheatbelt it is estimated that the marginal cost of heavy vehicle operations is in the range of 0.3c – 1.4c per tonne kilometre (tkm). It should be noted that this covers just the additional costs incurred as a result of the specific freight task, assuming that the road is adequately constructed and maintained in the first instance. It does not include a share of the fixed costs of constructing and maintaining the road.

Assuming 0.85c per tkm, a 1 million tonne freight task over 100 kilometres would have a marginal cost impact on a typical Local Government road of $850,000. However, for a road constructed to a low strength, or in poor condition in the first instance, the marginal cost is of the order of 5.1c per tkm; equivalent to a marginal cost of $5.1m for freight task over 100 kilometres. This would need to be funded every year. In many instances, it will therefore be more cost effective to upgrade the road structure to a suitable standard that can support the projected load.

There are no contemporary transport impact assessments that are able to quantify and define grain freight flows in an environment with reduced service availability (and potentially higher transport prices) on Tier 3 and Tier 2 grain rail lines. Without this, it is not possible to effectively compare the total cost of rail and road transport, or assess the capacity of each to meet the market demand.

The 2009 Strategic Grain Network Review focussed on the rail network, without a comprehensive understanding of the underpinning lease agreement and was only able to include essentially a desk top study into the required road investment. This Inquiry offers the opportunity to address this limitation.

[14] United States Department of Agriculture (2010). *Study of Rural Transportation Issues*. Retrieved from http://ageconsearch.umn.edu/bitstream/147544/2/Transportation%20Study.pdf.

10. Conclusions

Recent State Government strategic directions and policy decisions relating to grain freight have not considered the views of WA Local Governments and their constituents. This is not appropriate considering the impact that the closure of Tier 3 rail lines has on Local Government roads and affected communities.

The Association is also concerned about the lack of transparency regarding Brookfield's lease agreement with the PTA. Furthermore, the Association believes Brookfield's access charges need to more accurately reflect the level of service provided and that capital investment in the grain freight network has been heavily subsidised by the Federal and State Governments.

The separation of above rail and below rail operations contributes to difficulties in establishing the economically optimal service levels for each line. Brookfield does not have sufficient incentive to find this optimal service level. Better outcomes could be achieved for Wheatbelt communities if Government investment was increased on Tier 3 lines or if management of these lines was transferred to above rail operators with a greater willingness to invest in them.

State Government policy also needs to consider that higher levels of investment in rail are needed to counter the inherent cross subsidies that road freight operators receive as well as the externality costs that would result from increased heavy vehicle traffic. However, such investment should not occur at the expense of Local Government road funding, since there is already a substantial shortfall between actual preservation expenditure and that required to maintain roads in their current condition. Furthermore, where Tier 3 lines have been closed or will be closed, Local Governments should be adequately funded to both upgrade roads and maintain them into the future.

The unclear future of the remaining Tier 3 lines is creating uncertainty for Local Governments and industry. This is hindering infrastructure investment and impacting negatively on the productivity of grain growing areas. The Association also believes that Brookfield should not be able to prevent the use of Tier 3 lines since they are publicly owned assets.

Finally, decisions on grain freight policy should be based on suitable evidence. The 2009 Strategic Grain Network Review is no longer a contemporary assessment of grain freight in WA. The State Government now requires a more up-to-date, transparent and comprehensive assessment of the costs and benefits of the various policy options if appropriate decisions are to be made.